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Ewan McKendrick

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23. Damages

Ewan McKendrick

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Abstract

This chapter examines the entitlement of a claimant to recover damages in respect of a breach of contract committed by the defendant and is organized as follows. Section 23.2 discusses the different measures of damages that can be awarded, while 23.3 analyses the performance interest. Section 23.4 examines the circumstances in which a claimant can seek damages based on his 'reliance' losses rather than his performance interest, and 23.5 discusses the circumstances in which damages may be awarded to protect the claimant's 'restitution' interest. Section 23.6 examines the entitlement of a claimant to recover damages in respect of non-pecuniary losses, particularly 'mental distress'. Section 23.7 considers the general rule that damages are assessed as at the date of breach and the exceptions to that rule, while 23.8 considers the various doctrines which the courts use in order to keep liability within acceptable bounds. These include remoteness, mitigation, and contributory negligence. Section 23.9 examines the circumstances in which a claimant can recover what is known as 'negotiating damages' or the defendant can be ordered to account to a claimant for the profits that he has made from his breach of contract. Section 23.10 looks at the possibility that exemplary damages might play a role in breach of contract cases. The chapter concludes, in the final sections, with a discussion of agreed damages clauses (and related clauses) and their legal regulation.

Keywords: English contract law, breach of contract, performance interest, reliance interest, restitution interest, non-pecuniary losses, remoteness, mitigation, contributory negligence, agreed damages and the penalty clause rule

Central Issues

1. The aim of an award of damages is generally to put the claimant in the position which he would have been in had the contract been performed according to its terms. The aim is thus to protect the claimant's 'expectation interest', or his 'performance interest'. The scope of the claimant's expectation or performance interest is a major focus of this chapter. Is the claimant's expectation defined by reference to the financial value of performance or by reference to the performance itself? How are damages to be assessed in the case in which the claimant does not appear to have a direct financial interest in the performance of the contract? When is the claimant entitled to recover the cost of making performance conform to the terms of the contract and when is he entitled to recover the difference in value between the performance which he has received and the performance which he was promised? These questions will all be explored in this chapter.
2. The courts have also experienced difficulty in deciding when a claimant is entitled to recover damages for non-pecuniary losses suffered as a result of a breach of contract. Can damages be recovered for the disappointment of not receiving the contractual performance which the defendant promised to provide? What is the appropriate measure of damages in the case where, for example, the contract is one for the provision of pleasure such as a holiday and the defendant breaches the contract?
3. The law must place some limits on the liability of the defendant, otherwise liability could prove to be endless. Doctrines, such as remoteness of damage, are used by the courts to keep liability within acceptable bounds. These doctrines will be examined in this chapter. Consideration will also be given to the responsibility of the claimant not to take unreasonable steps to increase the loss and to take reasonable steps to reduce the loss caused by the breach.
4. English law has recently recognized a category of damages known as 'negotiating damages', the purpose of which is to award the claimant damages assessed by reference to the sum that the claimant would hypothetically have received in return for releasing the defendant from the obligation which it has failed to perform. The circumstances in which a claimant can recover negotiating damages will be considered in this chapter and note will also be taken of the reluctance of the courts to permit a claimant to recover damages assessed by reference to the gain or profit which the defendant has made from its breach of contract.

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5. Finally, consideration will be given to the extent to which it is open to the parties to make their own provision for the financial consequences of a breach of contract. The courts have long exercised a jurisdiction to control agreed damages clauses, although the extent of the jurisdiction, and the justifications for its existence, are a source of some controversy.

23.1 Introduction

The aim of this chapter is to examine the entitlement of a claimant to recover damages in respect of a breach of contract committed by the defendant. Every breach of contract gives rise to a claim for damages. In the case where the claimant has not suffered any loss as a result of the breach, he is still entitled to recover damages but damages will be nominal. The word 'damages', as used in this chapter, is not tied to compensatory damages. As Professor (now Justice) Edelman suggests in his book *Gain-Based Damages: Contract, Tort, Equity and Intellectual Property* (Hart, 2002), p. 22, the word '"damages" can only mean money awards which respond to wrongs'. On this view the word 'damages' is not tied to any particular measure of recovery. There is a range of measures available to the court, all of which can be described as different types of damages. Thus we have nominal damages, compensatory damages, negotiating damages, restitutionary (or disgorgement) damages, and exemplary (or punitive) damages. This chapter will focus on compensatory damages but it will also explore the circumstances in which a claimant can recover 'negotiating damages' and 'an account of profits'. Exemplary damages make only a fleeting appearance. English law does not, as yet, recognize an entitlement to recover exemplary damages for a breach of contract.

The chapter is divided into the following sections. The bulk of it is devoted to compensatory damages, given that they are the most commonly awarded form of damages. It opens (at 23.2) with a discussion of the different measures of damages that can be awarded and concludes that the aim of an award of damages is generally to protect the claimant's performance (or expectation) interest. The next section (23.3) is devoted to an analysis of the performance interest and it consists largely of an analysis of two decisions of the House of Lords. Section 23.4 examines the circumstances in which a claimant can seek damages based on his 'reliance' losses rather than his performance interest, while the circumstances in which damages may be awarded to protect the claimant's 'restitution' interest is discussed at 23.5. Section 23.6 examines the entitlement of a claimant to recover damages in respect of non-pecuniary losses, particularly 'mental distress'. Section 23.7 considers the general rule that damages are assessed as at the date of breach and the exceptions to that rule. Section 23.8 then turns to a consideration of the various doctrines that the courts use in order to keep liability within acceptable bounds. Doctrines examined in this section include remoteness, mitigation, and contributory negligence. Section 23.9 considers the availability of what have come to be known as 'negotiating
p. 817 damages' and it will also examine the reluctance ↵ of the modern courts to award to the innocent party an account of the profits which the defendant has made from its breach of contract. Section 23.10 examines, albeit briefly, the possibility that exemplary damages might have a role to play in breach of contract cases. The chapter concludes, at 23.11 and 23.12, with a discussion of agreed damages clauses (and related clauses) and their legal regulation.

23.2 Damages: The Different Measures

The most cited article ever written on the law of contract is probably Fuller and Perdue's article entitled 'The Reliance Interest in Contract Damages' which was published in two parts in the *Yale Law Journal* in 1936 and 1937. This article has been hailed as a classic and its influence on a number of contract scholars has been immense (see, for example, the preface to PS Atiyah, *The Rise and Fall of Freedom of Contract* (Oxford University

Press, 1979)). Its major impact has been on the terminology which we use when describing the different measures of damages that can be recovered on a breach of contract. In this, the opening section of their essay, they set out the three different interests that the law of contract might protect. The principal points to note are the ranking of these three interests, their relegation of the significance of the expectation interest (or performance interest) which, at the time, was the generally accepted measure of recovery, and their championing of the cause of the reliance interest.

LL Fuller and William R Perdue Jr, 'The Reliance Interest in Contract Damages'
(1936) 46 *Yale LJ* 52, 53–62

> It is convenient to distinguish three principal purposes which may be pursued in awarding contract damages. These purposes, and the situations in which they become appropriate, may be stated briefly as follows:
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> First, the plaintiff has in reliance on the promise of the defendant conferred some value on the defendant. The defendant fails to perform his promise. The court may force the defendant to disgorge the value he received from the plaintiff. The object here may be termed the prevention of gain by the defaulting promisor at the expense of the promisee; more briefly, the prevention of unjust enrichment. The interest protected may be called the restitution interest. …
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> Secondly, the plaintiff has in reliance on the promise of the defendant changed his position. For example, the buyer under a contract for the sale of land has incurred expense in the investigation of the seller's title, or has neglected the opportunity to enter other contracts. We may award damages to the plaintiff for the purpose of undoing the harm which his reliance on the defendant's promise has caused him. Our object is to put him in as good a position as he was in before the promise was made. The interest protected in this case may be called the reliance interest.
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> Thirdly, without insisting on reliance by the promisee or enrichment of the promisor, we may seek to give the promisee the value of the expectancy which the promise created. We may in a suit for specific performance actually compel the defendant to render the promised performance to the plaintiff, or, in a suit for damages, we may make the defendant pay the money value of this performance. Here our object is to put the plaintiff in as good a position as he would have occupied had the defendant performed his promise. The interest protected in this case we may call the expectation interest.
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> p. 818 ↵ It will be observed that what we have called the restitution interest unites two elements: (1) reliance by the promisee, (2) a resultant gain to the promisor. It may for some purposes be necessary to separate these elements. In some cases a defaulting promisor may after his breach be left with an unjust gain which was not taken from the promisee (a third party furnished the consideration), or which was not the result of reliance by the promisee (the promisor violated a promise not to appropriate the promisee's goods). Even in those cases where the promisor's gain results from the promisee's reliance it may happen that damages will be assessed somewhat differently, depending on whether we take the promisor's gain or the promisee's loss as the standard of measurement. Generally, however … gain by the promisor will be accompanied by a corresponding and, so far as its legal measurement is concerned, identical loss to the promisee, so that for our purposes the most workable classification is one which presupposes in the restitution interest a correlation of promisor's gain and promisee's loss. If, as we shall assume, the gain involved in the restitution interest results from and is identical with the plaintiff's loss through reliance, then the restitution interest is merely a special case of the reliance interest; all of the cases coming under the restitution interest will be covered by the reliance interest, and the reliance interest will be broader than the restitution interest only to the extent that it includes cases where the plaintiff has relied on the defendant's promise without enriching the defendant.

> It should not be supposed that the distinction here taken between the reliance and expectation interests coincides with that sometimes taken between 'losses caused' … and 'gains prevented'. In the first place, though reliance ordinarily results in 'losses' of an affirmative nature (expenditures of labor and money) it is also true that opportunities for gain may be foregone in reliance on a promise. Hence the reliance interest must be interpreted as at least potentially covering 'gains prevented' as well as 'losses caused'. … On the other hand, it is not possible to make the expectation interest entirely synonymous with 'gains prevented'. The disappointment of an expectancy often entails losses of a positive character.
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> It is obvious that the three 'interests' we have distinguished do not present equal claims to judicial intervention. It may be assumed that ordinary standards of justice would regard the need for judicial intervention as decreasing in the order in which we have listed the three interests. The 'restitution interest', involving a combination of unjust impoverishment with unjust gain, presents the strongest case for relief. If, following Aristotle, we regard the purpose of justice as the maintenance of an equilibrium of goods among members of society, the restitution interest presents twice as strong a claim to judicial intervention as the reliance interest, since if A not only causes B to lose one unit but appropriates that unit to himself, the resulting discrepancy between A and B is not one unit but two.
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> On the other hand, the promisee who has actually relied on the promise, even though he may not thereby have enriched the promisor, certainly presents a more pressing case for relief than the promisee who merely demands satisfaction for his disappointment in not getting what was promised him. In passing from compensation for change of position to compensation for loss of expectancy we pass, to use Aristotle's terms again, from the realm of corrective justice to that of distributive justice. The law no longer seeks merely to heal a disturbed status quo, but to bring into being a new situation. It ceases to act defensively or restoratively, and assumes a more active role. With the transition, the justification for legal relief loses its self-evident quality. It is as a matter of fact no easy thing to explain why the normal rule of contract recovery should be that which measures damages by the value of the promised performance. Since this 'normal rule' throws its shadow across our whole subject it will be necessary to examine the possible reasons for its existence. It may be said parenthetically that the discussion which follows, though directed primarily to the normal measure of recovery where damages are sought, also has relevance to the more general
> p. 819 question, ↵ why should a promise which has not been relied on ever be enforced at all, whether by a decree of specific performance or by an award of damages?. …

Why Should the Law Ever Protect the Expectation Interest?

Perhaps the most obvious answer to this question is one which we may label 'psychological'. The answer would run something as follows: The breach of a promise arouses in the promisee a sense of injury. This feeling is not confined to cases where the promisee has relied on the promise. Whether or not he has actually changed his position because of the promise, the promisee has formed an attitude of expectancy such that a breach of the promise causes him to feel that he has been 'deprived' of something which was 'his'. Since this sentiment is a relatively uniform one, the law has no occasion to go back to it. It accepts it as a datum and builds its rule about it.

> The difficulty with this explanation is that the law does in fact go back on the sense of injury which the breach of promise engenders. No legal system attempts to invest with juristic sanction all promises. Some rule or combination of rules effects a sifting out for enforcement of those promises deemed important enough to society to justify the law's concern with them. Whatever the principles which control this sifting out process may be, they are not convertible into terms of the degree of resentment which the breach of a particular kind of promise arouses. Therefore, though it may be assumed that the impulse to assuage disappointment is one shared by those who make and influence the law, this impulse can hardly be regarded as the key which solves the whole problem of the protection accorded by the law to the expectation interest.
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> A second possible explanation for the rule protecting the expectancy may be found in the much-discussed 'will theory' of contract law. This theory views the contracting parties as exercising, so to speak, a legislative power, so that the legal enforcement of a contract becomes merely an implementing by the state of a kind of private law already established by the parties. ... It is enough to note here that while the will theory undoubtedly has some bearing on the problem of contract damages, it cannot be regarded as dictating in all cases a recovery of the expectancy. If a contract represents a kind of private law, it is a law which usually says nothing at all about what shall be done when it is violated. A contract is in this respect like an imperfect statute which provides no penalties, and which leaves it to the courts to find a way to effectuate its purposes. There would, therefore, be no necessary contradiction between the will theory and a rule which limited damages to the reliance interest. Under such a rule the penalty for violating the norm established by the contract would simply consist in being compelled to compensate the other party for detrimental reliance. Of course there may be cases where the parties have so obviously anticipated that a certain form of judicial relief will be given that we can, without stretching things, say that by implication they have 'willed' that this relief should be given. This attitude finds a natural application to promises to pay a definite sum of money. But certainly as to most types of contracts it is vain to expect from the will theory a ready-made solution for the problem of damages.
>
> A third and more promising solution to our difficulty lies in an economic or institutional approach. The essence of a credit economy lies in the fact that it tends to eliminate the distinction between present and future (promised) goods. Expectations of future values become, for purposes of trade, present values. In a society in which credit has become a significant and pervasive institution, it is inevitable that the expectancy created by an enforceable promise should be regarded as a kind of property, and breach of the promise as an injury to that property. ...
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> The most obvious objection which can be made to the economic or institutional explanation is that it
p. 820 involves a *petitio principii*. A promise has present value, why? Because the ↵ law enforces it. 'The expectancy' regarded as a present value, is not the cause of legal intervention but the consequence of it. This objection may be reinforced by a reference to legal history. Promises were enforced long before there was anything corresponding to a general system of 'credit', and recovery was from the beginning measured by the value of the promised performance, the 'agreed price'. It may therefore be argued that the 'credit system' when it finally emerged was itself in large part built on the foundations of a juristic development which preceded it.

The view just suggested asserts the primacy of law over economics; it sees law not as the creature but as the creator of social institutions. The shift of emphasis thus implied suggests the possibility of a fourth explanation for the law's protection of the unrelied-on expectancy, which we may call juristic. This explanation would seek a justification for the normal rule of recovery in some policy consciously pursued by courts and other lawmakers. It would assume that courts have protected the expectation interest because they have considered it wise to do so, not through a blind acquiescence in habitual ways of thinking and feeling, or through an equally blind deference to the individual will. Approaching the problem from this point of view, we are forced to find not a mere explanation for the rule in the form of some sentimental, volitional, or institutional datum, but articulate reasons for its existence.

What reasons can be advanced? In the first place, even if our interest were confined to protecting promisees against out-of-pocket loss, it would still be possible to justify the rule granting the value of the expectancy, both as a cure for, and as a prophylaxis against, losses of this sort.

It is a cure for these losses in the sense that it offers the measure of recovery most likely to reimburse the plaintiff for the (often very numerous and very difficult to prove) individual acts and forbearances which make up his total reliance on the contract. If we take into account 'gains prevented' by reliance, that is, losses involved in foregoing the opportunity to enter other contracts, the notion that the rule protecting the expectancy is adopted as the most effective means of compensating for detrimental reliance seems not at all far-fetched. Physicians with an extensive practice often charge their patients the full office call fee for broken appointments. Such a charge looks on the face of things like a claim to the promised fee; it seems to be based on the 'expectation interest'. Yet the physician making the charge will quite justifiably regard it as compensation for the loss of the opportunity to gain a similar fee from a different patient. This foregoing of other opportunities is involved to some extent in entering most contracts, and the impossibility of subjecting this type of reliance to any kind of measurement may justify a categorical rule granting the value of the expectancy as the most effective way of compensating for such losses.

The rule that the plaintiff must after the defendant's breach take steps to mitigate damages tends to corroborate the suspicion that there lies hidden behind the protection of the expectancy a concern to compensate the plaintiff for the loss of the opportunity to enter other contracts. Where after the defendant's breach the opportunity remains open to the plaintiff to sell his services or goods elsewhere, or to fill his needs from another source, he is bound to embrace that opportunity. Viewed in this way the rule of 'avoidable harms' is a qualification on the protection accorded the expectancy, since it means that the plaintiff, in those cases where it is applied, is protected only to the extent that he has in reliance on the contract foregone other equally advantageous opportunities for accomplishing the same end.

But, as we have suggested, the rule measuring damages by the expectancy may also be regarded as a prophylaxis against the losses resulting from detrimental reliance. Whatever tends to discourage breach of contract tends to prevent the losses occasioned through reliance. Since the expectation interest furnishes a more easily administered measure of recovery than the reliance interest, it will in practice offer a more effective sanction against ↵ contract breach. It is therefore possible to view

> the rule measuring damages by the expectancy in a quasi-criminal aspect, its purpose being not so much to compensate the promisee as to penalize breach of promise by the promisor. The rule enforcing the unrelied-on-promise finds the same justification, on this theory, as an ordinance which fines a man for driving through a stop-light when no other vehicle is in sight.
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> In seeking justification for the rule granting the value of the expectancy there is no need, however, to restrict ourselves by the assumption hitherto made, that the rule can only be intended to cure or prevent the losses caused by reliance. A justification can be developed from a less negative point of view. It may be said that there is not only a policy in favor of preventing and undoing the harms resulting from reliance, but also a policy in favor of promoting and facilitating reliance on business agreements. As in the case of the stop-light ordinance we are interested not only in preventing collisions but in speeding traffic. Agreements can accomplish little, either for their makers or for society, unless they are made the basis for action. When business agreements are not only made but are also acted on, the division of labor is facilitated, goods find their way to the places where they are most needed, and economic activity is generally stimulated. These advantages would be threatened by any rule which limited legal protection to the reliance interest. Such a rule would in practice tend to discourage reliance. The difficulties in proving reliance and subjecting it to pecuniary measurement are such that the business man knowing, or sensing, that these obstacles stood in the way of judicial relief would hesitate to rely on a promise in any case where the legal sanction was of significance to him. To encourage reliance we must therefore dispense with its proof. For this reason it has been found wise to make recovery on a promise independent of reliance, both in the sense that in some cases the promise is enforced though not relied on (as in the bilateral business agreement) and in the sense that recovery is not limited to the detriment incurred in reliance.
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> The juristic explanation in its final form is then twofold. It rests the protection accorded to the expectancy on (1) the need for curing and preventing the harms occasioned by reliance, and (2) on the need for facilitating reliance on business agreements. From this spelling out of a possible juristic explanation, it is clear that there is no incompatibility between it and the economic or institutional explanation. The essence of both of them lies in the word ‘credit’. The economic justification views credit from its institutional side; the juristic explanation Views it from its rational side. The economic view sees credit as an accepted way of living; the juristic view invites us to explore the considerations of utility which underlie this mode of living; and the part which conscious human direction has played in bringing it into being.

At the end of the day Fuller and Perdue do not seriously challenge the courts’ practice of awarding expectation damages. Rather, they challenge the theoretical justifications for making such awards. The justification, in their view, lies not in the need to protect the ‘interest’ created by a binding promise but in the desire to provide a cure for, and prophylaxis against, reliance losses. Other jurists, building on the work of Fuller and Perdue, went further and openly questioned the justifications for awarding damages to protect the claimant’s expectation interest, particularly in the case where the contract remained executory. The courts have, however, remained stubbornly resistant to Fuller and Perdue’s analysis and have not demonstrated a willingness to abandon their commitment to the protection of the expectation or the performance interest (see S Macauley, ‘The Reliance Interest and the World Outside the Law Schools’ Doors’ [1991] *Wisc LR* 247, esp. pp. 266–287).

p. 822 ↵ Fuller and Perdue's analysis has been challenged, in what is suggested is a convincing fashion, by Professor Friedmann in the following terms:

D Friedmann, 'The Performance Interest in Contract Damages'
(1995) 111 *LQR* 628, 629–639, 646–650, and 654

> The essence of contract is performance. Contracts are made in order to be performed. This is usually the one and only ground for their formation. Ordinarily, a person enters into a contract because he is interested in getting that which the other party has to offer and because he places a higher value on the other party's performance than on the cost and trouble he will incur to obtain it. This interest in getting the promised performance (hereafter the 'performance interest') is the only pure contractual interest. The performance interest is protected by specific remedies which aim at getting the innocent party the very performance promised to him, and by substitutional remedies. The specific remedies are:
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> (1) Specific performance and injunction, originally equitable and, therefore, discretionary remedies.
>
> (2) The recovery of a debt. ...
>
> The substitutional remedies are:
>
> (1) Compensating damages or 'loss of bargain' damages. It is also possible to term them 'performance damages', since they are intended to put the plaintiff in as good a position as that in which he would have been, had the contract been performed.
>
> (2) Recovery of the 'substitute' which relates to the situation in which the promisor can no longer perform but has obtained a substitute for the promised performance. Examples of such a 'substitute' include insurance proceeds for a loss, and damages or price paid by a third party. ...
>
> (3) Recovery in restitution of profits made by the other party through the breach. This remedy partly overlaps the right to the substitute ... but the extent of its availability has been much debated. ...
>
> The performance interest is also protected against third parties by means of the tort of inducement of breach of contract and also by equitable and restitutionary remedies.

The Ranking of Interests and the New Terminology

> Fuller and Perdue ... identified three interests: the expectation interest, the reliance interest and the restitution interest. These interests were ranked in accordance with the strength of their claim for judicial intervention. Restitution arrived first and reliance second. The expectation interest ended at the bottom of the list.
>
> The expectation interest is simply an inappropriate term describing the performance interest. The other two have acquired the title 'interest' probably under the influence of German law. Whatever is the nature of reliance and restitution, they are certainly not contractual interests. Thus, the interest of a person who made a payment in order to get a house, a car or even a pizza is to get the house, the car or the pizza. Such a person will be greatly surprised to learn that upon contracting to purchase a

house, he acquired an interest in getting his payment back (restitution interest). In all probability he is likely to protest that this is not what he wanted. Had he preferred the money to the house he would
p. 823 not have made the ↵ contract in the first place. He would need a lot of coaching in an American course on contracts to learn that his interest in getting his payment back ranks higher in the hierarchy than his interest in getting the house. …

The greatest terminological innovation of Fuller and Perdue and the most inappropriate one, was the invention of the 'expectation' or 'expectancy'. This term … was used to describe the normal measure of contractual damages, namely the measure based upon the right to get the promised performance … one can hardly conceive of a term that is less appropriate than 'expectancy' or 'expectation'. 'Expectancy' is often used to describe a prospect or a probability of receiving a benefit in the future, when this possibility is not supported by a legal right … Indeed, the term 'expectation' may be more appropriate in this context, in which the expectation is not based upon a legal right, than in the contractual context, in which the plaintiff has a legal right to receive that which was promised to him.

The Marginalisation of the Performance Interest

The next step in Fuller and Perdue's derogation of the right to performance comes in the process of the ranking of interests, in which the performance interest (now already diminished to a mere 'expectancy') is outclassed by both restitution and reliance. That being accomplished, there comes a question which casts doubt upon the very legitimacy of the right to performance. The subtitle on page 57 of the article reads: 'Why Should the Law Ever Protect the Expectation Interest?' This is followed by a rather detailed discussion in which expectation again does not fare too well. In essence, three explanations are offered. …

The third and only justification which Fuller and Perdue find for what they term 'expectation' damages lies in the 'difficulties in proving reliance and subjecting it to pecuniary measurement … To encourage reliance we must therefore dispense with its proof'. Performance damages, thus, receive an additional blow. They are not justified in their own right. They are merely parasitic and exist because of the difficulties in measuring the 'real' interest, namely reliance.

The argument is most unconvincing. The proof of reliance losses is by no means more difficult than proof of performance (or 'expectation') losses, even if they are to include 'loss of opportunity'. … In fact, reliance damages are sometimes awarded on the ground that it is impossible to appraise the performance, or 'loss of bargain', damages. This, of course, is the very opposite of the argument made by Fuller and Perdue.

The difficulties with Fuller and Perdue's reasoning are, however, more fundamental … they accept the 'will theory' and the premise that a contractual promise is legally binding. They assume, however, that the question of the remedy is completely divorced from the nature of the right. It is, therefore, open to prefer the reliance measure of damages to that of the performance (in their terminology 'expectation'). The reasoning is, however, most unconvincing. It is, of course, legitimate to examine

the grounds for recognizing the binding effect of contracts. … However, Fuller and Perdue avoided this question. They accepted the validity of the contractual obligation but erroneously assumed that it entails few consequences as to the remedy.

It is, of course, true that the mere recognition of a specific right does not provide answers to all issues regarding the remedies available for its protection. Thus, the fact that the legal system recognizes the right of ownership does not tell us whether the owner, whose property was misappropriated, will be entitled to restitution in specie or merely to damages. The rules on remoteness of damages are similarly not self-evident. It is, however, an unwarranted jump to conclude that the right tells us nothing about the remedy and that rights and remedies raise totally unrelated issues.

p. 824 ↵ It is submitted that the very recognition of a legal right entails some consequences regarding the remedy, one of which relates to the initial point of inquiry. This initial point relates to the value of legal right, at least where such value can be ascertained. The right of recovery may be qualified or subject to exceptions. The initial point is, however, clear.

Thus, suppose that P acquired for $300 shares which are now worth $1000. The shares have been misappropriated by D. In Fuller and Perdue's terminology the $300 represents 'reliance loss' whereas the $1000 represents 'expectation damages'. After all, P never had the $1000. He had shares which he could expect to sell. This expectation, if realised, would yield him $1000. However, the translation of the situation into Fuller and Perdue's terminology merely confuses the issue. The historical expenditure or the reliance interest (in the above example, $300) is irrelevant, except where it serves as evidence of existing value. Recovery is based upon the present value of the shares. The recognition of P's right of property suffices to justify such recovery.

It is clearly legitimate to question the justification of private property. However, once private ownership is recognized, it follows as a matter of course that the owner whose property has been misappropriated will either recover it in specie or will get damages reflecting its value. In order to justify this result, there is no need to resort to the 'lost opportunity' explanation (the owner could have bought other shares that might have similarly appreciated in value) or to some other fiction.

Let us now revert to the contract situation. Suppose that in consideration of $300 D undertook to transfer to P, within 6 months, certain shares. After 5 months, when the price of the shares reaches $1000, D reneges. If we assume that the contract was valid so that it vested in P the right to the promised performance, it follows that P would be entitled either to specific performance (the value of which is $1000) or to the substitutionary remedy of damages, which will be based upon the value of the promised performance, namely $1000.

This argument, as well as the analogy to property, is strengthened by the possibility of assignment. In the property example P could sell the shares for $1000. In the contract example he could have assigned his contractual right to receive the shares for a similar amount. In both instances, the measure of recovery ought, therefore, to be similar. To claim that the contract was binding, i.e. that P was entitled to D's performance, and yet that recovery can be confined to P's expenditure ($300), is a contradiction in terms.

Fuller and Perdue feel, however, that the obvious result needs explanation. The superfluous explanation is based upon the lost opportunity theory, which forms part of the reliance loss. Because P entered into contract no. 1 with D, he gave up the possibility of another potential contract (contract no. 2) with a third party (T) which would have yielded him similar gains. The argument is doubly flawed. First, if P's gains from the actual contract (no. 1) with D are not recoverable in their own right as part of his performance (or 'expectation') interest, why do these very gains become recoverable when attributed to another potential contract (contract no. 2)? Is it because they have changed denomination and appear under the guise of reliance? Second, the whole argument is based on circular reasoning. If it is assumed that the entitlement to recover performance (expectation) damages in contract no. 1 derives solely from the lost opportunity (potential contract no. 2), we have to examine the value of this opportunity. This is obviously dependent upon the nature of the entitlement and the ensuing measure of damages in potential contract no. 2. If there is no justification for performance damages (other than lost opportunity) then the value of contract no. 2 was not $1000, but a mere $300, unless we assume that the recovery will again be based on lost opportunity (potential contract no. 3) and so ad infinitum.

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The Value of the Legal Right and the Measure of Damages in Contract and Tort

Fuller and Perdue raise the question whether broad adoption in contracts of the so called 'tort principle', namely, the reliance interest, would not 'blur the lines of division separating the different branches of the law'. In their view the breaking of the barriers between the branches of the law of obligations 'would represent a distinct service to legal thinking'.

The basic assumption that there exists, on this specific point, such a barrier between tort and contract damages is, however, erroneous. It is assumed that tort damages look backwards and aim at returning the plaintiff to the status quo ante whereas contract damages look forward and strive to put the plaintiff in the position in which he would have been in had the contract been performed. Reliance damages are, thus, akin to the tort principle since they are meant to put the plaintiff in his pre-contract position, whereas performance damages reflect the contract principle.

This analysis is based on a misconception which derives from the failure to adequately distinguish between rights and remedies. It is submitted that the basic principle as to damages is identical in contract and tort, though there may be some variations in its application. The principle provides in essence that the purpose of damages is to put the plaintiff, in economic terms, in the position in which he would have been had the wrong (either a tort or breach of contract) not been committed. The different results reached in tort and contract derive from the fact that they are usually called on to protect different rights. Where, however, they are invoked to protect the same right, the calculation of damages, which reflect the value of this right, either in tort or in contract, will be similar. ...

The Impact of Fuller and Perdue—Terminology and Substance

(a) Terminological impact

As already pointed out, the most significant effect of Fuller and Perdue lies in the introduction of new terminology. No student is likely to complete an American course on contracts without reciting 'expectation interest' and 'reliance interest'. In recent years the new terminology has spread to England and to other Commonwealth jurisdictions. ...

(b) Substantive impact

... Fuller and Perdue did not expressly advocate the curtailment of the protection granted to the performance interest. However, much of the article consists of an attempt to question its justification, to describe it as an 'expectancy' and to suggest its legitimacy depends on reliance. They also hinted at the possibility of limiting recovery to reliance losses in certain cases in which a binding contract has been concluded, notably in situations that are not within the credit system. Professor Atiyah went a step further. He was 'troubled and uncertain about the extent to which executory contracts should be enforced, and the extent to which the expectation damages measure is appropriate ... '. He also considered that 'it would not be surprising if future developments tend to show a still further whittling down of expectation damages'.

Modern law hardly reflects any traces of this approach ... Notwithstanding The Reliance Interest there are no signs of weakening of the performance interest. On the contrary, one of the major trends in modern contract law is the strengthening of the protection accorded to the performance interest. Traditional limitations upon the availability of specific performance and upon the recovery of performance damages have either been removed or severely curtailed. ...

p. 826 ↵ The scope of specific performance has spread beyond real estate cases to many other types of contracts. ... The law of damages shows similar signs of expanding the protection granted to the performance interest. The fundamental principle under which, so far as money can do it, the injured party should be placed in the same situation as if the contract had been performed, is constantly applied. Furthermore, legal rules that have in the past limited the prospect of obtaining full performance damages seem to lose at least part of their effect. ... Another development which reflects the strengthening of the performance interest relates to the measure of recovery where the defendant renders a defective performance or a performance which is not in line with contract requirements. The cost of curing the defect is usually higher than the difference in market value between the performance as rendered and the value of the performance had it conformed to the terms of the contract. In this type of situation recovery was often confined to the difference in value, if the cost of cure was disproportionate to the difference in value. However, the present tendency is to award the plaintiff the cost of repair even where there is a large disparity between this cost and the difference in value, provided that it is reasonable for the plaintiff to insist on reinstatement. Furthermore, circumstances are conceivable in which the costs of repair are unreasonable while the difference in value is small or even nil. Under the traditional approach, in such a case, the plaintiff might have been left without a remedy. The recent decision of the House of Lords in *Ruxley Electronics*

> *Ltd* [23.3.1] indicates that these two measures of recovery are not exhaustive, and that damages might be awarded by reference to the fact that the plaintiff's performance interest has been frustrated by the defendant's breach. The court may, thus, be required to appraise an element that has no market price in order to provide an adequate remedy. Needless to say, this development is predicated on the approach that *pacta sunt servanda* and that the plaintiff's performance interest should be respected.
>
> The expansion of the protection afforded to the performance interest is also reflected in the rules relating to non-economic losses. Traditionally, recovery of damages for such losses, resulting from breach of contract, has not been allowed. But this rule is becoming the subject of ever-increasing exceptions. ...
>
> There is a great discrepancy between The Reliance Interest's intellectual appeal and its effect on substantive law. The article made a deep impact on academic thinking, upon the language and discourse of contracts and led to the adoption of new terminology, which in the case of 'expectation' was an unhappy development. Its effect on substantive law is at best secondary. The attack upon the performance interest goes against the grain. This interest constitutes the very core of contract law. Its ample protection is likely to be maintained and possibly expanded as long as the essence of contract law as we know it remains.

23.3 The Performance Interest

As Professor Friedmann notes, the courts remain committed to the protection of the claimant's performance interest (to use Professor Friedmann's phrase in preference to the language of the 'expectation' interest employed by Fuller and Perdue). In his article Professor Friedmann argues that 'one of the major trends in modern contract law is the strengthening of the protection afforded to the performance interest'. It is certainly true that the courts' commitment to the protection of the performance interest has been tested in the courts but it is suggested that their commitment to the performance interest can be seen to be less than whole-hearted.

p. 827 ↵ It is the case that the starting point for the courts' Analysis is a commitment to the protection of the performance interest. This was classically expressed by Parke B in *Robinson* v. *Harman* (1848) 1 Ex 850, 855 when he stated that:

> the rule of the common law is, that where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed.

This commitment to the performance interest expressed by Parke B has been challenged in the courts recently in two different ways. The first relates to the method chosen by the court to fulfil the performance interest. There are two principal methods. The first is to award the claimant the difference in value between the performance for which he contracted and the performance which he received. This measure is committed to putting the claimant in the financial position which he would have been in had the contract been performed according to its terms (in the sense that the expected increase in his wealth will be protected). The

alternative is to award the claimant damages assessed on a 'cost of cure' basis. On this basis, the claimant is given the sum of money needed in order to enable him to obtain the performance for which he contracted. This measure is committed to enabling the claimant to obtain performance itself rather than the economic value of performance (as is the case in the diminution in value measure). In many cases the difference between the two measures is relatively trivial and it does not give rise to litigation. But in some cases the difference can be substantial. One such case is the decision of the House of Lords in *Ruxley Electronics and Construction Ltd* v. *Forsyth* [1996] AC 344, to which we shall shortly turn.

The second issue that has arisen relates to the case in which the claimant has no direct financial interest in the performance of the contract. The classic example is a case in which the claimant enters into a contract under which he agrees to pay for repair work to be done on the property of a third party. What is the measure of the claimant's recovery in the event that the repair work is carried out defectively? Can the party who carried out the work maintain that the claimant is only entitled to nominal damages on the basis that he has suffered no loss as a result of the fact that work on someone else's property has been done defectively? This is the principal issue that arose in our second case, which is the extremely difficult decision of the House of Lords in *Alfred McAlpine Construction Ltd* v. *Panatown Ltd* [2001] 1 AC 518 to which we will make brief reference after examining *Ruxley*.

23.3.1 *Ruxley Electronics and Construction Ltd* v. *Forsyth*

Ruxley Electronics and Construction Ltd v. Forsyth
[1996] AC 344, House of Lords

> The plaintiffs entered into a contract with the defendant under which they agreed to build a swimming pool for the defendant in his garden. It was agreed that the pool would be built to a depth of seven feet six inches. In breach of contract the plaintiffs built the swimming pool to a depth of six feet. When he eventually discovered this fact the defendant refused to pay the contract price. The
> p. 828 plaintiffs sued him for the price. The trial judge held that the ↵ defendant was liable to pay the price for the work done on the basis that the plaintiffs had 'substantially performed' their obligations under the contract. The defendant was therefore left to his counterclaim for damages for breach of contract.
>
> At trial, two points were established via expert evidence. The first was that the difference in value between a pool built to a depth of seven feet six inches and one built to a depth of six feet was nil. The second was that the only practicable way to increase the depth was to rebuild the pool at a cost of £21,560. The trial judge also found that the difference in depth did not in any way impair the defendant's use of the pool.
>
> The trial judge refused to award the defendant damages assessed on a cost of cure basis and instead awarded him 'loss of amenity' damages of £2,500. The Court of Appeal allowed the defendant's appeal and held that he was entitled to cost of cure damages of £21,560. The plaintiffs appealed to the House of Lords. The appeal was allowed. It was held that the defendant (the respondent in the appeal) was not entitled to recover damages assessed on a cost of cure basis on the ground that the cost of carrying out the work was out of all proportion to the benefit which he would receive from full performance. There being no challenge by the plaintiffs to the trial judge's award of £2,500 damages for 'loss of amenity', it was held that this fixed the measure of the defendant's recovery.

Lord Jauncey of Tullichettle

> Damages are designed to compensate for an established loss and not to provide a gratuitous benefit to the aggrieved party from which it follows that the reasonableness of an award of damages is to be linked directly to the loss sustained. If it is unreasonable in a particular case to award the cost of reinstatement it must be because the loss sustained does not extend to the need to reinstate. A failure to achieve the precise contractual objective does not necessarily result in the loss which is occasioned by a total failure. …
>
> I take the example suggested during argument by my noble and learned friend, Lord Bridge of Harwich. A man contracts for the building of a house and specifies that one of the lower courses of brick should be blue. The builder uses yellow brick instead. In all other respects the house conforms to the contractual specification. To replace the yellow bricks with blue would involve extensive demolition and reconstruction at a very large cost. It would clearly be unreasonable to award to the owner the cost of reconstructing because his loss was not the necessary cost of reconstruction of his

house, which was entirely adequate for its design purpose, but merely the lack of aesthetic pleasure which he might have derived from the sight of blue bricks. Thus in the present appeal the respondent has acquired a perfectly serviceable swimming pool, albeit one lacking the specified depth. His loss is thus not the lack of a useable pool with consequent need to construct a new one. Indeed were he to receive the cost of building a new one and retain the existing one he would have recovered not compensation for loss but a very substantial gratuitous benefit, something which damages are not intended to provide.

What constitutes the aggrieved party's loss is in every case a question of fact and degree. Where the contract breaker has entirely failed to achieve the contractual objective it may not be difficult to conclude that the loss is the necessary cost of achieving that objective. Thus if a building is constructed so defectively that it is of no use for its designed purpose the owner may have little difficulty in establishing that his loss is the necessary cost of reconstructing. Furthermore in taking reasonableness into account in determining the extent of loss it is reasonableness in relation to the particular contract and not at large. Accordingly if I contracted for the erection of a folly in my garden
p. 829 which shortly thereafter suffered a total collapse it ↵ would be irrelevant to the determination of my loss to argue that the erection of such a folly which contributed nothing to the value of my house was a crazy thing to do. As Oliver J said in *Radford* v. *De Froberville* [1977] 1 WLR 1262, 1270:

> 'If he contracts for the supply of that which he thinks serves his interests—be they commercial, aesthetic or merely eccentric—then if that which is contracted for is not supplied by the other contracting party I do not see why, in principle, he should not be compensated by being provided with the cost of supplying it through someone else or in a different way, subject to the proviso, of course, that he is seeking compensation for a genuine loss and not merely using a technical breach to secure an uncovenanted profit.'

However where the contractual objective has been achieved to a substantial extent the position may be very different.

It was submitted that where the objective of a building contract involved satisfaction of a personal preference the only measure of damages available for a breach involving failure to achieve such satisfaction was the cost of reinstatement. In my view this is not the case. Personal preference may well be a factor in reasonableness and hence in determining what loss has been suffered but it cannot per se be determinative of what that loss is.

My Lords, the trial judge found that it would be unreasonable to incur the cost of demolishing the existing pool and building a new and deeper one. In so doing he implicitly recognized that the respondent's loss did not extend to the cost of reinstatement. He was, in my view, entirely justified in reaching that conclusion. It therefore follows that the appeal must be allowed.

It only remains to mention two further matters. The appellant argued that the cost of reinstatement should only be allowed as damages where there was shown to be an intention on the part of the aggrieved party to carry out the work. Having already decided that the appeal should be allowed I no longer find it necessary to reach a conclusion on this matter. However I should emphasise that in the

normal case the court has no concern with the use to which a plaintiff puts an award of damages for a loss which has been established. Thus irreparable damage to an article as a result of a breach of contract will entitle the owner to recover the value of the article irrespective of whether he intends to replace it with a similar one or to spend the money on something else. Intention, or lack of it, to reinstate can have relevance only to reasonableness and hence to the extent of the loss which has been sustained. Once that loss has been established intention as to the subsequent use of the damages ceases to be relevant.

The second matter relates to the award of £2,500 for loss of amenity made by the trial judge. The respondent argued that he erred in law in making such award. However as the appellant did not challenge it, I find it unnecessary to express any opinion on the matter.

Lord Mustill

My Lords, I agree that this appeal should be allowed for the reasons stated by my noble and learned friends, Lord Jauncey of Tullichettle and Lord Lloyd of Berwick. I add some observations of my own on the award by the trial judge of damages in a sum intermediate between, on the one hand, the full cost of reinstatement, and on the other the amount by which the malperformance has diminished the market value of the property on which the work was done: in this particular case, nil. This is a question of everyday practical importance to householders who have engaged contractors to carry out small building works, and then find (as often happens) that performance has fallen short of what was promised. I think it proper to enter on the question here, although there is no appeal against the award, because the ↵ possibility of such a recovery in a suitable case sheds light on the employer's claim that reinstatement is the only proper measure of damage.

p. 830

The proposition that these two measures of damage represent the only permissible bases of recovery lie at the heart of the employer's case. From this he reasons that there is a presumption in favour of the cost of restitution, since this is the only way in which he can be given what the contractor had promised to provide. Finally, he contends that there is nothing in the facts of the present case to rebut this presumption.

The attraction of this argument is its avoidance of the conclusion that, in a case such as the present, unless the employer can prove that the defects have depreciated the market value of the property the householder can recover nothing at all. This conclusion would be unacceptable to the average householder, and it is unacceptable to me. It is a common feature of small building works performed on residential property that the cost of the work is not fully reflected by an increase in the market value of the house, and that comparatively minor deviations from specification or sound workmanship may have no direct financial effect at all. Yet the householder must surely be entitled to say that he chose to obtain from the builder a promise to produce a particular result because he wanted to make his house more comfortable, more convenient and more conformable to his own particular tastes; not because he had in mind that the work might increase the amount which he would receive if, contrary to expectation, he thought it expedient in the future to exchange his home for cash. To say that in order to escape unscathed the builder has only to show that to the mind of the average onlooker, or the average potential buyer, the results which he has produced seem just as

good as those which he had promised would make a part of the promise illusory, and unbalance the bargain. In the valuable analysis contained in *Radford* v. *De Froberville* [1977] 1 WLR 1262, Oliver J emphasised, at p. 1270, that it was for the plaintiff to judge what performance he required in exchange for the price. The court should honour that choice. *Pacta sunt servanda*. If the appellant's argument leads to the conclusion that in all cases like the present the employer is entitled to no more than nominal damages, the average householder would say that there must be something wrong with the law.

In my opinion there would indeed be something wrong if, on the hypothesis that cost of reinstatement and the depreciation in value were the only available measures of recovery, the rejection of the former necessarily entailed the adoption of the latter; and the court might be driven to opt for the cost of reinstatement, absurd as the consequence might often be, simply to escape from the conclusion that the promisor can please himself whether or not to comply with the wishes of the promisee which, as embodied in the contract, formed part of the consideration for the price. Having taken on the job the contractor is morally as well as legally obliged to give the employer what he stipulated to obtain, and this obligation ought not to be devalued. In my opinion however the hypothesis is not correct. There are not two alternative measures of damage, at opposite poles, but only one; namely, the loss truly suffered by the promisee. In some cases the loss cannot be fairly measured except by reference to the full cost of repairing the deficiency in performance. In others, and in particular those where the contract is designed to fulfil a purely commercial purpose, the loss will very often consist only of the monetary detriment brought about by the breach of contract. But these remedies are not exhaustive, for the law must cater for those occasions where the value of the promise to the promisee exceeds the financial enhancement of his position which full performance will secure. This excess, often referred to in the literature as the 'consumer surplus' (see for example the valuable discussion by Harris, Ogus and Phillips (1979) 95 *LQR* 581) is usually incapable of precise valuation in terms of money, exactly because it represents a personal, subjective and non-monetary gain. Nevertheless where it exists the law should recognize it and compensate the promisee if the misperformance takes it away. The lurid ↵ bathroom tiles, or the grotesque folly instanced in argument by my noble and learned friend, Lord Keith of Kinkel, may be so discordant with general taste that in purely economic terms the builder may be said to do the employer a favour by failing to install them. But this is too narrow and materialistic a view of the transaction. Neither the contractor nor the court has the right to substitute for the employer's individual expectation of performance a criterion derived from what ordinary people would regard as sensible. As my Lords have shown, the test of reasonableness plays a central part in determining the basis of recovery, and will indeed be decisive in a case such as the present when the cost of reinstatement would be wholly disproportionate to the non-monetary loss suffered by the employer. But it would be equally unreasonable to deny all recovery for such a loss. The amount may be small, and since it cannot be quantified directly there may be room for difference of opinion about what it should be. But in several fields the judges are well accustomed to putting figures to intangibles, and I see no reason why the imprecision of the exercise should be a barrier, if that is what fairness demands.

p. 831

My Lords, once this is recognized the puzzling and paradoxical feature of this case, that it seems to involve a contest of absurdities, simply falls away. There is no need to remedy the injustice of awarding too little, by unjustly awarding far too much. The judgment of the trial judge acknowledges

that the employer has suffered a true loss and expresses it in terms of money. Since there is no longer any issue about the amount of the award, as distinct from the principle, I would simply restore his judgment by allowing the appeal.

Lord Lloyd of Berwick

[after setting out the facts in considerable detail continued]

Reasonableness

The starting point is *Robinson* v. *Harman* [see 23.3].

This does not mean that in every case of breach of contract the plaintiff can obtain the monetary equivalent of specific performance. It is first necessary to ascertain the loss the plaintiff has in fact suffered by reason of the breach. If he has suffered no loss, as sometimes happens, he can recover no more than nominal damages. For the object of damages is always to compensate the plaintiff, not to punish the defendant.

This was never more clearly stated than by Viscount Haldane LC in the first of the two broad principles which he formulated in *British Westinghouse Electric and Manufacturing Co Ltd* v. *Underground Electric Railways Co of London Ltd* [1912] AC 673, 689:

> 'The first is that, as far as possible, he who has proved a breach of a bargain to supply what he contracted to get is to be placed, as far as money can do it, in as good a situation as if the contract had been performed. The fundamental basis is thus compensation for pecuniary loss naturally flowing from the breach. ...'

Note that Lord Haldane does not say that the plaintiff is always to be placed in the same situation physically as if the contract had been performed, but in as good a situation financially, so far as money can do it. This necessarily involves measuring the pecuniary loss which the plaintiff has in fact sustained.

In building cases, the pecuniary loss is almost always measured in one of two ways; either the difference in value of the work done or the cost of reinstatement. Where the cost of reinstatement is less than the difference in value, the measure of damages will invariably be the cost of reinstatement.
p. 832 By claiming the difference in value the plaintiff would be failing ↵ to take reasonable steps to mitigate his loss. In many ordinary cases, too, where reinstatement presents no special problem, the cost of reinstatement will be the obvious measure of damages, even where there is little or no difference in value, or where the difference in value is hard to assess. This is why it is often said that the cost of reinstatement is the ordinary measure of damages for defective performance under a building contract.

But it is not the only measure of damages. Sometimes it is the other way round. This was first made clear in the celebrated judgment of Cardozo J giving the majority opinion in the Court of Appeals of New York in *Jacob & Youngs* v. *Kent*, 129 NE 889. In that case the building owner specified that the plumbing should be carried out with galvanized piping of 'Reading manufacture'. By an oversight, the builder used piping of a different manufacture. The plaintiff builder sued for the balance of his account. The defendant, as in the instant case, counter-claimed the cost of replacing the pipe work even though it would have meant demolishing a substantial part of the completed structure, at great expense. Cardozo J pointed out, at p. 891, that there is 'no general license to install whatever, in the builder's judgment, may be regarded as "just as good"'. But he went on to consider the measure of damages in the following paragraph:

> 'In the circumstances of this case, we think the measure of the allowance is not the cost of replacement, which would be great, but the difference in value, which would be either nominal or nothing. ... It is true that in most cases the cost of replacement is the measure. ... The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value. Specifications call, let us say, for a foundation built of granite quarried in Vermont. On the completion of the building, the owner learns that through the blunder of a sub-contractor part of the foundation has been built of granite of the same quality quarried in New Hampshire. The measure of allowance is not the cost of reconstruction. There may be omissions of that which could not afterwards be supplied exactly as called for by the contract without taking down the building to its foundations, and at the same time the omission may not affect the value of the building for use or otherwise, except so slightly as to be hardly appreciable.'

Cardozo J's judgment is important, because it establishes two principles, which I believe to be correct, and which are directly relevant to the present case; first, the cost of reinstatement is not the appropriate measure of damages if the expenditure would be out of all proportion to the benefit to be obtained, and, secondly, the appropriate measure of damages in such a case is the difference in value, even though it would result in a nominal award.

If the court takes the view that it would be unreasonable for the plaintiff to insist on reinstatement, as where, for example, the expense of the work involved would be out of all proportion to the benefit to be obtained, then the plaintiff will be confined to the difference in value. If the judge had assessed the difference in value in the present case at, say, £5,000, I have little doubt that the Court of Appeal would have taken that figure rather than £21,560. The difficulty arises because the judge has, in the light of the expert evidence, assessed the difference in value as nil. But that cannot make reasonable what he has found to be unreasonable.

So I cannot accept that reasonableness is confined to the doctrine of mitigation. It has a wider impact. ... How then does [counsel for the defendant] seek to support the majority judgment? It can only be, I think, by attacking the judge's finding of fact that the cost of rebuilding the pool would have been out of all proportion to the benefit to be obtained. [Counsel for the defendant] argues that

p. 833

this was not an ordinary commercial contract but a contract for a personal preference. … I am far from saying that personal preferences are irrelevant ↵ when choosing the appropriate measure of damages ('predilections' was the word used by Ackner LJ in *G.W. Atkins Ltd* v. *Scott*, 7 Const LJ 215, 221, adopting the language of Oliver J in *Radford* v. *De Froberville* [1977] 1 WLR 1262). But such cases should not be elevated into a separate category with special rules. If, to take an example mentioned in the course of argument, a landowner wishes to build a folly in his grounds, it is no answer to a claim for defective workmanship that many people might regard the presence of a well built folly as reducing the value of the estate. The eccentric landowner is entitled to his whim, provided the cost of reinstatement is not unreasonable. But the difficulty of that line of argument in the present case is that the judge, as is clear from his judgment, took Mr Forsyth's personal preferences and predilections into account. Nevertheless, he found as a fact that the cost of reinstatement was unreasonable in the circumstances. The Court of Appeal ought not to have disturbed that finding. …

Intention

I fully accept that the courts are not normally concerned with what a plaintiff does with his damages. But it does not follow that intention is not relevant to reasonableness, at least in those cases where the plaintiff does not intend to reinstate. Suppose in the present case Mr Forsyth had died, and the action had been continued by his executors. Is it to be supposed that they would be able to recover the cost of reinstatement, even though they intended to put the property on the market without delay? … In the present case the judge found as a fact that Mr Forsyth's stated intention of rebuilding the pool would not persist for long after the litigation had been concluded. In these circumstances it would be 'mere pretence' to say that the cost of rebuilding the pool is the loss which he has in fact suffered. … Does Mr Forsyth's undertaking to spend any damages which he may receive on rebuilding the pool make any difference? Clearly not. He cannot be allowed to create a loss, which does not exist, in order to punish the defendants for their breach of contract. The basic rule of damages, to which exemplary damages are the only exception, is that they are compensatory not punitive.

Loss of amenity

I turn last to the head of damages under which the judge awarded £2,500. …

Addis v. *Gramophone Co Ltd* established the general rule that in claims for breach of contract, the plaintiff cannot recover damages for his injured feelings. But the rule, like most rules, is subject to exceptions. One of the well established exceptions is when the object of the contract is to afford pleasure, as, for example, where the plaintiff has booked a holiday with a tour operator. If the tour operator is in breach of contract by failing to provide what the contract called for, the plaintiff may recover damages for his disappointment: see *Jarvis* v. *Swans Tours Ltd* [1973] QB 233 and *Jackson* v. *Horizon Holidays Ltd* [1975] 1 WLR 1468.

This was, as I understand it, the principle which Judge Diamond applied in the present case. He took the view that the contract was one 'for the provision of a pleasurable amenity.' In the event, Mr Forsyth's pleasure was not so great as it would have been if the swimming pool had been 7 feet 6

inches deep. This was a view which the judge was entitled to take. If it involves a further inroad on the rule in *Addis* v. *Gramophone Co Ltd* [1909] AC 488, then so be it. But I prefer to regard it as a logical application or adaptation of the existing exception to a new situation. I should, however, add this note of warning. Mr Forsyth was, I think, lucky to have obtained so large an award for his disappointed expectations. But as there was no criticism from any quarter as to the quantum of the award as distinct from the underlying principle, it would not be right for your Lordships to interfere with the judge's figure.

p. 834 ↵ That leaves one last question for consideration. I have expressed agreement with the judge's approach to damages based on loss of amenity on the facts of the present case. But in most cases such an approach would not be available. What is then to be the position where, in the case of a new house, the building does not conform in some minor respect to the contract, as, for example, where there is a difference in level between two rooms, necessitating a step. Suppose there is no measurable difference in value of the complete house, and the cost of reinstatement would be prohibitive. Is there any reason why the court should not award by way of damages for breach of contract some modest sum, not based on difference in value, but solely to compensate the buyer for his disappointed expectations? Is the law of damages so inflexible, as I asked earlier, that it cannot find some middle ground in such a case? I do not give a final answer to that question in the present case. But it may be that it would have afforded an alternative ground for justifying the judge's award of damages. And if the judge had wanted a precedent, he could have found it in Sir David Cairns's judgment in *G.W. Atkins Ltd* v. *Scott*, 7 Const LJ 215, where, it will be remembered, the Court of Appeal upheld the judge's award of £250 for defective tiling. Sir David Cairns said, at p. 221:

> 'There are many circumstances where a judge has nothing but his common sense to guide him in fixing the quantum of damages, for instance, for pain and suffering, for loss of pleasurable activities or for inconvenience of one kind or another.'

If it is accepted that the award of £2,500 should be upheld, then that at once disposes of Mr Jacob's argument that Mr Forsyth is entitled to the cost of reinstatement, because he must be entitled to something. But even if he were entitled to nothing for loss of amenity, or for difference in value, it would not follow as Mr Jacob argued that he was entitled to the cost of reinstatement. There is no escape from the judge's finding of fact that to insist on the cost of reinstatement in the circumstances of the present case was unreasonable.

I would therefore allow the appeal and restore the judgment of Judge Diamond.

Lord Keith of Kinkel concurred and ***Lord Bridge of Harwich*** delivered a concurring speech.

Commentary

There are a number of points to note here. The first is that the defendant's claim for damages was made by way of a counterclaim. The initial point taken by the defendant by way of defence was that he was not liable to pay at all. The rule invoked by the defendant is often known as the 'entire contracts' rule, although the subject matter of the rule is generally entire obligations rather than entire contracts. A claimant who has partially

performed an obligation which is entire is generally not entitled to payment for his part performance (see *Cutter* v. *Powell* (1795) 6 TR 320, 21.6). The defendant is entitled to maintain that his obligation to pay does not arise until the claimant has fully performed his obligation in accordance with the contract. This rule is well established in the books, although it has been the subject of some criticism on the basis of its tendency to produce harsh results (see, for example, *Sumpter* v. *Hedges* [1898] 1 QB 673, although for a defence of the case see B McFarlane and R Stevens, 'In Defence of *Sumpter* v. *Hedges*' (2002) 118 *LQR* 569). The rule is the subject of some exceptions, one of which is known as the doctrine of substantial performance. The effect of this exception is to entitle a claimant who has substantially performed his obligations to recover the contract price subject to the defendant's claim for damages for the loss he has suffered as a result of the claimant's breach of
p. 835 contract. This rule was applied by the trial ↵ judge in *Ruxley* so that the plaintiffs were held to be entitled to recover the contract price subject to the defendant's counterclaim for damages. It was the counterclaim that was the subject matter of the appeal to the Court of Appeal and then to the House of Lords.

The second point to note is a tactical one. Technically, the award of £2,500 loss of amenity damages by the trial judge was not in issue in the House of Lords. The decision that was the subject matter of the appeal to the House of Lords was the Court of Appeal's decision that the plaintiffs were liable to pay cost of cure damages of £21,560. The plaintiffs did not seek to challenge the decision of the trial judge that they were liable for loss of amenity damages of £2,500. In many ways it was not in their interests to do so. This being the case, the decision in *Ruxley* should not be taken as an authority on the amount of damages payable in a loss of amenity case. Lord Lloyd clearly thought that £2,500 was high but, given that the plaintiffs did not dispute the amount, he did not intervene. The fact that the plaintiffs did not contest their liability to pay £2,500 made their submission to the House of Lords seem more reasonable, in that it enabled them to submit that their liability was to pay loss of amenity damages but not cost of cure damages. This tactic pushed counsel for the defendant into an extreme position in which he, in essence, argued that the judge was not entitled to award loss of amenity damages, and that the choice which faced the House of Lords was one between diminution in value (which was zero) and cost of cure. Their Lordships refused to be boxed into a corner in this way and concluded that it was not the case that they had to award the defendant everything or nothing at all. They were attracted by the 'third way' which enabled them to hold that the plaintiffs were liable to pay the defendant damages for the loss of amenity which he suffered in not getting the swimming pool for which he had contracted. Thus, although it was not technically in issue between the parties, the award of damages for loss of amenity played a critical role in the reasoning of their Lordships.

This leads us on to the award of damages for 'loss of amenity'. Lord Mustill and Lord Lloyd adopted different approaches in relation to this aspect of the claim. Lord Lloyd took the narrower approach and linked the claim for loss of amenity damages with a line of cases (to be discussed at 23.6) where damages were awarded against a defendant who failed to provide the plaintiff with the pleasure that he had promised (for example, a holiday which turned into a disaster as a result of the defendant's breach of contract). Lord Mustill adopted a broader approach which did not confine the recovery of loss of amenity damages to pleasurable amenity cases. His adoption of the concept of the 'consumer surplus' has a broader impact in that it would appear to be applicable in any case in which a consumer puts a higher value on performance than the market value. Particularly important in this regard is Lord Mustill's statement that 'the law must cater for those occasions where the value of the promise to the promisee exceeds the financial enhancement of his position which full performance will secure'. This is an explicit recognition of the fact that parties can and do enter into contracts for reasons other than to make money and that the law ought to reflect that fact in the approach which it

adopts to the assessment of damages (see to similar effect the judgment of Lord Reed in *One Step (Support) Ltd* v. *Morris-Garner* [2018] UKSC 20, [2019] AC 649, [39]–[40]). There is one further question here and that relates to the nature of an award of damages for 'loss of amenity'. What exactly is it? Is it a species of non-pecuniary loss? What is the 'amenity' which the claimant must have lost?

The fourth point relates to the reasons which led the House of Lords to conclude that cost of cure damages were unreasonable on the facts of the case. It would appear that the unreasonableness was attributable to a combination of two factors. First, the cost of carrying out the repair work was high; second, the work would not have been of benefit to the defendant. If the defendant had had the pool built to enable him to engage in
p. 836 his favourite hobby of ↵ diving into a swimming pool from a diving board then the result of the case would, in all probability, have been different. In such a case the difference in depth would have been material and, indeed, on such facts the defendant might have been able to resist the plaintiffs' action for the price on the ground that they had not substantially performed their obligations under the contract. This balancing exercise is a difficult one. On the one hand the law does not wish to encourage contractors to render a performance which is different from that which they agreed to supply and then deny the existence of a liability to pay damages, other than loss of amenity damages. For this reason, some consumer groups have been critical of the decision in *Ruxley*—it gives to contractors a licence to provide a different performance and then offer a trifling sum by way of loss of amenity damages as compensation. On the other hand, the law does not generally wish to over-compensate claimants by giving them cost of cure damages in cases where they do not appear to have any intention of carrying out the repair work. This in turn raises the difficult question of the role of intention. Their Lordships were unwilling to allow the defendant in *Ruxley* to turn an undertaking to use the damages in effecting the repairs into a passport to a claim for substantial damages. Intention was but one factor to be considered when deciding whether or not it was unreasonable to allow the party claiming damages to recover damages assessed on a cost of cure basis. However, the courts may be slow to conclude that the award of cost of cure damages is unreasonable. The reason for this is that the innocent party is the victim of the breach of contract and the party in breach is not in a position to 'place unreasonable obstacles' in the way of the innocent party's recovery of damages.

Three final points can be noted about *Ruxley*. First, the plaintiffs did not profit as a result of their breach of contract. This was not a case in which they had built a shallow pool in order to make a bigger profit. Secondly, *Ruxley* has been the subject of subsequent judicial analysis by the House of Lords in *McAlpine* v. *Panatown*, (23.3.2) and in *Farley* v. *Skinner* [2001] UKHL 49, [2002] 2 AC 732, (23.6), and so we shall have cause to return to the case. The third point relates to the question whether or not the effect of the decision was to protect the defendant's performance interest. Professor Friedmann (23.2) suggests that it does. He states that *Ruxley* is 'predicated on the approach that *pacta sunt servanda* and that the [defendant's] performance interest should be protected'. On the other hand, it can be argued that the House of Lords failed adequately to protect the defendant's performance interest. The basis for this argument is that the award did not enable him to obtain the pool for which he contracted. He had to put up with something less and was given an award of damages to reflect the disappointment or loss of amenity which he suffered as a result of not getting the promised contractual performance. In this sense, his full performance interest was not protected. Against this, it can be argued that English law is not committed to ensuring that an innocent party receives the actual performance for which he contracted. This is demonstrated by its reluctance to order a party in breach specifically to perform his contractual obligations (specific performance is discussed in more detail in Chapter 24). It is clear that the defendant in *Ruxley* would not have been granted a specific performance order requiring the

plaintiffs to build a pool in accordance with the contractual specifications. Does the fact that a court would have refused to make a specific performance order not suggest that the innocent party's interest is not in actual performance of the contract but in the financial equivalent of performance, which can be measured by the diminution or difference in value? Of course it can be argued that it does not follow from the fact that the innocent party is not entitled to performance from the party in breach that he is not entitled to recover by way of damages the cost of obtaining performance from another party, but the fact that the law is not prepared to
p. 837 commit itself to specific performance as the primary remedy does suggest ↵ that its commitment to ensuring that performance (rather than the economic end-result of performance) is achieved is less than whole-hearted. In this sense it has been argued that English law has failed to recognize the value of the right to performance itself rather than the consequences of performance or the economic end-result of performance (see generally B Coote, 'Contract Damages, *Ruxley* and the Performance Interest' [1997] *CLJ* 537).

23.3.2 *Alfred McAlpine Construction Ltd* v. *Panatown Ltd*

The question of the extent to which the law protects the performance interest of a claimant was also directly in issue in the difficult case of *Alfred McAlpine Construction Ltd* v. *Panatown Ltd* [2001] 1 AC 518, a case which is extracted and discussed in more detail in the online resources which support this book. Here it suffices to outline the key features of the case. The claim arose out of the construction of a building by the defendant. The claimant alleged that the building was defective and that the estimated cost of repairs amounted to some £40 million. The defendant took the point that the claimant was not entitled to recover substantial damages in respect of any breach of contract because the claimant did not own the land on which the building was built and so had not suffered any loss as a result of any breach of contract committed by the defendant. The claimant was a member of the Unex group of companies and the company which owned the land, UIPL, was another member of that corporate group. The House of Lords held, by a majority of 3–2, that the claimant was not entitled to recover substantial damages.

The claimant's case was put on two principal grounds. One ground was that the claimant was entitled to sue and recover damages in respect of the loss suffered by UIPL. This aspect of the case is discussed in more detail at 25.3.2.3. Here it suffices to note that the claimant's claim failed because the contracts between the parties had been structured in such a way as to give to UIPL a limited right of contractual recourse against the defendant under a duty of care deed ('DCD'). Under the terms of the DCD the defendant accepted that it owed a duty of care to UIPL and it also promised to UIPL that it would exercise all reasonable skill and care in the performance of its duties. Given that UIPL had its own limited right of recourse under the DCD, it was held that the claimant did not have a wider right to recover damages in respect of the loss suffered by UIPL. In other words, it was for UIPL to decide whether or not to exercise such rights as it had against the defendant and it was not for the claimant to sue and recover damages on behalf of UIPL.

This leads on to the second ground on which the claim was brought, namely that the claimant was entitled to recover substantial damages in respect of the loss which it had suffered as a result of the defendant's breach of contract. It is this claim that is the principal focus of our attention. If loss is viewed entirely in financial terms, then it appeared that the claimant was no worse off as a result of any breach of contract committed by the defendant. It did not own the land and it incurred no liability towards UIPL as a result of the defects in the building. Nor had the claimant incurred expenditure in seeking to repair the defects in the building. So, in

what sense was the claimant worse off as a result of any breach? In so far as there was a concern that UIPL was left without meaningful redress, one answer to that concern was that any lack of meaningful redress was a product of the way in which the Unex group had chosen to structure the transaction and the limited right of redress which it had negotiated for UIPL against the defendant.

In terms of the identification and definition of any loss suffered by the claimant, the important point to note is
p. 838 the difference of opinion between the majority and the minority. ↵ The majority was composed of Lord Clyde, Lord Jauncey, and Lord Browne-Wilkinson. The minority consisted of Lord Goff and Lord Millett. We shall commence our analysis with the approach adopted by the minority.

In reaching his conclusion that the claimant was entitled to recover substantial damages in respect of its own loss, Lord Goff made use of an illustration involving a wealthy philanthropist who contracts for work to be done to the village hall and the work is done defectively. In his judgment it was 'absurd' to conclude that the claim of the philanthropist in such a case would fail because he did not own the land and had not himself incurred the expense of employing another builder to carry out the remedial work. He continued by stating that 'the philanthropist's cause of action does not depend on his having actually incurred the financial expense' because, quoting from the judgment of Lord Griffiths in *Linden Garden Trust Ltd* v. *Lenesta Sludge Disposals Ltd* [1994] 1 AC 85, 95, he had 'suffered loss because he did not receive the bargain for which he had contracted' (see p. 548). On this basis Lord Goff held that the loss which the claimant had suffered on the facts of *Panatown* was that it did not receive the performance it was entitled to receive from the defendant under the contract and this was so notwithstanding the fact that the ownership of the building site was vested in UIPL. On this basis the claimant was, in his judgment, entitled to recover substantial damages.

Similarly, Lord Millett (at pp. 588–589) was critical of a narrow approach to the identification of loss which he stated was a 'product of the narrow accountants' balance sheet quantification of loss which measures the loss suffered by the promisee by the diminution of his overall financial position resulting from the breach'. Rather than use this narrow approach, Lord Millett (at pp. 589–590) used the language of 'defeated expectations' or 'defeated interests' to describe the loss in respect of which the claimant was seeking to recover substantial damages. Thus (at p. 589) he saw nothing new in the 'idea that a contracting party is entitled to damages measured by the value of his own defeated interest in having the contract performed'. In his judgment (at p. 591) it was no departure from orthodoxy to conclude that 'the building employer, whether or not he is also the owner of the building, is entitled to recover such damages as will put him in a position to have the building he contracted for'.

This broad approach to the identification of loss did not, however, commend itself to the majority. Lord Clyde, after referring to the language of defeated expectations, continued by observing that this terminology seemed to him 'to be coming very close to a way of describing a breach of contract'. But, he continued, in an important section of his judgment:

> A breach of contract may cause a loss, but is not in itself a loss in any meaningful sense. When one refers to a loss in the context of a breach of contract, one is in my view referring to the incidence of some personal or patrimonial damage.

There appear to be two factors which persuaded the majority to conclude that the claimant was not entitled to recover substantial damages in respect of its own loss. The first was that it had not incurred expenditure itself in seeking to repair the defects in the property. Thus Lord Jauncey stated (at p. 574) that the entitlement of the claimant to recover substantial damages in a case such as *Panatown* depends upon whether it 'has made good or intends to make good the effects of the breach'. His concern here seems to have been to avoid an
p. 839 'uncovenanted' profit by an employer who seeks to collect substantial damages but ↵ does not intend to take any steps to remedy the breach (and, as we saw, similar considerations were at work in the judgment of the House of Lords in *Ruxley*). This uncovenanted profit does not arise in the case where expenditure has been incurred because in such a case there is 'some personal or patrimonial damage' in respect of which the claimant is seeking compensation. It is no doubt correct to state that a party who has incurred such expenditure has suffered a loss which, subject to the possible application of the 'reasonableness' test in *Ruxley,* should entitle it to recover the expenditure which has been incurred in repairing the defects. More difficult perhaps is the reference by Lord Jauncey to the person who 'intends to make good the effects of the breach'. How does the court ascertain whether or not the claimant had such an intention and at what point in time is the intention of the claimant a relevant factor? Does an intention to carry out the works act as a passport to the recovery of the expenditure incurred or is it the case that, as in *Ruxley,* a reasonableness test will be applied to the entitlement of the claimant to recover substantial damages? Further, to pick up on the point made by Lord Goff, if the works have been carried out defectively by the contractor, why should the employer be required to incur expenditure, or to establish the existence of an intention to incur such expenditure, before it can recover damages in respect of the defects in a building for which it has paid and not received in return the performance for which it contracted? As Lord Millett pointed out (at pp. 592–593), it is generally of no concern to the law what the claimant proposes to do with the damages which it is awarded. In his judgment, the intention of the claimant was at most relevant to 'the reasonableness or otherwise' of the claimant's claim but should play no bigger role in the decision whether or not to award substantial damages (although he did at a later point in his judgment acknowledge the need for the remedial work to be carried out, albeit it was not 'material' whether the work was carried out by the claimant or by some other member of the Unex group).

The second obstacle was the duty of care deed. Thus Lord Browne-Wilkinson could see no justification for giving to the claimant a right to recover substantial damages given that the company which owned the land had 'a direct cause of action under the DCD'. Lord Clyde also attached importance to this factor, noting that on the facts of the case 'there was a plain and deliberate course adopted whereby the company with the potential risk of loss was given a distinct entitlement directly to sue the contractor and the professional advisers' and, in such a case, he concluded that 'in the light of such a clear and deliberate course I do not consider that an exception can be admitted to the general rule that substantial damages can only be claimed by a party who has suffered substantial loss'. Lord Goff, in the minority, was critical of this reasoning stating (at p. 558) that:

> I have to say that this is, on its face, a remarkable submission; it is a strange conclusion indeed that the effect of providing a subsidiary remedy for the owner of the land (UIPL), on a restricted basis (breach of a duty of care), is that the building employer, who has furnished the consideration for the building, is excluded from pursuing his remedy in damages under the main contract, which makes elaborate provision, under a standard form specially adapted for this particular development, for the terms upon which the contractor has agreed to design and construct the buildings in question.

There is considerable force in the point made by Lord Goff (and see also to similar effect the judgment of Lord Millett (at pp. 593–596) who took the view that 'the DCD was primarily designed to cater for subsequent
p. 840 purchasers' in the sense that it would give them a direct ↵ right of action against the defendant in the event of a defect appearing in the building). Further, it may have been the case that those acting for the Unex group saw in the DCD a means by which an *additional* right of action could be conferred upon UIPL and subsequent purchasers of the building and they had not anticipated that the conferral of that right of action would operate in the other direction by depriving the claimant of the right it would otherwise have had to recover substantial damages. But the majority saw the 'clear and deliberate course' taken by the Unex group in rather different terms and the desire to avoid giving to the claimant an 'uncovenanted' profit when it had not established its intention to carry out the works led it to adopt what seems to be a very narrow approach to the identification of loss the effect of which was to deprive the claimant of the performance for which it contracted and left substantially unremedied the defendant's failure to carry out its contractual obligations in relation to the construction of the building.

23.4 The Reliance Interest

A claimant may wish to bring a claim for damages to protect his reliance interest. As Fuller and Perdue demonstrate, the reliance interest is a somewhat elusive concept. They adopt an expansive conception of the reliance interest which encompasses 'losses involved in foregoing the opportunity to enter other contracts' (23.2). In practice this takes the reliance interest very close to the performance interest (in that the claimant is able to recover his loss of profits on any substitute transaction he would have concluded, rather than his loss of profit on the actual transaction). However, the more widely used conception of the reliance interest is that it enables the claimant to recover his out-of-pocket expenditure incurred in the course of performance of the contract.

As Professor Friedmann points out (23.2), a party does not enter into a contract in order to obtain the return of the expenditure which he incurs in the course of performance of the contract. He enters into a contract in order to obtain the promised performance. Of course, in most cases the protection of the claimant's performance interest will include the protection of his reliance interest on the basis that, in most cases, contracting parties expect to recoup their outlay and, in addition, make a profit on the transaction. The performance interest will therefore include reliance expenditure plus the net profit on the transaction. This being the case, a claimant will have an obvious interest in bringing a claim to protect his performance interest rather than confine himself to his reliance interest (which will not include net profit, unless, as per Fuller and Perdue, we allow the claimant to recover his net profit on a substitute transaction into which he would have entered but for the contract concluded with the defendant).

The nature of the claim to recover wasted expenditure has proved to be a disputed matter. As we have noted, Professor Friedmann stated that the reliance interest is not a contractual interest (see 23.2) and Professor Treitel has also maintained that a claim to recover wasted expenditure is based on a different 'method' of compensation to that which underpins a claim for expectation damages ('Damages for Breach of Contract in the High Court of Australia' (1992) 108 *LQR* 226, 229). These claims were considered and rejected by Teare J in *Omak Maritime Ltd* v. *Mamola Challenger Shipping Co (The Mamola Challenger)* [2010] EWHC 2026 (Comm),

[2011] 1 Lloyd's Rep 47. After reviewing the authorities, Teare J held that 'the expectation loss principle underpins the award of damages in wasted expenditure cases'. On this basis, a claim to recover reliance losses
p. 841 is a species of expectation loss and it ↵ is not 'fundamentally different', nor is it awarded on a different 'juridical basis of claim'. The essence of his reasoning is to be found in the following passage:

> 44. It seems to me that the expectation loss analysis does provide a rational and sensible explanation for the award of damages in wasted expenditure cases. The expenditure which is sought to be recovered is incurred in the expectation that the contract will be performed. It therefore appears to me to be rational to have regard to the position that the claimant would have been in had the contract been performed.
>
> 45. If there were an independent principle pursuant to which expenditure incurred in expectation of the performance of a contract was recoverable without regard to what the position would have been had the contract been performed the defendant would in effect underwrite the claimant's decision to enter the contract. If the contract was unwise from his point of view, because his expenses were likely to exceed any gross profit, it is difficult to understand why the defendant should pay damages in an amount equal to that expenditure. His breach has not caused that loss. The claimant's expenditure should only be recoverable where the likely gross profit would at least cover that expenditure. …
>
> 47. The authorities therefore state a rational and sensible explanation for the view that the expectation loss principle underpins the award of damages in wasted expenditure cases. In some cases a contract can be shown to be a bad bargain. In other cases it may not be possible to show one way or the other whether the likely gross profits would at least equal the expenditure. In that latter type of case the question arises as to which party should bear the evidential burden of proof. Should the burden be on the claimant to show that the likely profits would at least equal his expenditure or on the defendant to show that the likely profits would not at least equal the claimant's expenditure? The authorities … provide a rational and sensible explanation for the view that that burden should be on the defendant.

On this view, the law of contract permits a claimant to frame his claim as one for damages on the reliance basis rather than the expectancy basis (*CCC Films* v. *Impact Quadrant Films Ltd* [1985] QB 16; *Soteria Insurance Ltd (formerly CIS General Insurance Ltd)* v. *IBM UK Ltd* [2022] EWCA Civ 440, [2022] 2 All ER (Comm) 1082, [40]). However, where the claimant chooses to recover damages assessed on the reliance basis, the defendant is given the opportunity to prove that the expenditure sought to be recovered would not in any event have been recouped because, for example, the contract was a loss-making contract.

Generally speaking, however, claimants will wish to bring a claim for damages to protect their performance interest. The reason for this is that a reliance loss claim will generally be lower than a claim to protect the performance interest because the former will not include a claim for loss of profit. When will a claimant wish to bring a claim for his reliance losses? There are three principal situations. The first is where he cannot prove his loss of profit. The second is where he wishes to recover damages in respect of his pre-contract expenditure. The third is where he has entered into a losing bargain (although, as we shall see, the latter claim is unlikely to succeed). We shall take each case in turn.

The first example is the case of an extremely speculative transaction. In such a case the claimant may have to content himself with a claim for his reliance expenditure (see, for example, *McRae* v. *Commonwealth Disposals Commission* (1951) 84 CLR 377, 16.4). But the courts will generally strive to put a value on the claimant's performance interest. In *Chaplin* v. *Hicks* [1911] 2 KB 786 the plaintiff, an aspiring actress, entered into a competition organized by the defendant, a theatre manager. The prize for the competition winners was a term
p. 842 ↵ of employment with the defendant. The plaintiff won the first stage of the competition, being selected as one of 50 out of 6,000 entrants to proceed to the second stage. The second stage involved an interview with each of the 50 successful entrants by the defendant, who would then select 12 eventual winners. In breach of contract the defendant deprived the plaintiff of a reasonable opportunity of attending the interview. The plaintiff sued for breach of contract, claiming damages for the loss of a chance of winning the competition. The defendant argued that the plaintiff was only entitled to recover nominal damages. The jury awarded the plaintiff damages of £100. The defendant appealed to the Court of Appeal but they dismissed the appeal. Fletcher Moulton LJ stated (at pp. 798–799) that:

> Where by contract a man has a right to belong to a limited class of competitors, he is possessed of something of value, and it is the duty of the jury to estimate the pecuniary value of that advantage, if it is taken from him. The present case is a typical one. From a body of six thousand, who sent in their photographs, a smaller body of fifty was formed, of which the plaintiff was one, and among that smaller body twelve prizes were allotted for distribution; by reason of the defendant's breach of contract she has lost all the advantage of being in the limited competition, and she is entitled to have her loss estimated. I cannot lay down any rule as to the measure of damages in such a case; this must be left to the good sense of the jury. They must of course give effect to the consideration that the plaintiff's chance is only one out of four and that they cannot tell whether she would have ultimately proved to be the winner. But having considered all this they may well think that it is of considerable pecuniary value to have got into so small a class, and they must assess the damages accordingly.

The courts will generally strive to overcome valuation difficulties and will relegate a claimant to reliance loss damages only in the case where there is no objective basis for the award of damages designed to protect his performance interest.

The second situation in which a claimant will wish to bring a claim for reliance loss damages is in the case in which he wishes to recover damages in respect of his pre-contractual expenditure. An example in this category is provided by the following case:

Anglia Television v. Reed
[1972] 1 QB 60, Court of Appeal

The facts are set out in the judgment of Lord Denning MR.

Lord Denning MR

Anglia Television Ltd, the plaintiffs, were minded in 1968 to make a film of a play for television entitled 'The Man in the Wood'. It portrayed an American man married to an English woman. The American has an adventure in an English wood. The film was to last for 90 minutes. Anglia Television made many arrangements in advance. They arranged for a place where the play was to be filmed. They employed a director, a designer and a stage manager, and so forth. They involved themselves in much expense. All this was done before they got the leading man. They required a strong actor capable of holding the play together. He was to be on the scene the whole time. Anglia Television eventually found the man. He was Mr Robert Reed, the defendant, an American who has a
p. 843 very high reputation ↵ as an actor. He was very suitable for this part. By telephone conversation on August 30, 1968, it was agreed by Mr Reed through his agent that he would come to England and be available between September 9 and October 11, 1968, to rehearse and play in this film. He was to get a performance fee of £1,050, living expenses of £100 a week, his first class fares to and from the United States, and so forth. It was all subject to the permit of the Ministry of Labour for him to come here. That was duly given on September 2, 1968. So the contract was concluded. But unfortunately there was some muddle with the bookings. It appears that Mr Reed's agents had already booked him in America for some other play. So on September 3, 1968, the agent said that Mr Reed would not come to England to perform in this play. He repudiated his contract. Anglia Television tried hard to find a substitute but could not do so. So on September 11 they accepted his repudiation. They abandoned the proposed film. They gave notice to the people whom they had engaged and so forth.

Anglia Television then sued Mr Reed for damages. He did not dispute his liability, but a question arose as to the damages. Anglia Television do not claim their profit. They cannot say what their profit would have been on this contract if Mr Reed had come here and performed it. So, instead of claim for loss of profits, they claim for the wasted expenditure. They had incurred the director's fees, the designer's fees, the stage manager's and assistant manager's fees, and so on. It comes in all to £2,750. Anglia Television say that all that money was wasted because Mr Reed did not perform his contract.

Mr Reed's advisers take a point of law. They submit that Anglia Television cannot recover for expenditure incurred before the contract was concluded with Mr Reed. They can only recover the expenditure after the contract was concluded. They say that the expenditure after the contract was only £854.65, and that is all that Anglia Television can recover. ...

I cannot accept the proposition as stated. It seems to me that a plaintiff in such a case as this has an election: he can either claim for loss of profits; or for his wasted expenditure. But he must elect between them. He cannot claim both. If he has not suffered any loss of profits—or if he cannot prove

> what his profits would have been—he can claim in the alternative the expenditure which has been thrown away, that is, wasted, by reason of the breach. That is shown by *Cullinane* v. *British 'Rema' Manufacturing Co Ltd* [1954] 1 QB 292, 303, 308.
>
> If the plaintiff claims the wasted expenditure, he is not limited to the expenditure incurred after the contract was concluded. He can claim also the expenditure incurred before the contract, provided that it was such as would reasonably be in the contemplation of the parties as likely to be wasted if the contract was broken. Applying that principle here, it is plain that, when Mr Reed entered into this contract, he must have known perfectly well that much expenditure had already been incurred on director's fees and the like. He must have contemplated—or, at any rate, it is reasonably to be imputed to him—that if he broke his contract, all that expenditure would be wasted, whether or not it was incurred before or after the contract. He must pay damages for all the expenditure so wasted and thrown away. … It is true that, if the defendant had never entered into the contract, he would not be liable, and the expenditure would have been incurred by the plaintiff without redress; but, the defendant having made his contract and broken it, it does not lie in his mouth to say he is not liable, when it was because of his breach that the expenditure has been wasted.
>
> I think the master was quite right and this appeal should be dismissed.
>
> ***Phillimore*** and ***Megaw LJJ*** concurred.

p. 844

Commentary

Three points of interest arise from this case. First, one of the reasons why the plaintiffs brought a claim for reliance loss damages was that they could not prove what their loss of profit would have been. Secondly, the decision has been criticized in so far as it enables a claimant to recover damages in respect of pre-contractual expenditure. Professor Ogus ('Damages for Pre-Contract Expenditure' (1972) 35 *MLR* 423, 424) stated that the proposition that such damages are recoverable is a 'doubtful proposition'. He continued:

> The measure of damages so envisaged would not put the plaintiffs in the position they would have been in if the contract had not been made, for the expenses would still have been incurred. The expenses were incurred not in reliance on the defendant's promise to perform—they were incurred merely in the hope that agreement with the defendant would be secured. There was indeed no causal connection between the loss (the wasted expenses) and either the making of the contract or its breach. In the United States of America these theoretical objections have proved decisive: all attempts to recover pre-contract expenditure (where there was no special agreement binding the defaulting party to pay) have failed.
>
> Now it may be conceded that dogmatically to insist that there may be recovery of expenditure incurred only from the moment that the contract was complete may lead to artificial results. If the parties have clearly reached agreement on the substance of the contract and all that remains is for their legal advisers to draft and execute the contract, it would be unfair to the plaintiff to disallow a claim for expenses incurred at this stage. On the other hand, the doctrine of *restitutio in integrum* which lies at the heart of the reliance interest award surely dictates that while a contract is still being negotiated a party who incurs expenditure does so at his own risk. Perhaps the best solution would be for the reliance interest award to comprise those expenses incurred as from the time when there was *substantial agreement between the parties*.

Thirdly, Lord Denning MR suggested that a claimant must elect between a claim for reliance loss damages and damages to protect his performance interest: he cannot claim both. The use of the word 'election' is, perhaps, unfortunate in this context. It does not mean that the claimant must elect between two inconsistent remedies or courses of action. It simply means that 'a claimant may choose to frame his claim for damages on the reliance basis rather than on the expectancy basis' (*Omak Maritime Ltd* v. *Mamola Challenger Shipping Co (The Mamola Challenger)* [2010] EWHC 2026 (Comm), [2011] 1 Lloyd's Rep 47, [52]). While a claimant cannot recover both his reliance loss and his gross profit (because that would involve an element of double recovery), a claimant should be able to combine a claim for reliance loss with a claim for net profit. In such a case there is no element of double recovery and so it should be possible to combine these claims (see Treitel, *The Law of Contract* (15th edn, Sweet & Maxwell, 2020, edited by Edwin Peel), para 20-038).

The final situation in which a claimant may wish to bring a claim for reliance loss damages is where he has entered into a bad bargain. However the courts will not, in general, allow a claimant to use a claim for reliance losses as an escape route from what has turned out to be a bad bargain. This is demonstrated by the following case:

C & P Haulage v. Middleton
[1983] 1 WLR 1461, Court of Appeal

p. 845 The plaintiffs granted the defendant a contractual licence to use the plaintiffs' premises for the defendant's business on a renewable six-month basis. The licence provided that ↵ any fixtures added to the premises by the licence holder could not be removed upon the termination of the licence. Despite this, the defendant incurred expense in making improvements to the premises in order to make them suitable for his business. Ten weeks before the end of a six-month period, the defendant was unlawfully ejected from the premises by the plaintiffs. The defendant secured temporary permission from the local authority to use the garage of his home as his place of work. The defendant used his home in this manner until well after the six-month period would have expired. The plaintiffs brought an action against the defendant in relation to a cheque that had been stopped by the defendant. The defendant counterclaimed for damages for the cost of the improvements he had made to the premises and the appeal to the Court of Appeal was solely concerned with the counterclaim. At first instance, it was held that the defendant had suffered no loss as he had been able to move the business into his home where he did not have to pay any rent and the cost of improvements to the premises would have been lost in any event when the licence lawfully terminated after six months. The defendant appealed to the Court of Appeal who dismissed his appeal.

Ackner LJ

[set out the facts of the case, considered the decision of the Court of Appeal in *Anglia Television* v. *Reed* (earlier in this section) and continued]

The case which I have found of assistance—and I am grateful to counsel for their research—is a case in the British Columbia Supreme Court: *Bowlay Logging Ltd* v. *Domtar Ltd* [1978] 4 WWR 105. Berger J, in a very careful and detailed judgment, goes through various English and American authorities and refers to the leading textbook writers, and I will only quote a small part of his judgment. At the bottom of p. 115 he refers to the work of Professor LL Fuller and William R Perdue, Jr, in 'The Reliance Interest in Contract Damages: 1' (1936), 46 *Yale Law Journal* 52 and their statement, at p. 79:

> 'We will not in a suit for reimbursement for losses incurred in reliance on a contract knowingly put the plaintiff in a better position than he would have occupied had the contract been fully performed.'

Berger J, at p. 116, then refers to *L Albert & Son* v. *Armstrong Rubber Co* (1949) 178 F 2d 182 in which Learned Hand CJ, speaking for the Circuit Court of Appeals, Second Circuit:

> 'held that on a claim for compensation for expenses in part performance the defendant was entitled to deduct whatever he could prove the plaintiff would have lost if the contract had been fully performed.'

What Berger J had to consider was this, p. 105:

> 'The parties entered into a contract whereby the plaintiff would cut timber under the defendant's timber sale, and the defendant would be responsible for hauling the timber away from the site of the timber sale. The plaintiff claimed the defendant was in breach of the contract as the defendant had not supplied sufficient trucks to make the plaintiff's operation, which was losing money, viable, and claimed not for loss of profits but for compensation for expenditures. The defendant argued that the plaintiff's operation lost money not because of a lack of trucks but because of the plaintiff's inefficiency, and, further, that even if the defendant had breached the contract the plaintiff should not be awarded damages because its operation would have lost money in any case.'

This submission was clearly accepted because the plaintiff was awarded only nominal damages, and Berger J said, at p. 117:

p. 846 ↵ 'The law of contract compensates a plaintiff for damages resulting from the defendant's breach; it does not compensate a plaintiff for damages resulting from his making a bad bargain. Where it can be seen that the plaintiff would have incurred a loss on the contract as a whole, the expenses he has incurred are losses flowing from entering into the contract, not losses flowing from the defendant's breach. In these circumstances, the true consequence of the defendant's breach is that the plaintiff is released from his obligation to complete the contract—or in other words, he is saved from incurring further losses. If the law of contract were to move from compensating for the consequences of breach to compensating for the consequences of entering into contracts, the law would run contrary to the normal expectations of the world of commerce. The burden of risk would be shifted from the plaintiff to the defendant. The defendant would become the insurer of the plaintiff's enterprise. Moreover, the amount of the damages would increase not in relation to the gravity or consequences of the breach but in relation to the inefficiency with which the plaintiff carried out the contract. The greater his expenses owing to inefficiency, the greater the damages. The fundamental principle upon which damages are measured under the law of contract is restitutio in integrum. The principle contended for here by the plaintiff would entail the award of damages not to compensate the plaintiff but to punish the defendant.'

It is urged here that the garage itself was merely an element in the defendant's business; it was not a profit-making entity on its own. Nevertheless, if as a result of being kept out of these premises the defendant had found no other premises to go to for a period of time, his claim would clearly have been a claim for such loss of profit as he could establish his business suffered.

In my judgment, the approach of Berger J is the correct one. It is not the function of the courts where there is a breach of contract knowingly, as this would be the case, to put a plaintiff in a better financial position than if the contract had been properly performed. In this case the defendant who is

> the plaintiff in the counterclaim, if he was right in his claim, would indeed be in a better position because … had the contract been lawfully determined as it could have been in the middle of December, there would have been no question of his recovering these expenses. …
>
> I do not consider that a plaintiff is entitled in an action for damages for breach of contract to ask to be put in the position in which he would have been if the contract had never been made. Accordingly, save in the respect to which I have already made reference, namely that there should be judgment for the defendant for nominal damages of £10, I would dismiss the appeal.

Fox LJ

> The present case seems to me to be quite different both from *Anglia Television Ltd* v. *Reed* [1972] 1 QB 60 and from *Lloyd* v. *Stanbury* [1971] 1 WLR 535 in that while it is true that the expenditure could in a sense be said to be wasted in consequence of the breach of contract, it was equally likely to be wasted if there had been no breach, because the plaintiffs wanted to get the defendant out and could terminate the licence at quite short notice. A high risk of waste was from the very first inherent in the nature of the contract itself, breach or no breach. The reality of the matter is that the waste resulted from what was, on the defendant's side, a very unsatisfactory and dangerous bargain.
>
> I agree with Ackner LJ that the appeal must be dismissed.

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Commentary

The Court of Appeal held that the defendant's loss flowed, not from the breach of contract, but from the fact that he had entered into a bad bargain. The court refused to re-distribute the contractual allocation of risk on the ground that the plaintiffs had committed a repudiatory breach of contract. But it is important to note that it is the party in breach who bears the burden of proving that the bargain was a losing one for the innocent party. The law of contract, using what Leggatt J has termed 'the principle of reasonable assumptions' (*Yam Seng Pte Ltd* v. *International Trade Corporation Ltd* [2013] EWHC 111 (QB), [2013] 1 All ER (Comm) 1321, [188]), presumes that a party will recoup his expenditure and so throws on to the party in breach the burden of proving that this was not, in fact, the case (see *Commonwealth of Australia* v. *Amann Aviation Pty Ltd* (1991) 66 ALJR 123). This burden is not an easy one for the party in breach to discharge, given that it must prove that the gross returns which the innocent party expected to generate from the contract would not be sufficient to recoup its expenditure (*Grange* v. *Quinn* [2013] EWCA Civ 24, [2013] 1 P & CR 279, [102]). This being the case, the innocent party will generally be able to recover his wasted expenditure unless, as was the case in *C & P Haulage*, it is clear from the facts that the innocent party would not have been able to recoup his expenditure.

Another example of a case in which the claimant was held not to be entitled to recover its wasted expenditure is *Omak Maritime Ltd* v. *Mamola Challenger Shipping Co (The Mamola Challenger)* [2010] EWHC 2026 (Comm), [2011] 1 Lloyd's Rep 47. A charterer of a vessel committed a repudiatory breach of a charterparty. The unusual feature of the case was that the market rate of hire was significantly higher than the contract rate so that, on termination of the contract following the repudiatory breach, the owners of the vessel were able to earn about $7,500 per day more than they would have earned under the charterparty. Nevertheless, the owners brought a claim for damages in which they sought to recover wasted expenditure which they had incurred in preparing

the vessel for the charterers. Teare J concluded that to award substantial damages, measured by wasted expenditure, where the owners had, as a result of the charterer's breach, been able to trade its vessel at the higher market rates and more than made good their loss, was wrong in principle because it would put the owners in a better position than the one they would have occupied had the contract been performed according to its terms.

23.5 The Restitution Interest

Fuller and Perdue conclude (see 23.2) that the restitution interest presents the strongest claim for protection because there is both a benefit to the defendant and a loss to the claimant. But in fact the law of restitution plays a residual role in breach of contract claims. In particular, it has no role to play unless and until the contract between the parties is set aside (*Dargamo Holdings Ltd* v. *Avonwick Holdings Ltd* [2021] EWCA Civ 1149, [2022] 1 All ER (Comm) 1244, [72]). In the case where the contract has not been set aside, the contract governs the rights and remedies of the parties.

Where the contract is set aside as a result of the claimant's acceptance of the defendant's repudiatory breach, the claimant may have a claim to recover the value of any benefit conferred upon the defendant in the course of performance prior to the termination of the contract. But the right is only available within narrow confines.
p. 848 Where the claim is one to ↵ recover money paid to the defendant, it is only available where there has been a total failure of consideration, that is to say where the claimant has received no part of the performance for which he contracted (*Giles* v. *Edwards* (1797) 7 Term Rep 181). Where he has received part of the promised performance, he is confined to a claim for contractual damages (that is, the protection of his performance interest or, if appropriate, his reliance interest) unless the benefit which he has received is incidental or collateral to the bargained-for performance or the consideration is severable and there has been a total failure in respect of a severable part of that consideration (*Van der Garde* v. *Force India Formula One Team Ltd* [2010] EWHC 2373 (QB), [2010] All ER (D) 122 (Sep)). As Lord Toulson observed in *Barnes* v. *The Eastenders Group* [2014] UKSC 26, [2016] AC 1, [114], 'modern authorities show that the courts are prepared, where it reflects commercial reality, to treat consideration as severable' and it is, perhaps, this willingness to regard the consideration as severable that has enabled the 'total' failure requirement to withstand the criticisms that have been levelled against it (see below).

The situation in which a claimant will particularly wish to recover his money is in the case where he has entered into a bad bargain. Suppose a party enters into a contract under which he pays £500 for goods that are worth only £300. In breach of contract, the defendant fails to supply the goods. In such a case the claimant is not confined to the protection of his performance interest (£300) but can claim the return of his £500 on the ground that it was paid for a consideration which totally failed. In this way the claim to recover upon a total failure of consideration has the effect of rescuing the claimant from his bad bargain. The rule that money paid can only be recovered upon a total failure of consideration has been criticized by many academic commentators on the law of restitution (see, for example, P Birks, 'Failure of Consideration' in FD Rose (ed), *Consensus Ad Idem: Essays on the Law of Contract* (Sweet & Maxwell, 1996), p. 179). The generally accepted view among restitution scholars today is that money paid should be recoverable upon a failure of consideration,

whether that failure is total or partial. But, despite the occasional judicial hint that the courts will allow a claim to recover based on a partial failure of consideration (see, for example, *Goss* v. *Chilcott* [1996] AC 788, 798), the total failure requirement remains part of the law.

In the case where the innocent party has supplied goods or services to the party in breach prior to the termination of the contract, there is no total failure requirement. Total failure of consideration applies only to claims to recover money paid to the defendant. A claimant who wishes to recover the reasonable value of goods or services supplied prior to termination can either pursue a contractual claim or bring a restitutionary claim (usually referred to as a *quantum meruit* or a *quantum valebat* claim) for the reasonable value of the services provided or goods supplied (see, for example, *Planché* v. *Colburn* (1831) 8 Bing 14). The vital issue in this connection is not the existence of the restitutionary claim but the measure of recovery, in particular the question whether the contract price acts as a ceiling on the value of the claimant's restitutionary claim. There is much to be said for the view that the claimant should not be entitled to rely on the defendant's breach of contract for the purpose of reversing the contractual allocation of risk and recovering a sum in excess of the contract price (and this view was essentially adopted by the High Court of Australia in *Mann* v. *Paterson Constructions Pty Ltd* [2019] HCA 32, [2020] BLR 156), but the authorities, such as they are, appear to lend some support for the proposition that the claimant can, in a restitutionary claim, recover a sum in excess of the contract price (*Lodder* v. *Slowey* [1904] AC 442 and *Rover International Ltd* v. *Cannon Film Sales Ltd (No 3)* [1989] 1 WLR 912).

One final point remains to be made. The cases discussed in this section are cases in which there is a precise correlation between the gain to the defendant and the loss to the claimant; the one is the mirror image of the other. A separate issue arises in the case where the defendant makes a profit from his breach of contract and
p. 849 that profit exceeds the loss that has ↵ been suffered by the claimant. The question of the extent to which a claimant can recover such a gain from a party in breach of contract is discussed at 23.9.

23.6 Non-Pecuniary Losses

It is clear law that damages can be recovered for physical injury suffered by the claimant as a result of the defendant's breach of contract provided that the loss is not too remote a consequence of the breach of contract (see, for example, *Grant* v. *Australian Knitting Mills Ltd* [1936] AC 85). More difficult is the case in which the claimant suffers physical inconvenience or 'mental distress' as a result of the breach. The leading modern authority on the latter issue is the following decision of the House of Lords:

Farley v. Skinner
[2001] UKHL 49, [2002] 2 AC 732, House of Lords

The plaintiff employed the defendant surveyor to survey a 'gracious country residence' which the plaintiff was contemplating buying as a weekend residence. Given that the property was situated some 15 miles from Gatwick airport, the plaintiff expressly asked the defendant to report on whether or not aircraft noise was likely to be a problem. The defendant did so and reported that it was 'unlikely that the property will suffer greatly from such noise, although some planes will inevitably cross the area, depending on the direction of the wind and the positioning of the flight paths'. The plaintiff purchased the house and, after spending in excess of £100,000 in carrying out improvements, he discovered that aircraft noise was indeed a problem for him and that it interfered with his enjoyment of the house. The house was not far from Mayfield Stack, where aeroplanes waiting to land at Gatwick are stacked until a landing slot becomes available (the stacking tends to take place during busy periods, namely in the morning, early evening, and at weekends). The plaintiff sued the defendant for damages, alleging that he had been negligent in carrying out his obligations under the contract. The trial judge found that the defendant was in breach of contract. He held that the plaintiff was not entitled to recover damages on a diminution in value basis because he found that the property was not worth any less as a result of the defendant's failure to point out to the plaintiff the true position in relation to aircraft noise. Instead, he awarded the plaintiff damages of £10,000 for the distress and inconvenience caused to him by the aircraft noise. The defendant appealed to the Court of Appeal where it was held that the plaintiff had not suffered any physical discomfort and inconvenience as a result of the defendant's breach of contract and that the object of the contract between the parties was not to provide enjoyment or relief from stress so that the claim did not fall within the class of case in respect of which it was appropriate to award damages for distress and inconvenience. The defendant's appeal was therefore allowed and it was held that the plaintiff was entitled to recover nominal damages only. The plaintiff appealed to the House of Lords. His appeal was allowed and he was held to be entitled to damages of £10,000.

Lord Steyn

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14. The judgments in the Court of Appeal and the arguments before the House took as their starting point the propositions enunciated by Bingham LJ in *Watts* v. *Morrow* [1991] 1 WLR 1421. In that case the Court of Appeal had to consider a claim for damages for distress and inconvenience by a buyer of a house against his surveyor who had negligently failed to report defects in the house. Bingham LJ observed, at p. 1445:

> '(1) A contract-breaker is not in general liable for any distress, frustration, anxiety, displeasure, vexation, tension or aggravation which his breach of contract may cause to the innocent party. This rule is not, I think, founded on the assumption that such reactions are not foreseeable, which they surely are or may be, but on considerations of policy.
>
> (2) But the rule is not absolute. Where the very object of a contract is to provide pleasure, relaxation, peace of mind or freedom from molestation, damages will be awarded if the fruit of the contract is not provided or if the contrary result is procured instead. If the law did not cater for this exceptional category of case it would be defective. A contract to survey the condition of a house for a prospective purchaser does not, however, fall within this exceptional category.
>
> (3) In cases not falling within this exceptional category, damages are in my view recoverable for physical inconvenience and discomfort caused by the breach and mental suffering directly related to that inconvenience and discomfort. If those effects are foreseeably suffered during a period when defects are repaired I am prepared to accept that they sound in damages even though the cost of the repairs is not recoverable as such. But I also agree that awards should be restrained, and that the awards in this case far exceeded a reasonable award for the injury shown to have been suffered.' (Numbering introduced). ...
>
> 15. But useful as the observations of Bingham LJ undoubtedly are, they were never intended to state more than broad principles. ... Specifically, it is important to bear in mind that *Watts* v. *Morrow* [1991] 1 WLR 1421 was a case where a surveyor negligently failed to discover defects in a property. The claim was not for breach of a specific undertaking to investigate a matter important for the buyer's peace of mind. It was a claim for damages for inconvenience and discomfort resulting from breach. In *Watts* v. *Morrow* [1991] 1 WLR 1421 therefore there was no reason to consider the case where a surveyor is in breach of a distinct and important contractual obligation which was intended to afford the buyer information confirming the presence or absence of an intrusive element before he committed himself to the purchase.

V. Recovery of non-pecuniary damages

> 16. ... In the law of obligations the rules governing the recovery of compensation necessarily distinguish between different kinds of harm. ... In contract law distinctions are made about the kind of harm which resulted from the breach of contract. The general principle is that compensation is only awarded for financial loss resulting from the breach of contract: *Livingstone* v. *Rawyards Coal Co* (1880) 5 App Cas 25, 39, per Lord Blackburn. In the words of Bingham LJ in *Watts* as a matter of legal policy 'a contract breaker is not *in general* liable for any distress, frustration, anxiety, displeasure, vexation, tension or aggravation which his breach of contract may cause to the innocent party' (my emphasis). There are, however, limited exceptions to this rule. One such exception is damages for pain, suffering and loss of amenities caused to an individual by a breach of contract: see McGregor *On Damages*, 16th ed, para 96, pp. 56–57. It is not material in the present case. But the two exceptions mentioned by

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Bingham LJ, namely where the very object of the contract is to provide pleasure (proposition (2)) and recovery for physical inconvenience caused by the breach (proposition (3)), are pertinent. The scope of these exceptions is in issue in the present case. It is, however, correct, as counsel for the surveyor submitted, that the entitlement to damages for mental distress caused by a breach of contract is not established by mere foreseeability: the right to recovery is dependent on the case falling fairly within the principles governing the special exceptions. So far there is no real disagreement between the parties.

VI. The very object of the contract: The framework

17. I reverse the order in which the Court of Appeal considered the two issues. I do so because the issue whether the present case falls within the exceptional category governing cases where the very object of the contract is to give pleasure, and so forth, focuses directly on the terms actually agreed between the parties. It is concerned with the reasonable expectations of the parties under the specific terms of the contract. Logically, it must be considered first.

18. It is necessary to examine the case on a correct characterisation of the plaintiff's claim. .... The plaintiff made it crystal clear to the surveyor that the impact of aircraft noise was a matter of importance to him. Unless he obtained reassuring information from the surveyor he would not have bought the property. That is the tenor of the evidence. It is also what the judge found. The case must be approached on the basis that the surveyor's obligation to investigate aircraft noise was a major or important part of the contract between him and the plaintiff. It is also important to note that, unlike in *Addis* v. *Gramophone Co Ltd* [1909] AC 488, the plaintiff's claim is not for injured feelings caused by the breach of contract. Rather it is a claim for damages flowing from the surveyor's failure to investigate and report, thereby depriving the buyer of the chance of making an informed choice whether or not to buy resulting in mental distress and disappointment.

19. The broader legal context of *Watts* v. *Morrow* [1991] 1 WLR 1421 must be borne in mind. The exceptional category of cases where the very object of a contract is to provide pleasure, relaxation, peace of mind or freedom from molestation is not the product of Victorian contract theory but the result of evolutionary developments in case-law from the 1970s. Several decided cases informed the description given by Bingham LJ of this category. The first was the decision of the sheriff court in *Diesen* v. *Samson* 1971 SLT (Sh Ct) 49. A photographer failed to turn up at a wedding, thereby leaving the couple without a photographic record of an important and happy day. The bride was awarded damages for her distress and disappointment. In the celebrated case of *Jarvis* v. *Swans Tours Ltd* [1973] QB 233, the plaintiff recovered damages for mental distress flowing from a disastrous holiday resulting from a travel agent's negligent representations: compare also *Jackson* v. *Horizon Holidays Ltd* [1975] 1 WLR 1468. In *Heywood* v. *Wellers* [1976] QB 446, the plaintiff instructed solicitors to bring proceedings to restrain a man from molesting her. The solicitors negligently failed to take appropriate action with the result that the molestation continued. The Court of Appeal allowed the plaintiff damages for mental distress and upset. ...

20. At their Lordships' request counsel for the plaintiff produced a memorandum based on various publications which showed the impact of the developments already described on litigation in the county courts. Taking into account the submissions of counsel for the surveyor and making due allowance for a tendency of the court sometimes not to distinguish between the cases presently under consideration and cases of physical inconvenience and discomfort, I am satisfied that in the real life of our lower courts non-pecuniary damages are regularly awarded on the basis that the defendant's breach of contract deprived the plaintiff of the very object of the contract, viz pleasure, relaxation, and peace of mind. The cases arise in diverse contractual contexts, eg the supply of a wedding
p. 852 dress or double glazing, hire purchase transactions, landlord and tenant, building contracts, and engagements of estate agents and solicitors. The awards in such cases seem modest. For my part what happens on the ground casts no doubt on the utility of the developments since the 1970s in regard to the award of non-pecuniary damages in the exceptional categories. But the problem persists of the precise scope of the exceptional category of case involving awards of non-pecuniary damages for breach of contract where the very object of the contract was to ensure a party's pleasure, relaxation or peace of mind.

21. An important development for this branch of the law was *Ruxley Electronics and Construction Ltd* v. *Forsyth* [1996] AC 344. ...

[He set out the facts and continued]

I am satisfied that the principles enunciated in Ruxley's case in support of the award of £2,500 for a breach of respect of the provision of a pleasurable amenity have been authoritatively established.

VII. The very object of the contract: The arguments against the plaintiff's claim

22. Counsel for the surveyor advanced three separate arguments each of which he said was sufficient to defeat the plaintiff's claim. First, he submitted that even if a major or important part of the contract was to give pleasure, relaxation and peace of mind, that was not enough. It is an indispensable requirement that the object of the entire contract must be of this type. Secondly, he submitted that the exceptional category does not extend to a breach of a contractual duty of care, even if imposed to secure pleasure, relaxation and peace of mind. It only covers cases where the promiser guarantees achievement of such an object. Thirdly, he submitted that by not moving out of Riverside House the plaintiff forfeited any right to recover non-pecuniary damages.

23. The first argument fastened onto a narrow reading of the words 'the very object of [the] contract' as employed by Bingham LJ in *Watts* v. *Morrow* [1991] 1 WLR 1421, 1445. ... It is difficult to see what the principled justification for such a limitation might be. ...

24. ... There is no reason in principle or policy why the scope of recovery in the exceptional category should depend on the object of the contract as ascertained from all its constituent parts. It is sufficient if a major or important object of the contract is to give pleasure, relaxation or peace of mind. ...

25. That brings me to the second issue, namely whether the plaintiff's claim is barred by reason of the fact that the surveyor undertook an obligation to exercise reasonable care and did not guarantee the achievement of a result. ... But why should this difference between an absolute and relative contractual promise require a distinction in respect of the recovery of non-pecuniary damages? Take the example of a travel agent who is consulted by a couple who are looking for a golfing holiday in France. Why should it make a difference in respect of the recoverability of non-pecuniary damages for a spoiled holiday whether the travel agent gives a guarantee that there is a golf course very near the hotel, represents that to be the case, or negligently advises that all hotels of the particular chain of hotels are situated next to golf courses? If the nearest golf course is in fact 50 miles away a breach may be established. It may spoil the holiday of the couple. It is difficult to see why in principle only those plaintiffs who negotiate guarantees may recover non-pecuniary damages for a breach of contract ... I am satisfied that it is not the law. In my view the distinction drawn ... between contractual guarantees and obligations of reasonable care is unsound. ...

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VIII. Quantum

28. In the surveyor's written case it was submitted that the award of £10,000 was excessive. It was certainly high. Given that the plaintiff is stuck indefinitely with a position which he sought to avoid by the terms of his contract with the surveyor I am not prepared to interfere with the judge's evaluation on the special facts of the case. On the other hand, I have to say that the size of the award appears to be at the very top end of what could possibly be regarded as appropriate damages. Like Bingham LJ in *Watts* v. *Morrow* [1991] 1 WLR 1421, 1445H I consider that awards in this area should be restrained and modest. It is important that logical and beneficial developments in this corner of the law should not contribute to the creation of a society bent on litigation.

IX. Conclusion

29. In agreement with the reasoning of Clarke LJ I would therefore hold that the decision of the majority in the Court of Appeal was wrong. ...

X. Inconvenience and discomfort

30. It is strictly unnecessary to discuss the question whether the judge's decision can be justified on the ground that the breach of contract resulted in inconvenience and discomfort. It is, however, appropriate that I indicate my view. The judge had a great deal of evidence on aircraft noise at Riverside House. It is conceded that noise can produce a physical reaction and can, depending on its intensity and the circumstances, constitute a nuisance. Noise from aircraft is exempted from the statutory nuisance system and in general no action lies in common law nuisance by reason only of the flight of aircraft over a property: see section 6(1) of the Civil Aviation Act 1982 and McCracken, Jones, Pereira & Payne, *Statutory Nuisance* (2001), para 10.33. The existence of the legislation shows that aircraft noise could arguably

constitute a nuisance. In any event, aircraft noise is capable of causing inconvenience and discomfort within the meaning of Bingham LJ's relevant proposition. It is a matter of degree whether the case passes the threshold. It is sufficient to say that I have not been persuaded that the judge's decision on this point was not open to him on the evidence which he accepted. For this further reason, in general agreement with Clarke LJ, I would rule that the decision of the Court of Appeal was wrong.

XI. Disposal

31. I would allow the appeal and restore the judge's decision.

Lord Clyde

35. ... The expression 'physical inconvenience' may be traced at least to the judgment of *Hobbs* v. *London and South Western Railway Co* (1875) LR 10 QB 111, 122, where in that case damages were awarded for the inconvenience suffered by the plaintiffs for having to walk between four and five miles home as a result of the train on which they had taken tickets to Wimbledon travelling instead to Esher. They had tried to obtain a conveyance but found that there was none to be had. ... It does not seem to me that there is any particular magic in the word 'physical'. It served in *Hobbs*'s case to emphasise the exclusion of matters purely sentimental, but it should not require detailed analysis or definition. As matter of terminology I should have thought that 'inconvenience' by itself sufficiently covered the kinds of difficulty and discomfort which are more than mere matters of sentimentality, and that 'disappointment' would serve as a sufficient label for those mental reactions which in general the policy of the law will exclude.

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36. In *Hobbs's* case the defendants were prepared to compensate the plaintiffs for the cost of a conveyance, even although they had not been able to find any. In the present case the defendant would be prepared to pay for the costs of sale and removal if the plaintiff had decided to sell because of the noise. It is said by the respondent that since he has decided to keep the house he is not entitled to any damages at all. But in *Hobbs* the plaintiffs were entitled to damages in respect of the inconvenience. It is hard to understand why a corresponding result should not follow here. That an award may be made in such circumstances is to my mind in line with the thinking of this House in *Ruxley Electronics and Construction Ltd* v. *Forsyth* [1996] AC 344. ...

37. The judge found that the plaintiff was not a man of excessive susceptibility and he refers to the inconvenience he was suffering as 'real discomfort'. I do not consider it appropriate to explore the detail of the inconvenience as being 'physical', either because it impacts upon his eardrums, or because it has some geographical element, such as the relative locations of the aircraft and the property, or the obviously greater audibility of their movements when the plaintiff is seeking to enjoy the amenity of the terrace and the gardens than when he is inside the house. In my view the real discomfort which the judge found to exist constituted an inconvenience to the plaintiff which is not a mere matter of disappointment or sentiment.

It is unnecessary that the noise should be so great as to make it impossible for the plaintiff to sit at all on his terrace. Plainly it significantly interferes with his enjoyment of the property and in my view that inconvenience is something for which damages can and should be awarded. …

38. … In my view the appeal can be allowed on the foregoing basis.

39. But it is possible to approach the case as one of the exceptional kind in which the claim would be for damages for disappointment. If that approach was adopted so as to seek damages for disappointment, I consider that it should also succeed.

40. It should be observed at the outset that damages should not be awarded, unless perhaps nominally, for the fact of a breach of contract as distinct from the consequences of the breach. That was a point which I sought to stress in *Panatown Ltd* v. *Alfred McAlpine Construction Ltd* [2001] 1 AC 518. For an award to be made a loss or injury has to be identified which is a consequence of the breach but not too remote from it, and which somehow or other can be expressed and quantified in terms of a sum of money. So disappointment merely at the fact that the contract has been breached is not a proper ground for an award. The mere fact of the loss of a bargain should not be the subject of compensation. But that is not the kind of claim which the plaintiff is making here. What he is seeking is damages for the inconvenience of the noise, the invasion of the peace and quiet which he expected the property to possess and the diminution in his use and enjoyment of the property on account of the aircraft noise. …

42. … The present case is not an 'ordinary surveyor's contract'. The request for the report on aircraft noise was additional to the usual matters expected of a surveyor in the survey of a property and could properly have attracted an extra fee if he had spent extra time researching that issue. It is the specific provision relating to the peacefulness of the property in respect of aircraft noise which makes the present case out of the ordinary. …

44. The object of the request to consider the risk of aircraft noise was very plainly to enable the
p. 855 plaintiff to determine the extent of the peace and quiet which he could enjoy at the property. It would be within the contemplation of the defendant that if the noise was such as to interfere with the occupier's peaceful enjoyment of the property the plaintiff would either not buy it at all or live there deprived of his expectation of peace and quiet. Each of these consequences seems to me to flow directly from the breach of contract so as to enable an award of damages to be made on one or other basis. The present case can in my view qualify as one of the exceptional cases where a contract for peace or pleasure has been made and breached, thereby entitling the injured party to claim damages for the disappointment occasioned by the breach.

45. For the foregoing reasons I would allow the appeal and restore the judge's award.

Lord Scott of Foscote

79. *Ruxley's* case establishes, in my opinion, that if a party's contractual performance has failed to provide to the other contracting party something to which that other was, under the contract, entitled, and which, if provided, would have been of value to that party, then, if there is no other way of compensating the injured party, the injured party should be compensated in damages to the extent of that value. Quantification of that value will, in many cases be difficult and may often seem arbitrary. In *Ruxley's* case the value placed on the amenity value of which the pool owner had been deprived was £2,500. By that award, the pool owner was placed, so far as money could do it, in the position he would have been in if the diving area of the pool had been constructed to the specified depth.

80. In *Ruxley's* case the breach of contract by the builders had not caused any consequential loss to the pool owner. He had simply been deprived of the benefit of a pool built to the depth specified in the contract. It was not a case where the recovery of damages for consequential loss consisting of vexation, anxiety or other species of mental distress had to be considered.

81. In *Watts* v. *Morrow* [1991] 1 WLR 1921, however, that matter did have to be considered. ...

    [He set out the facts of the case and quoted the passage from the judgment of Bingham LJ set out at paragraph [14] and continued]

82. In the passage I have cited, Bingham LJ was dealing with claims for consequential damage consisting of the intangible mental states and sensory experiences to which he refers. Save for the matters referred in the first paragraph, all of which reflect or are brought about by the injured party's disappointment at the contract breaker's failure to carry out his contractual obligations, and recovery for which, if there is nothing more, is ruled out on policy grounds, Bingham LJ's approach is, in my view, wholly consistent with established principles for the recovery of contractual damages.

83. There are, however, two qualifications that I would respectfully make to the proposition in the final paragraph of the cited passage that damages 'for physical inconvenience and discomfort caused by the breach' are recoverable.

84. First, there will, in many cases, be an additional remoteness hurdle for the injured party to clear. Consequential damage, including damage consisting of inconvenience or discomfort, must, in order to be recoverable, be such as, at the time of the contract, was reasonably foreseeable as liable to result from the breach:. ...

85. Second, the adjective 'physical', in the phrase 'physical inconvenience and discomfort', requires, I think, some explanation or definition. The distinction between the 'physical' and the 'non-physical' is not always clear and may depend on the context. Is being awoken at
p. 856 night by aircraft noise 'physical'? If it is, is being unable to sleep because of worry and anxiety 'physical'? What about a reduction in light caused by the erection of a building under a planning permission that an errant surveyor ought to have warned his purchaser-client about but failed to do so? In my opinion, the critical distinction to be drawn is not a distinction between the different types of inconvenience or discomfort of which complaint may be made but a distinction based on the cause of the inconvenience or discomfort. If the

cause is no more than disappointment that the contractual obligation has been broken, damages are not recoverable even if the disappointment has led to a complete mental breakdown. But, if the cause of the inconvenience or discomfort is a sensory (sight, touch, hearing, smell etc) experience, damages can, subject to the remoteness rules, be recovered.

86. In summary, the principle expressed in *Ruxley Electronics and Construction Ltd* v. *Forsyth* [1996] AC 344 should be used to provide damages for deprivation of a contractual benefit where it is apparent that the injured party has been deprived of something of value but the ordinary means of measuring the recoverable damages are inapplicable. The principle expressed in *Watts* v. *Morrow* [1991] 1 WLR 1421 should be used to determine whether and when contractual damages for inconvenience or discomfort can be recovered.

87. These principles, in my opinion, provide the answer, not only to the issue raised in the present case, but also to the issues raised in the authorities which were cited to your Lordships.

88. In *Hobbs* v. *London and South Western Railway Co* (1875) LR 10 QB 111 the claim was for consequential damage caused by the railway company's breach of contract. ...

[He set out the facts of the case, on which see paragraph [35], and continued]

This was, in my view, a *Ruxley Electronics and Construction Ltd* v. *Forsyth* [1996] AC 344 case. ...

[He applied the principles set out in paragraph [86] to a range of cases and continued]

105. It is time for me to turn to the present case and apply the principles expressed in *Ruxley Electronics and Construction Ltd* v. *Forsyth* [1996] AC 344 and *Watts* v. *Morrow* [1991] 1 WLR 1421. In my judgment, Mr Farley is entitled to be compensated for the 'real discomfort' that the judge found he suffered. He is so entitled on either of two alternative bases.

106. First, he was deprived of the contractual benefit to which he was entitled. He was entitled to information about the aircraft noise from Gatwick bound aircraft that Mr Skinner, through negligence, had failed to supply him with. If Mr Farley had, in the event, decided not to purchase Riverside House, the value to him of the contractual benefit of which he had been deprived would have been nil. But he did buy the property. And he took his decision to do so without the advantage of being able to take into account the information to which he was contractually entitled. If he had had that information he would not have bought. So the information clearly would have had a value to him. Prima facie, in my opinion, he is entitled to be compensated accordingly.

107. In these circumstances, it seems to me, it is open to the court to adopt a *Ruxley Electronics and Construction Ltd* v. *Forsyth* [1996] AC 344 approach and place a value on the contractual benefit of which Mr Farley has been deprived. In deciding on the amount, the discomfort experienced by Mr Farley can, in my view, properly be taken into account. If he had had the aircraft noise information he would not have bought Riverside House and would not have had that discomfort.

108. Alternatively, Mr Farley can, in my opinion, claim compensation for the discomfort as consequential loss. Had it not been for the breach of contract, he would not have suffered the discomfort. It was caused by the breach of contract in a causa sine qua non sense. Was the discomfort a consequence that should reasonably have been contemplated by the parties at the time of contract as liable to result from the breach? In my opinion, it was. It
p. 857 was obviously within the reasonable contemplation of the parties that, deprived of the information about aircraft noise that he ought to have had, Mr Farley would make a decision to purchase that he would not otherwise have made. Having purchased, he would, having become aware of the noise, either sell—in which case at least the expenses of the re-sale would have been recoverable as damages—or he would keep the property and put up with the noise. In the latter event, it was within the reasonable contemplation of the parties that he would experience discomfort from the noise of the aircraft. And the discomfort was 'physical' in the sense that Bingham LJ in *Watts* v. *Morrow* [1991] 1 WLR 1421, 1445 had in mind. In my opinion, the application of *Watts* v. *Morrow* principles entitles Mr Farley to damages for discomfort caused by the aircraft noise.

109. I would add that if there had been an appreciable reduction in the market value of the property caused by the aircraft noise, Mr Farley could not have recovered both that difference in value and damages for discomfort. To allow both would allow double recovery for the same item.

110. Whether the approach to damages is on *Ruxley Electronics and Construction Ltd* v. *Forsyth* [1996] AC 344 lines, for deprivation of a contractual benefit, or on *Watts* v. *Morrow* [1991] 1 WLR 1421 lines, for consequential damage within the applicable remoteness rules, the appropriate amount should, in my opinion, be modest. The degree of discomfort experienced by Mr Farley, although 'real', was not very great. I think £10,000 may have been on the high side. But in principle, in my opinion, the judge was right to award damages and I am not, in the circumstances, disposed to disagree with his figure.

111. For the reasons I have given and for the reasons contained in the opinion of my noble and learned friend, Lord Steyn, I would allow the appeal and restore the judge's order.

Lord Browne-Wilkinson concurred. ***Lord Hutton*** delivered a concurring speech.

Commentary

A number of points should be noted about this decision (see further E McKendrick and M Graham, 'The Sky's the Limit: Contractual Damages for Non-Pecuniary Loss' [2002] *LMCLQ* 161). The first relates to the conclusion that it is no longer necessary that the 'object of the contract' be the provision of pleasure or peace of mind. It now suffices that the object of the term broken is to provide pleasure or freedom from distress and that the term is an important one in the context of the contract as a whole. While this is a welcome development, it may not always be easy to ascertain whether this requirement has been satisfied on the facts of any given case. Some cases are likely to be relatively straightforward: for example a contract to take photographs at a wedding (*Diesen* v. *Samson*, 1971 SLT (Sh Ct) 49) or to provide a holiday (*Jarvis* v. *Swans Tours Ltd* [1973] QB 233). But others are likely to prove more difficult. An example is *Hamilton Jones* v. *David & Snape (a firm)* [2003]

EWHC 3147 (Ch), [2004] 1 All ER 657. The claimant, who was concerned that her husband might remove their children from the jurisdiction, instructed the defendant solicitors. As a result of the solicitors' negligence, her husband was able to abduct their sons to Tunisia, where he was awarded custody. Neuberger J held that the claimant was entitled to recover damages of £20,000 in respect of the distress which she had suffered. The claimant had, and was perceived by the defendants to have had, 'her own peace of mind and pleasure in the company of her children as an important factor' when entering into the contract with the defendants. Contracts with surveyors have also given rise to difficulty in this respect. There appears to be a distinction
p. 858 between an 'ordinary surveyor's contract', which the House of Lords in *Farley* ↵ held does not fall within this category, and the contract in *Farley*, which did (see [42]). The distinction between the two cases would appear to rest on the fact that the plaintiff in *Farley* specifically asked the surveyor to investigate noise levels from aircraft (see [15]). Yet why should the plaintiff have to ask for peace of mind in this respect? Is it not implicit in every contract with a surveyor that the house owner is seeking peace of mind?

The second point relates to the recovery of damages for inconvenience and discomfort. Lord Clyde held that the plaintiff was entitled to recover damages on the basis of the inconvenience and discomfort that he suffered as a result of the defendant's breach. This was Lord Clyde's primary ground for his decision (see [37]–[39]), whereas for the others it was their secondary ground. The difficulty here relates to the scope of the category. How far does it extend and how does one distinguish between inconvenience (which falls within its scope) and disappointment (which does not)? Inconvenience is not easy to define. The definition adopted by Lord Scott, which places emphasis on the existence of a 'sensory' cause of the inconvenience or discomfort (see [85]), may prove to be a workable definition in many cases. Further, Lord Steyn's reference to the law of nuisance (in [30]) has the advantage of tapping into an established body of case-law. On the other hand, Lord Clyde found it unnecessary ([35]) to provide a 'detailed analysis or definition' of inconvenience. For him, 'inconvenience' was to be distinguished from the 'purely sentimental'. The aircraft noise fell into the former category since it 'significantly interfered' with the plaintiff's use of his property. Of the four speeches, only Lord Scott purported to draw a principled distinction between disappointment and inconvenience, the others being prepared only to identify 'inconvenience' on the facts of the particular case.

A related difficulty is that inconvenience and discomfort are highly subjective in nature. In this respect *Farley* may be close to the line. As Lord Scott observed (at [68]), there was 'evidence that many, perhaps most, of the residents in the area were not troubled by the noise'. But the test for the existence of discomfort does not appear to be an objective one: it contains a significant subjective element in that regard must be had to the plaintiff's mode of life. In the present case the plaintiff was in the habit of enjoying 'a quiet, reflective breakfast, a morning stroll in his garden', and pre-dinner drinks on the terrace and all three activities were interfered with by the noise from the aircraft. Will this subjective approach to the identification of inconvenience open the floodgates to claims of this type? Probably not. Liability will be contained by the remoteness rules (on which see 23.8.1). Had the plaintiff not made clear to the defendant the importance that he attached to not being troubled by aircraft noise, the defendant would not have been liable on the ground that the loss suffered by the plaintiff would not have been within the contemplation of both parties at the time of entry into the contract.

The third point relates to the scope of *Ruxley*. The speeches in *Farley* contain three different explanations for Mr Forsyth's entitlement to recover £2,500. Lords Steyn (at [21]) and Hutton (at [49]) classified the contract in *Ruxley* as one for the provision of a pleasurable amenity, thus the damages reflected Mr Forsyth's

disappointment at the loss of this amenity. By contrast, Lord Clyde, while he made reference to the fact that the contract was one for the provision of a pleasurable amenity, analysed *Ruxley* in the section of his speech devoted to the award of damages for inconvenience ([35]). However, Lord Lloyd in his speech in *Ruxley* records that the trial judge awarded Mr Forsyth damages of £750 for 'general inconvenience and disturbance' separately from the award of £2,500 in respect of his 'loss of amenity'. It therefore seems at best doubtful whether the award of £2,500 in *Ruxley* can also be regarded as compensation for inconvenience. The third and most radical analysis of *Ruxley* was adopted by Lord Scott (at [79]).

p. 859 ↵ The fourth point relates to Lord Scott's division of the cases into two distinct groups (see [86]). The first group, represented by *Ruxley*, consists of cases where the claim is one to recover the value of the promised performance which has not been supplied by the party in breach. The second group, represented by *Watts* v. *Morrow*, consists of claims to recover consequential loss. In theory, the distinction has merit. But in practice it is likely to be difficult to distinguish between the two categories. A case that illustrates the difficulty is *Hobbs* v. *London and South Western Rly Co* (1875) LR 10 QB 111 (discussed by Lord Scott at [88]). Does this case fall within Lord Scott's first category or his second? Lord Scott himself put it in the first category on the basis that the damages were awarded to compensate the plaintiff for the loss of the contractual benefit to which he was entitled, namely carriage of him and his family to Hampton Court. On the other hand, Lord Clyde (at [35]–[36]) clearly regarded it as a case where damages were awarded to compensate the plaintiff for the inconvenience suffered (and, on this basis, it would appear to fall within Lord Scott's second category). The difficulty in distinguishing between the two categories lies in part in the fact that damages are assessed in a category one case in a manner which may resemble the approach taken in a category two case. Thus Lord Scott classified *Hobbs* as a category one case but, in relation to the assessment of damages, stated (at [88]) that it was reasonable to value the contractual benefit to which the plaintiff was entitled 'by reference to the discomfort to the family of the walk home'. This very much mirrors the approach that would be taken in a category two case and so, in practice, tends to blur the distinction between the two categories.

Nevertheless, Lord Scott's analysis is useful in so far as it demonstrates that there is more than one way of framing a claim for damages. One of the difficulties with *Hobbs* lies in explaining the basis on which damages were recovered for the inconvenience suffered by the members of the plaintiff's family, given the general rule that a contracting party cannot sue and recover damages in respect of a loss that has been suffered by a third party (on which see 25.3.2.3). Thus if the claim was a category two case, only the plaintiff should have been compensated for his inconvenience and discomfort. On the other hand, if the claim is properly classified as a category one case then it becomes possible to argue that the performance for which the plaintiff contracted was the carriage of himself and his family to Hampton Court.

An alternative analysis (see E McKendrick and K Worthington, 'Damages for Non-Pecuniary Loss' in N Cohen and E McKendrick (eds), *Comparative Remedies for Breach of Contract* (Hart, 2004), p. 274), which is similar to that adopted by Lord Scott, is to distinguish those cases in which the claimant seeks damages in respect of the defendant's failure to confer on the claimant a promised non-pecuniary benefit from those cases in which the claimant seeks damages to compensate her for the non-pecuniary loss which she has suffered as a result of, or as a consequence of, the defendant's breach of contract. The first category consists of cases in which the defendant, expressly or impliedly, promises to confer a non-pecuniary benefit on the claimant or the effect of the breach was to deny the claimant the non-pecuniary benefit which she would have obtained from performance in accordance with the terms of the contract. This category encompasses the holiday cases (such

as *Jarvis* v. *Swans Tours Ltd* [1973] QB 233) but it can also extend to cases such as *Ruxley* where the defendant did not promise, either expressly or impliedly, to confer a non-pecuniary benefit on the claimant, but the contractual specification broken, of no intrinsic financial value in itself, was accorded 'added value' by the claimant. The second category consists of cases in which the claimant has attempted to recover damages in respect of non-pecuniary losses which she has suffered as a consequence of the defendant's breach of contract. These consequential non-pecuniary losses can be divided into different categories, although the
p. 860 categories are not watertight. The types of consequential non-pecuniary losses that have been
↵ recognized in the cases include physical injury, psychiatric injury or illness, embarrassment and loss of reputation, (physical) inconvenience, and mental distress or disappointment. The courts have been much more willing to allow damages to be recovered in respect of physical injuries suffered as a result of a breach of contract than they have been in the case where the claimant suffers mental distress or disappointment. The latter appear to be recoverable only within the limits recognized by the House of Lords in *Farley*, although it is suggested that most of the cases in which damages have been awarded for distress and loss of enjoyment are better seen within the first category; that is to say they are cases in which the defendant expressly or impliedly promised to provide the claimant with pleasure or relief from distress or the claimant was deprived, as a result of the breach, of performance to which she attached 'added value'.

The final point regarding *Farley* relates to the assessment of damages. In this respect *Farley* resembles *Ruxley* (see 23.3.1) in that all the reasoned speeches in the House of Lords recognized that £10,000 was at the top end of the scale but they were not prepared to deem it to be excessive on the facts of the case. Fears that this case will open the floodgates seem misplaced. Rather, the effect of the decision is more likely to be to bring the law formally into line with practice in the lower courts, particularly the county courts, which, as Lord Steyn pointed out (at [20]), regularly award damages on a modest scale for non-pecuniary losses in the 'diverse contractual contexts' to which he makes reference. This practice has been legitimated by the House of Lords but the decision in *Farley* should not be seen as a green light for the increase in the level of damages awarded. It is not. Damages should continue to be awarded on a modest scale. In order to ensure a measure of consistency, the Court of Appeal has taken account of the level of damages awarded in analogous claims, such as bereavement damages and the amounts awarded for an affront to one's feelings in cases of sex and race discrimination (*Milner* v. *Carnival plc (t/a Cunard)* [2010] EWCA Civ 389, [2010] 3 All ER 701). When assessing damages, it is important that judges 'stand back' and look at the different elements in the round before arriving at the figure which provides the claimant with appropriate compensation. It is also important to ensure that there is no element of double counting.

23.7 The Date of Assessment

The general rule is that damages are to be assessed as at the date of the breach of contract (*Johnson* v. *Agnew* [1980] AC 367). The reason for this is that the innocent party is presumed to be able to go out into the market at the date of breach and obtain substitute performance, and the cost of that substitute performance will fix the measure of damages to which it is entitled. The rule is based on the assumption that there is an immediately available market for the subject matter of the contract. Where this is not the case (for example, a contract for the sale of land where, on the default of the purchaser, the vendor—taking all reasonable steps—cannot find an alternative purchaser for the property) then the courts are more likely to defer the date of

assessment to a later point in time, such as the date on which a sale is achieved (*Hooper* v. *Oates* [2013] EWCA Civ 91, [2013] 3 All ER 211). Thus the rule that damages are to be assessed at the date of breach is not without its exceptions. As Lord Wilberforce observed in *Johnson* v. *Agnew* (at p. 401), 'if to follow [the rule] would give rise to injustice, the court has power to fix such other date as may be appropriate in the circumstances'. Thus, in
p. 861 the case where the claimant could not have been aware of the breach at ↵ the time at which it occurred, damages will generally be assessed as at the date on which the claimant could, with reasonable diligence, have discovered the existence of the breach. Further, in *Wroth* v. *Tyler* [1974] Ch 30 the date of assessment was postponed because the innocent party, who was the purchaser of property in a contract which the defendant wrongfully repudiated, did not have the resources to enter into a substitute transaction on a rapidly rising housing market.

The general rule and its exceptions were examined by the House of Lords in *Golden Strait Corporation* v. *Nippon Yusen Kubishika Kaisha* [2007] UKHL 12, [2007] 2 AC 353. The parties entered into a charterparty on 10 July 1998; the duration was stated to be seven years. On 14 December 2001 the charterers repudiated the contract. The owners accepted the repudiation on 17 December 2001. The arbitrator held that the earliest date for contractual redelivery of the vessel was 6 December 2005. Accordingly, the claimants sought to recover damages for the period between 17 December 2001 and 6 December 2005. The defendants maintained that they could not recover damages beyond 20 March 2003, when the Second Gulf War commenced. The reason for this was that clause 33 of the contract gave a right to cancel the contract in the event of the outbreak of war or hostilities and the outbreak of the Second Gulf War was such an event. The defendants maintained that they could not be liable in damages post 20 March 2003 when they would have terminated the contract pursuant to clause 33. A majority of the House of Lords held that the defendants' submission was correct and that the claimants were not entitled to recover damages after that date given that clause 33 would not have required any performance by the charterers after that date.

The majority affirmed that the principle that damages should be assessed as at the date of the breach of contract is not an inflexible rule. The underlying principle was held to be that the aim of an award of damages is to put the claimant in the financial position which it would have been in had the contract been performed according to its terms; that is to say, the claimant is entitled to recover damages representing the value of the contractual benefit of which it has been deprived (a similar principle was applied by the Supreme Court in *Bunge SA* v. *Nidera BV* [2015] UKSC 43, [2015] 3 All ER 1082). While this aim will be met in most cases by assessing damages as at the date of breach, it will not be achieved in all cases. In these exceptional cases damages need not be assessed as at the date of breach. The present case was held, by a majority of their Lordships, to be such an exceptional case. The essence of the reasoning of the majority is to be found in the following passage from the speech of Lord Scott (at [38]):

> The arguments of the Owners [that they were entitled to recover damages beyond 20 March 2003] offend the compensatory principle. They are seeking compensation exceeding the value of the contractual benefits of which they were deprived. Their case requires the assessor to speculate about what might happen over the period 17 December 2001 to 6 December 2005 regarding the occurrence of a clause 33 event and to shut his eyes to the actual happening of a clause 33 event in March 2003. The argued justification for thus offending the compensatory principle is that priority should be given to the so-called principle of certainty. My Lords there is, in my opinion, no such principle. Certainty is a desideratum and a very important one, particularly in commercial contracts. But it is not a principle and must give way to principle. Otherwise incoherence of principle is the likely result. The achievement of certainty in relation to commercial contracts depends, I would suggest, on firm and settled principles of the law of contract rather than on the tailoring of principle in order to
> p. 862 frustrate tactics of delay to which many litigants in many areas of litigation are wont ↵ to resort. Be that as it may, the compensatory principle that must underlie awards of contractual damages is, in my opinion, clear and requires the appeal in the case to be dismissed.

But the arguments are not all one way. Lord Bingham and Lord Walker dissented on the ground that the decision puts at risk the values of certainty and finality in commercial contract law. In particular, the decision of the majority gives a potential incentive to delay the settlement process so that account can be taken of subsequent events. As Lord Bingham pointed out (at [22]) in his dissenting speech, the owners would have not been able to point to the certainty of the outbreak of war in 2003 if they had 'promptly honoured their secondary obligation to pay damages' at the end of 2001. While Lord Carswell was of the view (at [67]) that the courts have the ability to prevent such delaying tactics by contract-breakers if an application is made to the court 'to proceed with dispatch', others are less confident in the ability of the courts to prevent such abuse (on which see further Lord Mustill, '*The Golden Victory*—Some Reflections' (2008) 124 *LQR* 569).

23.8 Limiting the Protection of the Performance Interest

A claimant cannot in all circumstances claim the full protection of his performance interest. The law places various limits upon his ability to do so. These limits are sometimes inherent in the ordinary rules of proof. For example, a claimant must prove that the defendant has breached the terms of the contract and that the breach has caused him the loss in respect of which he brings his claim for damages. In some cases it can be a difficult task for a claimant to show that the breach has caused that loss (see, for example, *Chaplin* v. *Hicks* [1911] 2 KB 786, 23.4, and *Monarch Steamship Co Ltd* v. *Karlshamns Oljefabriker (A/B)* [1949] AC 196). In this section three doctrines will be examined. Each doctrine demonstrates that the law is not committed to the full protection of the claimant's performance interest (albeit that the reasons for limiting the extent of the claim differ in each category).

23.8.1 Remoteness

A claimant cannot recover damages in respect of a loss which is too remote a consequence of the defendant's breach of contract. As has been pointed out (13.1), claims for consequential losses are extremely significant in practice, largely because of their size. The remoteness rules are therefore extremely important because, the greater the extent of the liability that is imposed at common law, the greater the steps that may have to be taken to draft clauses, such as exclusion and limitation clauses, which aim to keep liability within acceptable bounds.

It is in fact no easy task to discern the point at which the courts draw the line between losses that are too remote and hence irrecoverable and losses that are recoverable. The difference between a loss that is too remote and one that is not appears to be one of degree, and not kind. The leading case is *Hadley* v. *Baxendale* (1854) 9 Exch 341. The rule there laid down was that the losses are recoverable if they flow naturally from the breach or if they are in the contemplation of both parties at the time of entry into the contract. In the twentieth century the principal issue of controversy was the relationship between the decisions of the Court
p. 863 of Appeal in *Victoria Laundry (Windsor)* v. *Newman Industries* [1949] 2 KB 528 and *Parsons (Livestock) Ltd* ↵ v. *Uttley Ingham & Co Ltd* [1978] QB 791. The tension between these two cases remains largely unresolved. But certain things are clear. First, the nature of the breach is irrelevant; that is to say the courts do not distinguish between intentional, careless and inadvertent breaches of contract (although in tort the law does distinguish in this respect between intentional and unintentional torts). Secondly, the recoverability of damages does not depend upon the nature of the loss suffered, although Lord Denning sought to draw such a distinction in *Parsons*. Rather, the recoverability of damages depends upon the knowledge or the contemplation of the parties at the time of entry into the contract and, in particular, the knowledge of the party in breach. In the twenty-first century the major development has been the decision of the House of Lords in *Transfield Shipping Inc* v. *Mercator Shipping Inc (The Achilleas)* [2008] UKHL 48, [2009] 1 AC 61, in which Lord Hoffmann sought to re-state the approach which the courts should take in cases in which it is alleged that the loss suffered is too remote a consequence of the breach of contract.

Hadley v. Baxendale
(1854) 9 Exch 341, Court of Exchequer

The plaintiff, a mill owner, entered into a contract with the defendant, a carrier, under which the defendant agreed to carry a broken crank shaft from the plaintiff's mill to a third party engineer for repair and then to deliver the crank shaft back to the plaintiff once the repairs had been completed. In breach of contract, the defendant delayed in the delivery of the crank shaft to the third party engineer and this resulted in a complete loss of production at the mill for five extra days. The plaintiff claimed damages for the loss of profit for the five days that the mill was shut down as a consequence of the defendant's breach but it was held that the loss of profits was too remote a consequence of the breach and was therefore not recoverable.

Alderson B

Now we think the proper rule in such a case as the present is this:—Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e. according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. But, on the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he, at the most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract. For, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to the damages in that case; and of this advantage it would be very unjust to deprive them. Now the above principles are
p. 864 those by which we think the ↵ jury ought to be guided in estimating the damages arising out of any breach of contract. It is said, that other cases such as breaches of contract in the non-payment of money, or in the not making a good title to land, are to be treated as exceptions from this, and as governed by a conventional rule. But as, in such cases, both parties must be supposed to be cognisant of that well-known rule, these cases may, we think, be more properly classed under the rule above enunciated as to cases under known special circumstances, because there both parties may reasonably be presumed to contemplate the estimation of the amount of damages according to the conventional rule. Now, in the present case, if we are to apply the principles above laid down, we find that the only circumstances here communicated by the plaintiffs to the defendants at the time the contract was made, were, that the article to be carried was the broken shaft of a mill, and that the plaintiffs were the millers of that mill. But how do these circumstances shew reasonably that the profits of the mill must be stopped by an unreasonable delay in the delivery of the broken shaft by the carrier to the third person? Suppose the plaintiffs had another shaft in their possession put up or

> putting up at the time, and that they only wished to send back the broken shaft to the engineer who made it; it is clear that this would be quite consistent with the above circumstances, and yet the unreasonable delay in the delivery would have no effect upon the intermediate profits of the mill. Or, again, suppose that, at the time of the delivery to the carrier, the machinery of the mill had been in other respects defective, then, also, the same results would follow. Here it is true that the shaft was actually sent back to serve as a model for a new one, and that the want of a new one was the only cause of the stoppage of the mill, and that the loss of profits really arose from not sending down the new shaft in proper time, and that this arose from the delay in delivering the broken one to serve as a model. But it is obvious that, in the great multitude of cases of millers sending off broken shafts to third persons by a carrier under ordinary circumstances, such consequences would not, in all probability, have occurred; and these special circumstances were here never communicated by the plaintiffs to the defendants. It follows, therefore, that the loss of profits here cannot reasonably be considered such a consequence of the breach of contract as could have been fairly and reasonably contemplated by both the parties when they made this contract. For such loss would neither have flowed naturally from the breach of this contract in the great multitude of such cases occurring under ordinary circumstances, nor were the special circumstances, which, perhaps, would have made it a reasonable and natural consequence of such breach of contract, communicated to or known by the defendants. The Judge ought, therefore, to have told the jury, that, upon the facts then before them, they ought not to take the loss of profits into consideration at all in estimating the damages. There must therefore be a new trial in this case.
>
> Rule absolute.

Commentary

Hadley was decided at a critical point in the development of English contract law. It was decided at a time when the judges were assuming a greater role in the formulation of legal principle and, in consequence, the role of the jury was diminishing. The judgment thus aims to lay down principles to be applied by the jury when assessing the damages payable upon a breach of contract.

The rule laid down in *Hadley* is sometimes required to do work for which it was not intended. In some cases it is cited as authority for the basic measure of recovery (see, for example, *Bence Graphics International Ltd* v. *Fasson UK Ltd* [1998] QB 87, 102) when in fact the ↵ function of the rule laid down in the case is to *limit* the liability of the party in breach. It does so by stating that the innocent party cannot be put in the position which he would have been in had the contract been performed according to its terms if the losses sought to be recovered do not flow naturally from the breach or were not within the reasonable contemplation of both parties at the time of entry into the contract. The rules relating to the interpretation of a clause which purports to exclude liability for 'indirect or consequential loss' have also become intertwined with *Hadley* v. *Baxendale* (see 13.2.4). The reason for this is that the courts have held that the effect of such a clause is to exclude liability for losses falling within the second limb of *Hadley* (that is to say, losses that are within the contemplation of both parties at the time of entry into the contract) but not losses that fall within the first (losses that flow naturally from the breach). The use of *Hadley* in this latter context seems doubly unfortunate. First, it is unlikely that the court in *Hadley* intended such a result and it also seems unlikely that parties to a

p. 865

contract containing such an exclusion clause intended to produce this result. Secondly, it is a matter of some doubt whether there are two rules in *Hadley* or only one and it seems unfortunate that the courts in the context of the interpretation of an exclusion clause insist that there are two rules when in the remoteness cases, the drift of judicial opinion appears to be in the direction of there being only one test (see, for example, the judgment of Asquith LJ in *Victoria Laundry (Windsor)* v. *Newman Industries* [1949] 2 KB 528, later in this section).

Why was the loss not recoverable on the facts of the case? First, the loss did not flow naturally from the breach; the mill owner might have had a spare mill shaft. Secondly, it was not within the contemplation of both parties at the time of entry into the contract because the defendants did not have knowledge of the loss likely to be suffered by the plaintiffs. Three points should be noted here. First, it is important to note that the relevant time is the time of entry into the contract and not the time of breach. What the courts are doing is to examine the contractual allocation of risk. A defendant who knows at the time of entry into the contract that he is potentially exposed to a claim for substantial damages will either insert a clause into the contract in order to exclude or limit that liability or he will increase the price in order to reflect the increased risk he must bear. What the law does not allow a claimant to do is to say nothing about the extent of any special loss he is likely to suffer as a result of the breach, and so avoid the possibility of being asked to pay more in return for the defendant agreeing to accept responsibility for that loss, and then seek to recover in respect of that loss. In this sense, the remoteness rules encourage parties to disclose special losses likely to be suffered as a result of the breach. The price of failing to do so is that the innocent party may be unable to recover in respect of that loss.

The second point relates to the knowledge of the defendants on the facts of *Hadley*. This proved to be an issue of some controversy on the facts of the case itself. The headnote to the case states that the defendant's clerk was told, prior to the conclusion of the contract, that the mill was stopped and that the shaft must be delivered immediately. The Court of Appeal in *Victoria Laundry (Windsor)* v. *Newman Industries* [1949] 2 KB 528 (later in this section) concluded that the headnote was, in this respect, misleading on the basis that the court must have rejected the evidence adduced on behalf of the plaintiffs on this issue because Alderson B concluded (in *Hadley*) that:

> we find that the only circumstances here communicated by the plaintiffs to the defendants at the time the contract was made, were, that the article to be carried was the broken shaft of a mill, and that the plaintiffs were the millers of that mill.

p. 866 ↵ Thus *Hadley* is a case in which the defendants did not have knowledge of the fact that the mill would be shut until the crankshaft had been repaired and returned to the mill.

This leads us to the third point which relates to the matters that the plaintiffs in *Hadley* would have had to prove in order to hold the defendants liable for the losses which they suffered. There are two possible approaches. One view is that it would suffice for the plaintiffs to prove that the defendants had knowledge of the fact that the mill was shut. A second view is that knowledge is not enough of itself and that it must be demonstrated that the defendant has, in some way, accepted that he would bear responsibility for the loss should it eventuate. In *British Columbia Saw Mill Co* v. *Nettleship* (1868) LR 3 CP 499 Willes J stated that the knowledge must be brought home to the defendant under such circumstances that he knows that the person

with whom he contracts reasonably believes that he accepts responsibility for the special loss (to similar effect see *Horne* v. *Midland Railway Co* (1873) LR 8 CP 131 where there are suggestions that the notice must amount to an agreement to accept liability before the loss can be recovered). On the other hand, a more liberal approach was adopted by the court in *Simpson* v. *London and North Western Railway Co* (1876) 1 QBD 274, where the stipulation that samples 'must be at Newcastle on Monday certain' was held to be sufficient to impose a liability on the defendant for the loss of profit suffered by the plaintiff as a result of the defendant's failure to deliver the goods to the showground in time for an agricultural show. This is a matter to which we shall return after consideration of the decision of the House of Lords in *Transfield Shipping* (later in this section).

Victoria Laundry (Windsor) v. Newman Industries
[1949] 2 KB 528, Court of Appeal

The plaintiffs entered into a contract with the defendants under which they agreed to buy from the defendants a large boiler for use in their business as launderers and dyers. At the time at which the contract was concluded the boiler was installed on the defendants' premises. It was therefore necessary to dismantle the boiler before it could be delivered to the plaintiffs. The boiler was badly damaged while it was being dismantled and the consequence was that there was a delay of some five months in delivering it to the plaintiffs. The defendants knew that the plaintiffs were launderers and dyers and that they wanted the boiler for use in their business. During the negotiations the plaintiffs expressed their intention to put the boiler 'into use in the shortest possible space of time'. The plaintiffs brought an action for damages for the losses they had suffered as a result of the defendants' breach of contract.

The trial judge, Streatfeild J, gave judgment for the plaintiffs for damages of £110 under certain minor heads, but held that the plaintiffs were not entitled to recover damages in respect of their loss of profit during the period of delay. He concluded that the boiler was not a whole plant capable of being used by itself as a profit-making machine, that the case fell within the second limb of the rule laid down in *Hadley* v. *Baxendale*, and that the defendants were not liable for the plaintiffs' loss of profit because the special object for which the plaintiffs were acquiring the boiler had not been drawn to the defendants' attention. The plaintiffs appealed to the Court of Appeal who allowed the appeal and held that the plaintiffs were entitled to recover damages for their general loss of profits but not for the loss of profits which they suffered on the lucrative contracts that they had concluded with the Ministry of Supply.

p. 867

Asquith LJ

[delivering the judgment of the court]

The authorities on recovery of loss of profits as a head of damage are not easy to reconcile. At one end of the scale stand cases where there has been non-delivery or delayed delivery of what is on the face of it obviously a profit-earning chattel; for instance, a merchant or passenger ship. ... In such cases loss of profit has rarely been refused. A second and intermediate class of case in which loss of profit has often been awarded is where ordinary mercantile goods have been sold to a merchant with knowledge by the vendor that the purchaser wanted them for resale; at all events, where there was no market in which the purchaser could buy similar goods against the contract on the seller's default ... At the other end of the scale are cases where the defendant is not a vendor of the goods, but a carrier, see, for instance, *Hadley* v. *Baxendale* 9 Exch 341. ... In such cases the courts have been slow to allow loss of profit as an item of damage. This was not, it would seem, because a different principle applies in such cases, but because the application of the same principle leads to different results. A carrier commonly knows less than a seller about the purposes for which the buyer or consignee needs the goods, or about other 'special circumstances' which may cause exceptional loss if due delivery is withheld.

Three of the authorities call for more detailed examination.

[He examined *Hadley* v. *Baxendale, British Columbia Sawmills* v. *Nettleship* LR 3 CP 409, and *Cory* v. *Thames Ironworks Company* LR 3 QB 181 and continued]

What propositions applicable to the present case emerge from the authorities as a whole, including those analysed above? We think they include the following:—

(1) It is well settled that the governing purpose of damages is to put the party whose rights have been violated in the same position, so far as money can do so, as if his rights had been observed: (*Sally Wertheim* v. *Chicoutimi Pulp Company* [1911] AC 301). This purpose, if relentlessly pursued, would provide him with a complete indemnity for all loss de facto resulting from a particular breach, however improbable, however unpredictable. This, in contract at least, is recognized as too harsh a rule. Hence,

(2) In cases of breach of contract the aggrieved party is only entitled to recover such part of the loss actually resulting as was at the time of the contract reasonably foreseeable as liable to result from the breach.

(3) What was at that time reasonably so foreseeable depends on the knowledge then possessed by the parties or, at all events, by the party who later commits the breach.

(4) For this purpose, knowledge 'possessed' is of two kinds; one imputed, the other actual. Everyone, as a reasonable person, is taken to know the 'ordinary course of things' and consequently what loss is liable to result from a breach of contract in that ordinary course. This is the subject matter of the 'first rule' in *Hadley* v. *Baxendale* 9 Exch 341. But to this knowledge, which a contract-breaker is assumed to possess whether he actually possesses it or not, there may have to be added in a particular case knowledge which he actually possesses, of special circumstances outside the 'ordinary course of things', of such a kind that a breach in those special circumstances would be liable to cause more loss. Such a case attracts the operation of the 'second rule' so as to make additional loss also recoverable.

(5) In order to make the contract-breaker liable under either rule it is not necessary that he should actually have asked himself what loss is liable to result from a breach. As has often
p. 868 been pointed out, parties at the time of contracting contemplate not the breach of the contract, but its performance. It suffices that, if he had considered the question, he would as a reasonable man have concluded that the loss in question was liable to result (see certain observations of Lord du Parcq in the recent case of *A/B Karlshamns Oljefabriker* v. *Monarch Steamship Company Limited* [1949] AC 196).

(6) Nor, finally, to make a particular loss recoverable, need it be proved that upon a given state of knowledge the defendant could, as a reasonable man, foresee that a breach must necessarily result in that loss. It is enough if he could foresee it was likely so to result. It is indeed enough, to borrow from the language of Lord du Parcq in the same case, at page 158, if the loss (or some factor without which it would not have occurred) is a 'serious possibility' or a 'real danger'. For short, we have used the word 'liable' to result. Possibly the colloquialism 'on the cards' indicates the shade of meaning with some approach to accuracy.

[He set out the facts of the case and continued]

Since we are differing from a carefully reasoned judgment, we think it due to the learned judge to indicate the grounds of our dissent.

[He set out the reasoning of the trial judge and continued]

First, ... the learned judge appears to infer that because certain 'special circumstances' were, in his view, not 'drawn to the notice of' the defendants and therefore, in his view, the operation of the 'second rule' was excluded, ergo nothing in respect of loss of business can be recovered under the 'first rule.' This inference is, in our view, no more justified in the present case than it was in the case of *Cory* v. *Thames Ironworks Company* (1868) LR 3 QB 181. Secondly, that while it is not wholly clear what were the 'special circumstances' on the non-communication of which the learned judge relied, it would seem that they were, or included, the following:—(a) the 'circumstance' that delay in delivering the boiler was going to lead 'necessarily' to loss of profits. But the true criterion is surely not what was bound 'necessarily' to result, but what was likely or liable to do so, and we think that it was amply conveyed to the defendants by what was communicated to them (plus what was patent without express communication) that delay in delivery was likely to lead to 'loss of business'; (b) the 'circumstance' that the plaintiffs needed the boiler 'to extend their business'. It was surely not necessary for the defendants to be specifically informed of this, as a precondition of being liable for loss of business. Reasonable persons in the shoes of the defendants must be taken to foresee without any express intimation, that a laundry which, at a time when there was a famine of laundry facilities, was paying 2,000l. odd for plant and intended at such a time to put such plant 'into use' immediately, would be likely to suffer in pocket from five months' delay in delivery of the plant in question, whether they intended by means of it to extend their business, or merely to maintain it, or to reduce a loss; (c) the 'circumstance' that the plaintiffs had the assured expectation of special contracts, which they could only fulfil by securing punctual delivery of the boiler. Here, no doubt, the learned judge had in mind the particularly lucrative dyeing contracts to which the plaintiffs looked forward and which they mention in ... [their] statement of claim. We agree that in order that the plaintiffs should recover specifically and as such the profits expected on these contracts, the defendants would have had to know, at the time of their agreement with the plaintiffs, of the prospect and terms of such contracts. We also agree that they did not in fact know these things. It does not, however, follow that the plaintiffs are precluded from recovering some general (and perhaps conjectural) sum for loss of business in respect of dyeing contracts to be reasonably expected, any more than in respect of laundering contracts to be reasonably expected.

Thirdly, the other point on which Streatfield J largely based his judgment was that there is a critical
p. 869 difference between the measure of damages applicable when the defendant defaults ↵ in supplying a self-contained profit-earning whole and when he defaults in supplying a part of that whole. In our view, there is no intrinsic magic, in this connection, in the whole as against a part. The fact that a part only is involved is only significant in so far as it bears on the capacity of the supplier to foresee the consequences of non-delivery. If it is clear from the nature of the part (or the supplier of it is informed) that its non-delivery will have the same effect as non-delivery of the whole, his liability will be the same as if he had defaulted in delivering the whole ... [On the facts of the present

> case] there was no question of a total stoppage resulting from non-delivery, yet there was ample means of knowledge on the part of the defendants that business loss of some sort would be likely to result to the plaintiffs from the defendants' default in performing their contract.

Commentary

This is another case in which the plaintiffs' claim did not succeed (at least in respect of the claim to recover the loss of profit on the contracts with the Ministry of Supply). The defendants did not have knowledge of these lucrative contracts and so were not liable for the exceptional loss of profits suffered by the plaintiffs. The distinction between ordinary losses of profit and exceptional losses of profit is a difficult one. It is a distinction of degree rather than kind and elsewhere in the law the extent of the loss need not be foreseeable provided that the kind of loss is foreseeable. We shall return to this issue after a brief detour in order to consider the rather difficult decision of the House of Lords in:

Koufos v. C Czarnikow Ltd (The Heron II)
[1969] 1 AC 350, House of Lords

The plaintiff chartered the defendant's vessel to carry 3,000 tons of sugar to Basrah. In breach of contract, the vessel arrived at its destination nine days late. The plaintiff intended to sell the sugar at Basrah. However, by the time the vessel arrived the market for sugar had fallen from £32 10s per ton to £31 2s 9d per ton. The plaintiff sued the defendant for breach of contract, claiming the difference in price as damages. At trial, it was found that, although the defendant *did not* know what the plaintiff intended to do with the sugar, the defendant *did* know that there was a market for sugar in Basrah. However, the judge found that it was impossible to say that it was reasonably foreseeable to the defendant that delay in delivery would result in that kind of loss. The Court of Appeal reversed this decision, and held that loss due to the fall in market prices was not too remote. The House of Lords unanimously affirmed the decision of the Court of Appeal.

Lord Reid

It is generally sufficient that that event would have appeared to the defendant as not unlikely to occur. It is hardly ever possible in this matter to assess probabilities with any degree of mathematical accuracy. But I do not find ... any warrant for regarding as within the contemplation of the parties any event which would not have appeared to the defendant, had he thought about it, to have a very substantial degree of probability.

But then it has been said that the liability of defendants has been further extended by *Victoria Laundry (Windsor) Ltd.* v. *Newman Industries Ltd*. I do not think so.

p. 870 ↵ [He set out the facts of the case and considered the six propositions of law to be found in the judgment of Asquith LJ (earlier in this section) and continued]

But what is said to create a 'landmark' is the statement of principles by Asquith LJ. This does to some extent go beyond the older authorities and in so far as it does so, I do not agree with it. In paragraph (2) it is said that the plaintiff is entitled to recover 'such part of the loss actually resulting as was at the time of the contract reasonably foreseeable as liable to result from the breach.' To bring in reasonable foreseeability appears to me to be confusing measure of damages in contract with measure of damages in tort. A great many extremely unlikely results are reasonably foreseeable: it is true that Lord Asquith may have meant foreseeable as a likely result, and if that is all he meant I would not object further than to say that I think that the phrase is liable to be misunderstood. For the same reason I would take exception to the phrase 'liable to result' in paragraph (5). Liable is a very vague word but I think that one would usually say that when a person foresees a very improbable result he foresees that it is liable to happen.

I agree with the first half of paragraph (6). For the best part of a century it has not been required that the defendant could have foreseen that a breach of contract must necessarily result in the loss which has occurred. But I cannot agree with the second half of that paragraph. It has never been held to be sufficient in contract that the loss was foreseeable as 'a serious possibility' or 'a real danger' or as

being 'on the cards.' It is on the cards that one can win £100,000 or more for a stake of a few pence—several people have done that. And anyone who backs a hundred to one chance regards a win as a serious possibility—many people have won on such a chance. … It appears to me that in the ordinary use of language there is wide gulf between saying that some event is not unlikely or quite likely to happen and saying merely that it is a serious possibility, a real danger, or on the cards. Suppose one takes a well-shuffled pack of cards, it is quite likely or not unlikely that the top card will prove to be a diamond: the odds are only 3 to 1 against. But most people would not say that it is quite likely to be the nine of diamonds for the odds are then 51 to 1 against. On the other hand I think that most people would say that there is a serious possibility or a real danger of its being turned up first and of course it is on the cards. If the tests of 'real danger' or 'serious possibility' are in future to be authoritative then the *Victoria Laundry* case would indeed be a landmark because it would mean that *Hadley* v. *Baxendale* would be differently decided today. I certainly could not understand any court deciding that, on the information available to the carrier in that case, the stoppage of the mill was neither a serious possibility nor a real danger. If those tests are to prevail in future then let us cease to pay lip service to the rule in *Hadley* v. *Baxendale*. But in my judgment to adopt these tests would extend liability for breach of contract beyond what is reasonable or desirable. From the limited knowledge which I have of commercial affairs I would not expect such an extension to be welcomed by the business community and from the legal point of view I can find little or nothing to recommend it. …

It appears to me that, without relying in any way on the *Victoria Laundry* case, and taking the principle that had already been established, the loss of profit claimed in this case was not too remote to be recoverable as damages.

Lord Morris of Borth-y-Gest

I think it is clear that the loss need not be such that the contract-breaker could see that it was certain to result. The question that arises concerns the measure of prevision which should fairly and reasonably be ascribed to him.

My Lords, in applying the guidance given in *Hadley* v. *Baxendale* I would hope that no undue emphasis would be placed upon any one word or phrase … The result in any particular case need not
p. 871 depend upon giving pride of place to any one of such phrases as 'liable ↵ to result' or 'not unlikely to result.' Each one of these phrases may be of help but so may many others. …

My Lords, the words, phrases and passages to which I have referred are useful and helpful indications of the application of the rule in *Hadley* v. *Baxendale*. But they neither add to the rule nor do they modify it. I regard the illuminating judgment of the Court of Appeal in *Victoria Laundry (Windsor) Ltd.* v. *Newman Industries Ltd.* as a most valuable analysis of the rule. It was there pointed out that in order to make a contract-breaker liable under what was called 'either rule' in *Hadley* v. *Baxendale* it is not necessary that he should actually have asked himself what loss is liable to result from a breach but that it suffices that if he had considered the question he would as a reasonable man have concluded that the loss in question was liable to result. Nor need it be proved, in order to recover a particular loss, that upon a given state of knowledge he could, as a reasonable man, foresee that a breach must necessarily result in that loss. Certain illustrative phrases are employed in that case. They are

valuable by way of exposition but for my part I doubt whether the phrase 'on the cards' has a sufficiently clear meaning or possesses such a comparable shade of meaning as to qualify it to take its place with the various other phrases which line up as expositions of the rule.

If the problem in the present case is that of relating accepted principle to the facts which have been found, I entertain no doubt that if at the time of their contract the parties had considered what the consequence would be if the arrival of the ship at Basrah was delayed they would have contemplated that some loss to the respondents was likely or was liable to result. The appellant at the time that he made his contract must have known that if in breach of contract his ship did not arrive at Basrah when it ought to arrive he would be liable to pay damages. He would not know that a loss to the respondents was certain or inevitable but he must, as a reasonable business man, have contemplated that the respondents would very likely suffer loss, and that it would be or would be likely to be a loss referable to market price fluctuations at Basrah. I cannot think that he should escape liability by saying that he would only be aware of a possibility of loss but not of a probability or certainty of it. He might have used any one of many phrases. He might have said that a loss would be likely; or that a loss would not be unlikely; or that a loss was liable to result; or that the risk that delay would cause loss to the respondents was a serious possibility; or that there would be a real danger of a loss; or that the risk of his being liable to have to pay for the loss was one that he ought commercially to take into account. As a practical business man he would not have paused to reflect on the possible nuances of meaning of any one of these phrases. Nor would he have sent for a dictionary …

Lord Hodson

A close study of the [remoteness] rule was made by the Court of Appeal in the case of the *Victoria Laundry (Windsor) Ltd* v. *Newman Industries Ltd.* The judgment of the court … was delivered by Asquith LJ, who referred to the *Monarch Steamship* case [1949] AC 196 and suggested the phrase 'liable to result' as appropriate to describe the degree of probability required. This may be a colourless expression but I do not find it possible to improve on it. If the word 'likelihood' is used it may convey the impression that the chances are all in favour of the thing happening, an idea which I would reject.

Lord Pearce

[T]he case of *Victoria Laundry (Windsor) Ltd* v. *Newman Industries Ltd* … represented (in felicitous language) the approximate view of *Hadley* v. *Baxendale* taken by many judges in trying ordinary cases of breach of contract.

p. 872 ↵ It is argued that it was an erroneous departure from *Hadley* v. *Baxendale* in that it allowed damages where the loss was 'a serious possibility' or 'a real danger' instead of maintaining that the loss must be 'probable,' in the sense that it was more likely to result than not … in my opinion the expressions used in the *Victoria Laundry* case were right. I do not however accept the colloquialism 'on the cards' as being a useful test because I am not sure just what nuance it has either in my own personal vocabulary or in that of others.

> **Lord Upjohn**
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> Asquith LJ in *Victoria Laundry* used the words 'likely to result' and he treated that as synonymous with a serious possibility or a real danger. He went on to equate that with the expression 'on the cards' but like all your Lordships I deprecate the use of that phrase which is far too imprecise and to my mind is capable of denoting a most improbable and unlikely event, such as winning a prize on a premium bond on any given drawing. …
>
> It is clear that on the one hand the test of foreseeability as laid down in the case of tort is not the test for breach of contract; nor on the other hand must the loser establish that the loss was a near certainty or an odds-on probability. I am content to adopt as the test a 'real danger' or a 'serious possibility.' There may be a shade of difference between these two phrases but the assessment of damages is not an exact science and what to one judge or jury will appear a real danger may appear to another judge or jury to be a serious possibility.

Commentary

The decision of the House of Lords has attracted some criticism, not so much in terms of the result of the case but in relation to the length of the speeches and the variety of phrases used to express the outcome. Writing extrajudicially ('*The Achilleas*: Custom and Practice or Foreseeability?' [2010] *Edinburgh Law Review* 47, 51) Lord Hoffmann stated that 'the *Heron II* contains a thesaurus of expressions which can be used to describe the necessary degree of probability'. The reasoning of their Lordships has been summarized as follows (H Beale (ed), *Chitty on Contracts* (35th edn, Sweet & Maxwell, 2023), para 30-137, footnotes omitted):

> What was in the contemplation of reasonable men obviously depends on the relevant degree of likelihood that a particular kind of loss may occur, and this issue was extensively discussed in *The Heron II*. Lord Reid used 'the words "not unlikely" as denoting a degree of probability considerably less than an even chance but nevertheless not very unusual and easily foreseeable.' Although Lord Morris thought it unnecessary to choose any one phrase he used 'not unlikely to occur', with 'liable to result' as an alternative; Lord Hodson accepted the latter phrase. Both Lords Pearce and Upjohn adopted the words 'a real danger' or 'a serious possibility' which were the phrases used in the House of Lords in 1991. (Four of their Lordships in *The Heron II* agreed that the colloquialism 'on the cards' should not be used.)

A more concise summary of the case has been offered by Professor Burrows in the following terms (A Burrows, 'Limitations on Compensation' in A Burrows and E Peel (eds), *Commercial Remedies: Current Issues and Problems* (Oxford University Press, 2003), pp. 27, 33): 'perhaps the clearest way of expressing the essence of their Lordships' reasoning is that, while a slight possibility of the loss occurring is required in tort, a serious possibility of the loss occurring is required in contract'. Not unsurprisingly, the decision in *Heron II* has not been the last word on the subject of remoteness of damage. The next important case to consider the topic was the following decision of the Court of Appeal:

p. 873 ↵

Parsons (Livestock) Ltd v. Uttley Ingham & Co Ltd
[1978] QB 791, Court of Appeal

The defendant company contracted to supply and install a large cylindrical metal hopper on the plaintiffs' pig farm, in which the plaintiffs intended to store pig feed. When they erected the hopper the defendants failed to notice that the ventilator at the top of the hopper was closed. The plaintiffs then filled the hopper with pignuts and subsequently fed them to the pigs. As a result of the lack of ventilation the nuts began to turn mouldy over a period of time. The plaintiffs continued to feed the nuts to the pigs because mouldy nuts do not generally cause harm to pigs. Over time the pigs began to show signs of illness and the plaintiffs eventually discovered the lack of ventilation in the hopper. The plaintiffs alleged that a large number of their pigs contracted E coli as a result of eating the mouldy nuts. They alleged that 254 pigs had died as a result of the outbreak, that they had incurred considerable expense in combating it, and that they had suffered a substantial loss of profit.

The defendants denied that they were liable for the loss of profit suffered by the plaintiffs on the basis that it was too remote a consequence of their breach of contract. The Court of Appeal held that they were liable for the illness and death of the pigs, albeit that the judges gave different reasons for allowing the claim.

Lord Denning MR

The law as to remoteness

Remoteness of damage is beyond doubt a question of law. In *C Czarnikow Ltd* v. *Koufos* [1969] AC 350 the House of Lords said that, in remoteness of damage, there is a difference between contract and tort. In the case of a *breach of contract*, the court has to consider whether the consequences were of such a kind that a reasonable man, at the time of making the contract, would *contemplate* them as being of a very substantial degree of probability. (In the House of Lords various expressions were used to describe this degree of probability, such as, not merely 'on the cards' because that may be too low: but as being 'not unlikely to occur' (see pp. 383 and 388); or 'likely to result or at least not unlikely to result' (see p. 406); or 'liable to result' (see p. 410); or that there was a 'real danger' or 'serious possibility' of them occurring (see p. 415).)

In the case of a tort, the court has to consider whether the consequences were of such a kind that a reasonable man, at the time of the tort committed, would foresee them as being of a much lower degree of probability. (In the House of Lords various expressions were used to describe this, such as, it is sufficient if the consequences are 'liable to happen in the most unusual case' (see p. 385); or in a 'very improbable' case (see p. 389); or that 'they may happen as a result of the breach, however unlikely it may be, unless it can be brushed aside as far-fetched' (see p. 422).)

I find it difficult to apply those principles universally to all cases of contract or to all cases of tort: and to draw a distinction between what a man 'contemplates' and what he 'foresees'. I soon begin to get out of my depth. I cannot swim in this sea of semantic exercises—to say nothing of the different

p. 874

degrees of probability—especially when the cause of action can be laid either in contract or in tort. I am swept under by the conflicting currents. I go back with ↵ relief to the distinction drawn in legal theory by Professors Hart and Honoré in their book Causation in the Law (1959), at pp. 281–287. They distinguish between those cases in contract in which a man has suffered no damage to person or property, but only economic loss, such as, loss of profit or loss of opportunities for gain in some future transaction: and those in which he claims damages for an injury actually done to his person or damage actually done to his property (including his livestock) or for ensuing expense (*damnum emergens*) to which he has actually been put. In the law of tort, there is emerging a distinction between economic loss and physical damage … It seems to me that in the law of contract, too, a similar distinction is emerging. It is between loss of profit consequent on a breach of contract and physical damage consequent on it.

Loss of profit cases

I would suggest as a solution that in the former class of case—loss of profit cases—the defaulting party is only liable for the consequences if they are such as, at the time of the contract, he ought reasonably to have *contemplated* as a *serious* possibility or real danger. You must assume that, at the time of the contract, he had the very kind of breach in mind—such a breach as afterwards happened, as for instance, delay in transit—and then you must ask: ought he reasonably to have *contemplated* that there was a *serious* possibility that such a breach would involve the plaintiff in loss of profit? If yes, the contractor is liable for the loss unless he has taken care to exempt himself from it by a condition in the contract—as, of course, he is able to do if it was the sort of thing which he could reasonably contemplate. The law on this class of case is now covered by the three leading cases of *Hadley* v. *Baxendale*, 9 Exch 341; *Victoria Laundry (Windsor) Ltd* v. *Newman Industries Ltd* [1949] 2 KB 528; and *C Czarnikow Ltd* v. *Koufos* [1969] 1 AC 350. These were all ‘loss of profit’ cases: and the test of ‘reasonable contemplation’ and ‘serious possibility’ should, I suggest, be kept to that type of loss or, at any rate, to economic loss.

Physical damage cases

In the second class of case—the physical injury or expense case—the defaulting party is liable for any loss or expense which he ought reasonably to have *foreseen* at the time of the breach as a possible consequence, even if it was only a *slight* possibility. You must assume that he was aware of his breach, and then you must ask: ought he reasonably to have foreseen, at the time of the breach, that something of this kind might happen in consequence of it? This is the test which has been applied in cases of tort ever since *The Wagon Mound* cases [1961] AC 388 and [1967] 1 AC 617. But there is a long line of cases which support a like test in cases of contract.

One class of case which is particularly apposite here concerns latent defects in goods: in modern words ‘product liability’. In many of these cases the manufacturer is liable in contract to the immediate party for a breach of his duty to use reasonable care and is liable in tort to the ultimate consumer for the same want of reasonable care. The ultimate consumer can either sue the retailer in contract and pass the liability up the chain to the manufacturer, or he can sue the manufacturer in

tort and thus by-pass the chain. The liability of the manufacturer ought to be the same in either case. In nearly all these cases the defects were outside the range of anything that was in fact contemplated, or could reasonably have been contemplated, by the manufacturer or by anyone down the chain to the retailers. Yet the manufacturer and others in the chain have been held liable for the damage done to the ultimate user. ...

p. 875 ↵ Instances could be multiplied of injuries to persons or damage to property where the defendant is liable for his negligence to one man in contract and to another in tort. Each suffers like damage. The test of remoteness is, and should be, the same in both.

Coming to the present case, we were told that in some cases the makers of these hoppers supply them direct to the pig farmer under contract with him, but in other cases they supply them through an intermediate dealer—who buys from the manufacturer and resells to the pig farmer on the self-same terms—in which the manufacturer delivers direct to the pig farmer. In the one case the pig farmer can sue the manufacturer in contract. In the other in tort. The test of remoteness should be the same. It should be the test in tort.

Conclusion

The present case falls within the class of case where the breach of contract causes physical damage. The test of remoteness in such cases is similar to that in tort. The contractor is liable for all such loss or expense as could reasonably have been foreseen, at the time of the breach, as a possible consequence of it. Applied to this case, it means that the makers of the hopper are liable for the death of the pigs. They ought reasonably to have foreseen that, if the mouldy pignuts were fed to the pigs, there was a possibility that they might become ill. Not a serious possibility. Nor a real danger. But still a slight possibility. On that basis the makers were liable for the illness suffered by the pigs. They suffered from diarrhoea at the beginning. This triggered off the deadly E. coli. That was a far worse illness than could then be foreseen. But that does not lessen this liability. The type or kind of damage was foreseeable even though the extent of it was not: see *Hughes* v. *Lord Advocate* [1963] AC 837. The makers are liable for the loss of the pigs that died and of the expenses of the vet and such like, but not for loss of profit on future sales or future opportunities of gain: see *Simon* v. *Pawson and Leafs Ltd* (1932) 38 Com Cas 151.

So I reach the same result as the judge, but by a different route. I would dismiss the appeal.

Orr LJ

I agree with Lord Denning MR and also with Scarman LJ, whose judgment I have had the opportunity of reading, that this appeal should be dismissed, but with respect to Lord Denning MR I would dismiss it for the reasons to be given by Scarman LJ and not on the basis that a distinction is to be drawn for the present purposes between loss of profits and physical damage cases. I have not been satisfied that such a distinction is sufficiently supported by the authorities.

Scarman LJ

My conclusion in the present case is the same as that of Lord Denning MR but I reach it by a different route. I would dismiss the appeal. I agree with him in thinking it absurd that the test for remoteness of damage should, in principle, differ according to the legal classification of the cause of action, though one must recognize that parties to a contract have the right to agree on a measure of damages which may be greater, or less, than the law would offer in the absence of agreement. I also agree with him in thinking that, notwithstanding the interpretation put on some dicta in *C Czarnikow Ltd* v. *Koufos* [1969] AC 350, the law is not so absurd as to differentiate between contract and tort save in situations where the agreement, or the factual relationship, of the parties with each other requires it in the interests of justice. I differ from him only to this extent: the cases do not, in my judgment, support ↵ a distinction in law between loss of profit and physical damage. Neither do I think it necessary to develop the law judicially by drawing such a distinction. Of course (and this is a reason for refusing to draw the distinction in law) the type of consequence—loss of profit or market or physical injury—will always be an important matter of fact in determining whether in all the circumstances the loss or injury was of a type which the parties could reasonably be supposed to have in contemplation.

p. 876

In *C Czarnikow Ltd* v. *Koufos* [1969] 1 AC 350 (a case of a contract of carriage of goods by sea) the House of Lords resolved some of the difficulties in this branch of the law. The law which the House in that case either settled or recognized as already settled may be stated as follows. (1) The general principle regulating damages for breach of contract is that 'where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation … as if the contract had been performed': see per Lord Pearce, at p. 414, quoting Parke B in *Robinson* v. *Harman* (1848) 1 Exch 850, 855. (2) The formulation of the remoteness test is not the same in tort and in contract because the relationship of the parties in a contract situation differs from that in tort: see per Lord Reid, at pp. 385–386. (3) The two rules formulated by Alderson B in *Hadley* v. *Baxendale*, 9 Exch. 341 are but two aspects of one general principle—that to be recoverable in an action for damages for breach of contract the plaintiff's loss must be such as may reasonably be supposed would have been in the contemplation of the parties as a serious possibility had their attention been directed to the possibility of the breach which has, in fact, occurred.

Two problems are left unsolved by *C Czarnikow Ltd* v. *Koufos*: (1) the law's reconciliation of the remoteness principle in contract with that in tort where, as, for instance, in some product liability cases, there arises the danger of differing awards, the lesser award going to the party who has a contract, even though the contract is silent as to the measure of damages and all parties are, or must be deemed to be, burdened with the same knowledge, or enjoying the same state of ignorance; and (2) what is meant by 'serious possibility' or its synonyms: is it a reference to the type of consequence which the parties might be supposed to contemplate as possible though unlikely, or must the chance of it happening appear to be likely? (see the way Lord Pearce puts it, at pp. 416–417).

As to the first problem, I agree with Lord Denning MR in thinking that the law must be such that, in a factual situation where all have the same actual or imputed knowledge and the contract contains no term limiting the damages recoverable for breach, the amount of damages recoverable does not

> depend upon whether, as a matter of legal classification, the plaintiff's cause of action is breach of contract or tort. It may be that the necessary reconciliation is to be found, notwithstanding the strictures of Lord Reid at pp. 389–390, in holding that the difference between 'reasonably foreseeable' (the test in tort) and 'reasonably contemplated' (the test in contract) is semantic, not substantial. Certainly, Asquith LJ, in *Victoria Laundry (Windsor) Ltd* v. *Newman Industries Ltd* [1949] 2 KB 528, 535 and Lord Pearce in *C Czarnikow Ltd* v. *Koufos* [1969] 1 AC 350, 414 thought so; and I confess I think so too.
>
> The second problem—what is meant by a 'serious possibility'—is, in my judgment, ultimately a question of fact. I shall return to it, therefore, after analysing the facts, since I believe it requires of the judge no more—and no less—than the application of common sense in the particular circumstances of the case. ...
>
> The court's task, therefore, is to decide what loss to the plaintiffs it is reasonable to suppose would have been in the contemplation of the parties as a serious possibility had they had in mind the breach when they made their contract.
>
> I now turn to the facts of the case. ...
>
> Given the situation of the parties at the time of contract, was the loss of profit, or market, a serious possibility, something that would have been in their minds had they contemplated breach?
>
> p. 877 ↵ It does not matter, in my judgment, if they thought that the chance of physical injury, loss of profit, loss of market, or other loss as the case may be, was slight, or that the odds were against it, provided they contemplated as a serious possibility the type of consequence, not necessarily the specific consequence, that ensued upon breach. Making the assumption as to breach that the judge did, no more than common sense was needed for them to appreciate that food affected by bad storage conditions might well cause illness if the pigs fed upon it.
>
> As I read the judgment under appeal, this was how the judge ... reached this decision. In my judgment, he was right, upon the facts as found, to apply the first rule in *Hadley* v. *Baxendale*, 9 Exch 341 or, if the case be one of breach of warranty, as I think it is, the rule in section 53(2) of the Sale of Goods Act 1893 without inquiring as to whether, upon a juridical analysis, the rule is based upon a presumed contemplation. At the end of a long and complex dispute the judge allowed common sense to prevail. I would dismiss the appeal.

Commentary

Parsons is a difficult case because the Court of Appeal gave different reasons for reaching the decision which it did. Lord Denning distinguished between physical damage cases and economic loss cases but this distinction did not commend itself to Scarman and Orr LJJ. The majority phrased the question at a high level of generality. The question which they asked was not whether it was reasonably contemplated at the time of contracting as a serious possibility that supplying a hopper with inadequate ventilation would make the pigs ill. Rather they asked whether it was reasonably contemplated at the time of contracting as a serious possibility that supplying a hopper that was unfit for the purpose of storing food for pigs would make the pigs ill. As

Professor Burrows has pointed out (*Remedies for Torts, Breach of Contract and Equitable Wrongs* (4th edn, Oxford University Press, 2019), p. 96), 'Scarman LJ's approach shows that, by defining the breach more generally, the loss is less likely to be judged too remote'. It would appear that the courts do have a measure of discretion in relation to the level of generality at which a breach is described, and the way in which the courts choose to exercise that discretion can have a profound impact on the outcome of a case. *Parsons* also creates a difficulty in that it is not entirely easy to reconcile with the decision of the Court of Appeal in *Victoria Laundry.* Put shortly, the broad approach to the identification of the type of loss in *Parsons* does not fit easily with the distinction drawn in *Victoria Laundry* between recoverable loss of ordinary profits and irrecoverable loss of exceptional profits (see Burrows, *Remedies for Torts, Breach of Contract and Equitable Wrongs*, p. 96).

Further uncertainty was introduced into this area of law by the decision of the House of Lords in *Transfield Shipping Inc* v. *Mercator Shipping Inc (The Achilleas)* [2008] UKHL 48, [2009] 1 AC 61, which is now the leading modern decision on the law relating to remoteness of damage. It is necessary to consider the case in some detail.

Transfield Shipping Inc v. Mercator Shipping Inc (The Achilleas)
[2008] UKHL 48, [2009] 1 AC 61, House of Lords

A charterer of a vessel redelivered the vessel late and, as a result, the owners of the vessel had to agree a reduced rate of hire for the follow-on time charter. They claimed that their loss amounted to $8,000 per day for the duration of the follow-on charter (which was 191 days). ↵ Thus they claimed $1,364,584 in damages. The charterers submitted that their liability was confined to the difference between the market and the charter rates of hire for the nine days during which the owners were deprived of the use of the ship. On this basis damages amounted to $158,301.17. It was found that the general understanding in the shipping market was that liability was restricted to the difference between the market rate and the charter rate for the overrun period. The House of Lords, allowing an appeal from the decision of the Court of Appeal, held that liability was confined to the latter figure.

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Lord Hoffmann

9. The case … raises a fundamental point of principle in the law of contractual damages: is the rule that a party may recover losses which were foreseeable ('not unlikely') an external rule of law, imposed upon the parties to every contract in default of express provision to the contrary, or is it a prima facie assumption about what the parties may be taken to have intended, no doubt applicable in the great majority of cases but capable of rebuttal in cases in which the context, surrounding circumstances or general understanding in the relevant market shows that a party would not reasonably have been regarded as assuming responsibility for such losses? …

11. The question of principle has been extensively discussed in the literature. Recent articles by Adam Kramer ('An Agreement-Centred Approach to Remoteness and Contract Damages' in Cohen and McKendrick (ed), *Comparative Remedies for Breach of Contract* (2004) pp 249–286), Andrew Tettenborn ('Hadley v Baxendale Foreseeability: a Principle Beyond its Sell-by Date' in (2007) 23 *Journal of Contract Law* 120–147) and Andrew Robertson ('The basis of the remoteness rule in contract' (2008) 28 *Legal Studies* 172–196) are particularly illuminating. They show that there is a good deal of support in the authorities and academic writings for the proposition that the extent of a party's liability for damages is founded upon the Interpretation of the particular contract; not upon the interpretation of any particular language in the contract, but (as in the case of an implied term) upon the interpretation of the contract as a whole, construed in its commercial setting. Professor Robertson considers this approach somewhat artificial, since there is seldom any helpful evidence about the extent of the risks the particular parties would have thought they were accepting. I agree that cases of departure from the ordinary foreseeability rule based on individual circumstances will be unusual, but limitations on the extent of liability in particular types of contract arising out of general expectations in certain markets, such as banking and shipping, are likely to be more common. There is, I think, an analogy with the distinction

which Lord Cross of Chelsea drew in *Liverpool City Council v. Irwin* [1977] AC 239, 257–258 between terms implied into all contracts of a certain type and the implication of a term into a particular contract.

12. It seems to me logical to found liability for damages upon the intention of the parties (objectively ascertained) because all contractual liability is voluntarily undertaken. It must be in principle wrong to hold someone liable for risks for which the people entering into such a contract in their particular market, would not reasonably be considered to have undertaken.

13. The view which the parties take of the responsibilities and risks they are undertaking will determine the other terms of the contract and in particular the price paid. Anyone asked to assume a large and unpredictable risk will require some premium in exchange. A rule of law which imposes liability upon a party for a risk which he reasonably thought was excluded gives the other party something for nothing. And as Willes J said in *British Columbia Saw Mill Co Ltd v. Nettleship* (1868) LR 3 CP 499, 508:

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> ↵ 'I am disposed to take the narrow view, that one of two contracting parties ought not to be allowed to obtain an advantage which he has not paid for.'

14. In their submissions to the House, the owners said that the 'starting point' was that damages were designed to put the innocent party, so far as it is possible, in the position as if the contract had been performed: see *Robinson* v. *Harman* (1848) 1 Exch 850, 855. However, in *Banque Bruxelles Lambert SA* v. *Eagle Star Insurance Co Ltd* (sub nom *South Australia Asset Management Corpn* v. *York Montague Ltd*) [1997] AC 191, 211, I said (with the concurrence of the other members of the House):

> 'I think that this was the wrong place to begin. Before one can consider the principle on which one should calculate the damages to which a plaintiff is entitled as compensation for loss, it is necessary to decide for what kind of loss he is entitled to compensation. A correct description of the loss for which the valuer is liable must precede any consideration of the measure of damages.'

15. In other words, one must first decide whether the loss for which compensation is sought is of a 'kind' or 'type' for which the contract-breaker ought fairly to be taken to have accepted responsibility. …

21. It is generally accepted that a contracting party will be liable for damages for losses which are unforeseeably large, if loss of that type or kind fell within one or other of the rules in *Hadley* v. *Baxendale* … That is generally an inclusive principle: if losses of that type are foreseeable, damages will include compensation for those losses, however large. But … it may also be an exclusive principle and that a party may not be liable for foreseeable losses because they are not of the type or kind for which he can be treated as having assumed responsibility.

22. What is the basis for deciding whether loss is of the same type or a different type? It is not a question of Platonist metaphysics. The distinction must rest upon some principle of the law of contract. In my opinion, the only rational basis for the distinction is that it reflects what would have been reasonable and have been regarded by the contracting party as significant for the purposes of the risk he was undertaking. In *Victoria Laundry (Windsor) Ltd* v. *Newman Industries Ltd* [1949] 2 KB 528, where the plaintiffs claimed for loss of the profits from their laundry business because of late delivery of a boiler, the Court of Appeal did not regard 'loss of profits from the laundry business' as a single type of loss. They distinguished (at p 543) losses from 'particularly lucrative dyeing contracts' as a different type of loss which would only be recoverable if the defendant had sufficient knowledge of them to make it reasonable to attribute to him acceptance of liability for such losses. The vendor of the boilers would have regarded the profits on these contracts as a different and higher form of risk than the general risk of loss of profits by the laundry.

23. If, therefore, one considers what these parties, contracting against the background of market expectations found by the arbitrators, would reasonably have considered the extent of the liability they were undertaking, I think it is clear that they would have considered losses arising from the loss of the following fixture a type or kind of loss for which the charterer was not assuming responsibility. Such a risk would be completely unquantifiable, because although the parties would regard it as likely that the owners would at some time during the currency of the charter enter into a forward fixture, they would have no idea when that would be done or what its length or other terms would be. If it was clear to the owners that the last voyage was bound to overrun and put the following fixture at risk, it was open to them to refuse to undertake it. What this shows is that the purpose of the provision for timely redelivery in the charterparty is to enable the ship to be at the full disposal of the
p. 880 owner from the redelivery date. If the charterer's orders will defeat this right, the owner may reject them. If the orders are accepted and the last voyage overruns, the owner is entitled to be paid for the overrun at the market rate. All this will be known to both parties. It does not require any knowledge of the owner's arrangements for the next charter. That is regarded by the market as being, as the saying goes, *res inter alios acta*.

24. The findings of the majority arbitrators [that the charterers were liable for the loss on the new fixture because it arose naturally from the breach] shows that they considered their decision to be contrary to what would have been the expectations of the parties, but dictated by the rules in *Hadley* v. *Baxendale* as explained in *The Heron II* [1969] 1 AC 350. But in my opinion these rules are not so inflexible; they are intended to give effect to the presumed intentions of the parties and not to contradict them. ...

26. The owners say that the parties are entirely at liberty to insert an express term excluding consequential loss if they want to do so. Some standard forms of charter do. I suppose it can be said of many disputes over interpretation, especially over implied terms, that the parties could have used express words or at any rate expressed themselves more clearly than they have done. But, as I have indicated, the implication of a term as a matter of construction of the contract as a whole in its commercial context and the implication of the limits of damages liability seem to me to involve the application of essentially the same techniques of

interpretation. In both cases, the court is engaged in construing the agreement to reflect the liabilities which the parties may reasonably be expected to have assumed and paid for. It cannot decline this task on the ground that the parties could have spared it the trouble by using clearer language. In my opinion, the findings of the arbitrators and the commercial background to the agreement are sufficient to make it clear that the charterer cannot reasonably be regarded as having assumed the risk of the owner's loss of profit on the following charter. I would therefore allow the appeal.

Lord Hope of Craighead

31. Assumption of responsibility, which forms the basis of the law of remoteness of damage in contract, is determined by more than what at the time of the contract was reasonably foreseeable ... The fact that the loss was foreseeable—the kind of result that the parties would have had in mind, as the majority arbitrators put it—is not the test. Greater precision is needed than that. The question is whether the loss was a type of loss for which the party can reasonably be assumed to have assumed responsibility. ...

34. In this case it was within the parties' contemplation that an injury which would arise generally from late delivery would be loss of use at the market rate, as compared with the charter rate, during the relevant period. This is something that everybody who deals in the market knows about and can be expected to take into account. But the charterers could not be expected to know how, if—as was not unlikely—there was a subsequent fixture, the owners would deal with any new charterers. This was something over which they had no control and, at the time of entering into the contract, was completely unpredictable. Nothing was known at that time about the terms on which any subsequent fixture might be entered into—how short or long the period would be, for example, or what was to happen should the previous charter overrun and the owner be unable to meet the new commencement date. It is true that neither party had any control over the state of the market. But in the ordinary course of things rates in the market will fluctuate. So it can be presumed that the party in breach has assumed responsibility for any loss caused by delay which can be measured by comparing the charter rate with the market rate during that period. There can be no such
p. 881 presumption where the loss claimed is not the product of the market itself, which can be contemplated, but results from arrangements entered into between the owners and the new charterers, which cannot. ...

36. ... a party cannot be expected to assume responsibility for something that he cannot control and, because he does not know anything about it, cannot quantify. It is not enough for him to know in general and on open-ended terms that there is likely to be a follow-on fixture ... What he needs is some information that will enable him to assess the extent of any liability. The policy of the law is that effect should be given to the presumed intention of the parties. That is why the damages that are recoverable for breach of contract are limited to what happens in ordinary circumstances—in the great multitude of cases, as Alderson B put it in *Hadley* v. *Baxendale*—where an assumption of responsibility can be presumed, or what arises from special circumstances known to or communicated to the party who is in breach at the

time of entering into the contract which because he knew about he can be expected to provide for. This is a principle of general application. We are dealing in this case with a highly specialised area of commercial law. But the principle by which the issue must be resolved is that which applies in the law of contract generally.

37. For these reasons … I too would allow the appeal.

Lord Rodger of Earlsferry

53. … the extent of the relevant rise and fall in the market within a short time was actually unusual. The owners' loss stemmed from that unusual occurrence.

54. The obligation of the charterers was to redeliver the vessel to the owners by midnight on 2 May. Therefore, the charterers are taken to have had in contemplation, at the time when they entered into the addendum, the loss which would generally happen in the ordinary course of things if the vessel were delivered some nine days late so that the owners missed the cancelling date for a follow-on fixture. Obviously, that would include loss suffered as a result of the owners not having been paid under the contract for the charterers' use of the vessel for the period after midnight on 2 May. So, as both sides agree, the owners had to be compensated for that loss by the payment of damages. But the parties would also have contemplated that, if the owners lost a fixture, they would then be in a position to enter the market for a substitute fixture. Of course, in some cases, the available market rate would be lower and, in some cases, higher, than the rate under the lost fixture. But the parties would reasonably contemplate that, for the most part, the availability of the market would protect the owners If they lost a fixture. That I understand to be the thinking which lies behind the dicta to the effect that the appropriate measure of damages for late redelivery of a vessel is the difference between the charter rate and the market rate if the market rate is higher than the charter rate for the period between the final terminal date and redelivery. …

58. I would enter two caveats [to the principle set out in the last sentence of [54]]. First, it may be that, at least in some cases, when concluding a charterparty, a charterer could reasonably contemplate that late delivery of a vessel of that particular type, in a certain area of the world, at a certain season of the year would mean that the market for its services would be poor. In these circumstances, the owners might have a claim for some general sum for loss of business, somewhat along the line of the damages for the loss of business envisaged by the Court of Appeal in *Victoria Laundry (Windsor) Ltd* v. *Newman Industries Ltd* [1949] 2 KB 528, 542–543. Because of the agreement on figures, the matter was not explored in this case and I express no view on it. But, even if some such loss of business could have been reasonably contemplated, as *Victoria Laundry* shows, this would not mean that the owners' particular
p. 882 loss of profit as a result of the re-negotiation … should be recoverable. To hold otherwise would risk undermining the first limb of *Hadley* v. *Baxendale*, which limits the charterers' liability to 'the amount of injury' that would arise 'ordinarily' or 'generally'.

59. Secondly, the position on damages might also be different, if, for example—when a charterparty was entered into—the owners drew the charterers' attention to the existence of a forward charter of many months' duration for which the vessel had to be delivered on a particular date. The charterers would know that a failure to redeliver the vessel in time to allow the owners to deliver it under that charter would be liable to result in the loss of that fixture. Then the second rule or limb in *Hadley* v. *Baxendale* might well come into play. But the point does not arise in this case.

60. Returning to the present case, I am satisfied that, when they entered into the addendum in September 2003, neither party would reasonably have contemplated that an overrun of nine days would 'in the ordinary course of things' cause the owners the kind of loss for which they claim damages. That loss was not the 'ordinary consequence' of a breach of that kind. It occurred in this case only because of the extremely volatile market conditions which produced both the owners' initial (particularly lucrative) transaction, with a third party, and the subsequent pressure on the owners to accept a lower rate for that fixture. Back in September 2003, this loss could not have been reasonably foreseen as being likely to arise out of the delay in question. It was, accordingly, too remote to give rise to a claim for damages for breach of contract. …

63. I have not found it necessary to explore the issues concerning *South Australia Asset Management Corpn* v. *York Montague Ltd* [1997] AC 191 and assumption of responsibility, which my noble and learned friend, Lord Hoffmann, has raised. Nevertheless, I am otherwise in substantial agreement with his reasons as well as with those to be given by Lord Walker of Gestingthorpe. I would allow the appeal.

Lord Walker of Gestingthorpe

69. … the underlying idea—what was the common basis on which the parties were contracting?—seems to me essential to the rule in *Hadley* v. *Baxendale* as a whole. Businessmen who are entering into a commercial contract generally know a fair amount about each other's business. They have a shared understanding (differing in precision from case to case) as to what each can expect from the contract, whether or not it is duly performed without breach on either side. …

[He considered the authorities and the findings of the arbitrators and concluded]

86. … No doubt the fixture was made at an appropriate time … But it was contrary to the principle stated in the *Victoria Laundry* case, and reaffirmed in *The Heron II*, to suppose that the parties were contracting on the basis that the charterers would be liable for any loss, however large, occasioned by a delay in re-delivery in circumstances where the charterers had no knowledge of, or control over, the new fixture entered into by the new owners.

87. For these reasons, and for the further reasons given by my noble and learned friends Lord Hoffmann, Lord Hope and Lord Rodger, whose opinions I have had the advantage of reading in draft, I would allow this appeal.

Baroness Hale of Richmond

90. My Lords, this could be an examination question. ...

91. ... We are looking here at the general principles which limit a contract breaker's liability when the contract itself does not do so. The contract breaker is not inevitably liable for all
p. 883 the loss which his breach has caused. Loss of the type in question has to be 'within the contemplation' of the parties at the time when the contract was made. It is not enough that it should be foreseeable if it is highly unlikely to happen. It would not then arise 'in the usual course of things': see *The Heron II* [1969] 1 AC 350, 385, per Lord Reid. So one answer to our question, given as I understand it by my noble and learned friend, Lord Rodger of Earlsferry, is that these parties would not have had this particular type of loss within their contemplation. They would expect that the owner would be able to find a use for his ship even if it was returned late. It was only because of the unusual volatility of the market at that particular time that this particular loss was suffered. It is one thing to say, as did the majority arbitrators, that missing dates for a subsequent fixture was within the parties' contemplation as 'not unlikely'. It is another thing to say that the 'extremely volatile' conditions which brought about this particular loss were 'not unlikely'.

92. Another answer to the question, given as I understand it by my noble and learned friends, Lord Hoffmann and Lord Hope, is that one must ask, not only whether the parties must be taken to have had this *type of loss* within their contemplation when the contract was made, but also whether they must be taken to have had liability for this type of loss within their contemplation then. In other words, is the charterer to be taken to have undertaken legal responsibility for this type of loss? What should the unspoken terms of their contract be taken to be? If that is the question, then it becomes relevant to ask what has been the normal expectation of parties to such contracts in this particular market. If charterers would not normally expect to pay more than the market rate for the days they were late, and shipowners would not normally expect to get more than that, then one would expect something extra before liability for an unusual loss such as this would arise. That is essentially the reasoning adopted by the minority arbitrator.

93. My Lords, I hope that I have understood this correctly, for it seems to me that it adds an interesting but novel dimension to the way in which the question of remoteness of damage in contract is to be answered, a dimension which does not clearly emerge from the classic authorities. There is scarcely a hint of it in *The Heron II*, apart perhaps from Lord Reid's reference, at p 385, to the loss being 'sufficiently likely to result from the breach of contract *to make it proper* to hold that the loss flowed naturally from the breach or that loss of that kind should have been within his contemplation' (emphasis supplied). In general, *The Heron II* points the other way, as it emphasises that there are no special rules applying to charterparties and that the law of remoteness in contract is not the same as the law of remoteness in tort ... To incorporate it generally would be to introduce into ordinary contractual liability the principle adopted in the context of liability for professional negligence in *South Australia Asset Management Corpn* v. *York Montague Ltd* [1997] AC 191, 211. In an examination, this might well make the difference between a congratulatory and an

> ordinary first class answer to the question. But despite the excellence of counsels' arguments it was not explored before us, although it is explored in academic textbooks and other writings, including those cited by Lord Hoffmann in paragraph 11 of his opinion. I note, however, that the most recent of these, Professor Robertson's article on 'The basis of the remoteness rule in contract' (2008) 28 *Legal Studies* 172 argues strongly to the contrary. I am not immediately attracted to the idea of introducing into the law of contract the concept of the scope of duty which has perforce had to be developed in the law of negligence. The rule in *Hadley* v. *Baxendale* asks what the parties must be taken to have had in their contemplation, rather than what they actually had in their contemplation, but the criterion by which this is judged is a factual one. Questions of assumption of risk depend upon a wider range of factors and value judgments. This type of reasoning is, as Lord Steyn put it in *Aneco Reinsurance Underwriting Ltd* v. *Johnson & Higgins Ltd* [2002] 1 Lloyd's Rep 157, [186], a 'deus ex
> p. 884 machina'. Although its result in this case may be to bring about certainty and clarity in this particular market, such an imposed limit on liability could easily be at the expense of justice in some future case. It could also introduce much room for argument in other contractual contexts. Therefore, if this appeal is to be allowed, as to which I continue to have doubts, I would prefer it to be allowed on the narrower ground identified by Lord Rodger, leaving the wider ground to be fully explored in another case and another context.

Commentary

The case appears to signal a new approach to the recovery of damages, although its precise ambit is unclear. It seems that it is no longer sufficient simply to show that the loss which has been suffered is a reasonably foreseeable consequence of the breach. In deciding whether or not the loss is recoverable, it may be important to ask whether or not the defendant accepted responsibility for the loss in respect of which the claim has been brought. The expectation of the market would also appear to be an important factor to take into account when deciding whether the defendant should be held responsible for the loss which has been suffered.

Lord Hoffmann and Lord Hope (at [15] and [32]) attached importance to the question whether or not the defendant has, objectively, assumed responsibility for the loss in question. Lord Hoffmann in particular sought to transplant the approach adopted in *South Australia Asset Management Corp* v. *York Montague Ltd* [1997] AC 191 into the law of contract more generally. Thus, for him, it was important to decide whether the loss for which compensation is sought is of a 'kind' or a 'type' for which the contract-breaker ought fairly to be taken to have accepted responsibility (see [15]). His analogy with the law relating to implied terms should be noted (at [11]), a point which he developed in his judgment in *Attorney-General of Belize* v. *Belize Telecom Ltd* [2009] UKPC 10, [2009] 1 WLR 1988 (10.4.1 and from which the Supreme Court has subsequently distanced itself). On the facts of the present case he held, having regard to the expectations of the market as found by the arbitrators who initially heard the case, that contracting parties would not have considered losses arising from the loss of the following fixture to be a type or kind of loss for which the charterer was assuming responsibility.

Lord Hope also gave a central role to the idea that the defendant must have assumed responsibility for the loss in question and, importantly, he added (at [31]) that assumption of responsibility is 'determined by more than what at the time of the contract was reasonably foreseeable'. In his view the charterers had not assumed responsibility for any follow-on charter which the owners concluded because they could neither control that loss nor quantify it. It was not, in his judgment, sufficient that they knew 'in general and on open-ended terms' that there was likely to be a follow-on fixture.

Lord Rodger of Earlsferry did not find it necessary to explore the issues arising out of *South Australia Asset Management Corp* (at [63]), nor to consider the role, if any, of assumption of responsibility in delimiting the scope of liability. In his view, the loss suffered by the owners was not the 'ordinary consequence' of the breach of contract. The loss arose as a result of the 'extremely volatile market conditions' which could not have been reasonably foreseen as being likely to arise out of the delay (at [53] and to similar effect see the judgment of Lord Hodge in *Attorney-General of the Virgin Islands* v. *Global Water Associates Ltd* [2020] UKPC 18, [2021] AC 23, [26]). The difficulty with this approach is that what was not foreseen was the extent of the loss, rather than its
p. 885 nature. As Lord Rodger observed (at [53]), 'the ↵ extent of the relevant rise and fall in the market within a short time was actually unusual'. The problem which this approach creates is that the law does not generally require the parties to foresee the extent of the loss that has been suffered by the innocent party; rather, the law requires that the nature or the kind of loss be reasonably foreseeable. In the present case, the kind of loss (the loss of a subsequent fixture) was reasonably foreseeable and so it could be said that it should have been recovered by the owners (a point made extrajudicially by Lord Hoffmann in '*The Achilleas*: Custom and Practice or Foreseeability?' [2010] *Edinburgh Law Review* 47, 51–52).

Lord Walker also distinguished between the loss of a subsequent fixture and the particular loss which the owners had suffered on the facts of the case. Thus he concluded (at [83]) that it was open to the arbitrators to decide that it was not unlikely that the delay would cause the owners to miss a subsequent fixture but that 'it did not follow … that the charterers were liable for an exceptionally large loss (measured by the entire term of the fixture) when the market fell suddenly and sharply'. In his judgment the parties had not contracted on the basis that the charterers would be liable for 'any loss, however large, occasioned by a delay in re-delivery in circumstances where the charterers had no knowledge of, or control over, the new fixture entered into by the new owners' (see [86]).

Baroness Hale also expressed her doubts about the wisdom of incorporating into the law of contract the principles set out by the House of Lords in *South Australia Asset Management Corp* (see [93]). She therefore decided the case 'on the narrower ground identified by Lord Rodger' (at [93]). Thus she concluded that the 'parties would not have had this particular type of loss within their contemplation'. In her judgment, the parties would have expected that the owner would be able to find a use for the ship even if it was returned late and that 'it was only because of the unusual volatility of the market at that particular time that this particular loss was suffered'.

Although it is no easy task to discern the ratio of this case, it is possible to identify the factors which persuaded the House of Lords to conclude that the loss was too remote. The first was that their Lordships were clearly reluctant to conclude that a defendant would accept responsibility for a potentially extensive liability which, at the time of entry into the contract, it could neither know about nor control. The second related to the

expectations of the market. The general understanding of the shipping market was that liability was restricted to the difference between the market rate and the charter rate for the overrun period and this was a critical factor in persuading their Lordships to conclude that the loss was not recoverable.

Returning to the difficulty of locating the ratio of the case, Lord Rodger and Baroness Hale did not support the analysis adopted by Lord Hoffmann. The approach of Lord Hope is similar to that adopted by Lord Hoffmann. Lord Walker's analysis is more difficult to discern. He stated (at [87]) that he agreed with the reasons given by Lords Hoffmann, Hope, and Rodger. Further, he stated that he found the analogy with *South Australia Asset Management Corp* to be 'helpful' (at [79]) but stopped short of positively endorsing it in a contractual context. Given Lord Walker's apparent endorsement of both approaches, what is the ratio of the case? The answer given by Hamblen J in *Sylvia Shipping Co Ltd* v. *Progress Bulk Carriers Ltd (The Sylvia)* [2010] EWHC 542 (Comm), [2010] 2 Lloyd's Rep 81, [39] was that 'the rationale of assumption of responsibility' had 'the support of the majority'.

This leaves us with the difficulty of working out the relationship between the traditional approach, based on *Hadley* v. *Baxendale*, and Lord Hoffmann's assumption of responsibility test. This issue was also considered by Hamblen J in *The Sylvia* and he concluded (at [40]–[41]) that:

p. 886 ↵

> the decision in *The Achilleas* results in an amalgam of the orthodox and the broader approach. The orthodox approach remains the general test of remoteness applicable in the great majority of cases. However, there may be 'unusual' cases, such as *The Achilleas* itself, in which the context, surrounding circumstances or general understanding in the relevant market make it necessary specifically to consider whether there has been an assumption of responsibility. This is most likely to be in those relatively rare cases where the application of the general test leads or may lead to an unquantifiable, unpredictable, uncontrollable or disproportionate liability or where there is clear evidence that such a liability would be contrary to market understanding and expectations.
>
> In the great majority of cases it will not be necessary specifically to address the issue of assumption of responsibility. Usually the fact that the type of loss arises in the ordinary course of things or out of special known circumstances will carry with it the necessary assumption of responsibility.

It is, however, unlikely that this rationalization is consistent with the intention of Lord Hoffmann. Given his criticisms of the 'high degree of indeterminacy' produced by the orthodox approach ([2010] *Edinburgh Law Review* 47, 52–53), it is likely that Lord Hoffmann intended to displace it and not merely supplement it in the occasional case. That said, Hamblen J's approach has the merit of reducing the uncertainty which would be created by elevating the assumption of responsibility test over the orthodox analysis.

Notwithstanding Lord Hoffmann's own criticisms of the orthodox approach on the ground that it generates uncertainty, the same difficulty would appear to be present in his assumption of responsibility test. This point has been made most effectively by Paul CK Wee ('Contractual Interpretation and Remoteness' [2010] *LMCLQ* 150). It suffices to give one example and that relates to the application of Lord Hoffmann's approach to the facts of *Hadley* v. *Baxendale.* Wee applies the test in the following way (at p. 170):

> Under the agreement-centred approach, the critical question would have been: to whom would a reasonable person have understood the parties' agreement to allocate the risk of lost profits due to late delivery? The parties had not expressly considered this issue. The lack of discussion in the judgments of any common practice or understanding on this issue among common carriers suggests that no such understanding existed. The facts, as reported, disclose no clues as to what the parties were likely to have intended in the circumstances that had occurred; on the available evidence, it seems that a reasonable person would understand the parties' agreement not to have allocated the risk in question to anybody. … It appears that the fountainhead of the doctrine of remoteness would itself pose a problem for the agreement-centred approach. It is simple to identify the conclusion which the new approach would need to reach (ie, that the parties' agreement allocated the risk of lost profits due to late delivery to the claimants), but the inevitable limitations of the parties' intentions make it impossible to identify a reliable and consistent route to this conclusion. *Hadley* itself therefore lends support to the conclusion that the agreement-centred approach to remoteness is simply incapable, without resorting to fiction, of providing an answer where the parties' intentions run out.

Lord Hoffmann would, presumably, disagree with this criticism. Writing extrajudicially ([2010] *Edinburgh Law Review* 47, 57) he stated that:

> what made the loss in *Hadley* v. *Baxendale* unforeseeable by the carrier was that he lacked information in the possession of the mill owner. He did not know how badly the mill owner needed to get the crank shaft replaced.

p. 887 ↵ Further, as we have noted, Lord Hoffmann would claim that it is the orthodox approach which is uncertain or 'indeterminate', not his approach.

Nevertheless, the 'excessive and unnecessary uncertainty' generated by Lord Hoffmann's approach led the Court of Appeal of Singapore to decline to follow it in *MFM Restaurants Pte Ltd* v. *Fish & Co Restaurants Pte Ltd* [2010] SGCA 36, [2011] 1 SLR 150. Delivering the judgment of the court, Andrew Phang Boon Leong JA stated (at [140]):

> We … take this opportunity to state that the approach advocated by Lord Hoffmann in *The* Achilleas is not the law in Singapore, except to the extent that the learned law lord's reliance on the concept of assumption of responsibility by the defendant is already incorporated or embodied in both limbs in *Hadley* itself.

It is important to note the qualification relating to the extent to which the concept of assumption of responsibility is already embodied within the two limbs of *Hadley.* The Singaporean Court of Appeal was of the view that the first limb of *Hadley* necessarily embodies an implied undertaking or assumption of responsibility on the part of the defendant on the basis that the reasonable person in the position of the defendant would be taken to have assumed responsibility for a loss that flowed naturally from the breach (see [103]). This suggests that, in relation to limb one, there is little difference between the two approaches. However, this view rests on the hypothesis that the assumption of responsibility is implicit in the first limb of

Hadley and is not an additional element. If, on the other hand, it is an additional element, then there is a difference between the two approaches. In relation to the second limb of *Hadley*, the Court of Appeal understood it to rest solely on the actual knowledge of the defendant ([105]) and so perceived there to be a difference between the two approaches. On the other hand, if the knowledge of the defendant is seen as but one of the factors relevant to the second limb of *Hadley* then the difference between the two tests may not be great, given that, as we have noted (earlier in this section), there is authority which supports the proposition that it must be demonstrated that the defendant has accepted responsibility for the loss in question before it can be recovered under the second limb of *Hadley*.

Given that *Transfield Shipping* is a decision of the House of Lords, it is not open to the English courts (other than the Supreme Court) to go down the route taken by the Singaporean Court of Appeal. The English courts must therefore apply Lord Hoffmann's approach where it is appropriate to do so. The difficulty lies in working out when it is appropriate to do so and in ascertaining the relationship between the orthodox approach in *Hadley* and the approach of Lord Hoffmann. A possible rationalization of the relationship between the two approaches was provided by Sir David Keene in *John Grimes Partnership Ltd* v. *Gubbins* [2013] EWCA Civ 37, [2013] BLR 126. He stated (at [24]):

> [I]t seems to me to be right to bear in mind, as Lord Hoffmann emphasised in *The Achilleas*, that one is dealing with the law of contract, where the situation is governed by what has been agreed between the parties. If there is no express term dealing with what types of losses a party is accepting potential liability for if he breaks the contract, then the law in effect implies a term to determine the answer. Normally, there is an implied term accepting responsibility for the types of losses which can reasonably be foreseen at the time of contract to be not unlikely to result if the contract is broken. But if there is evidence in a particular case that the nature of the contract and the commercial background, or indeed other relevant special circumstances, render that implied assumption of responsibility inappropriate for a type of loss, then the contract-breaker escapes liability. Such was the case in *The Achilleas*.

p. 888 ↵ The attempt that is made here is to rationalize both cases on the basis that they seek to give effect to the presumed intention of the parties. The default rule is that to be found in *Hadley* v. *Baxendale*, namely that the contract-breaker is to be held liable for the type of loss which can reasonably be foreseen at the time of entry into the contract to be not unlikely to result if the contract is broken. But it is open to the parties to contract out of that default rule. And they can do so either way. They can restrict the liability of the contract-breaker (as in *The Achilleas* where the defendant was held not to be liable for a loss that, on one view, could have been said to be reasonably foreseeable because it had not assumed responsibility for that loss) or they can increase it (as in *Supershield Ltd* v. *Siemens Building Technologies FE Ltd* [2010] EWCA Civ 7, [2010] 1 Lloyd's Rep 349 where the defendant was held to have assumed a responsibility for a loss that would not have occurred in ordinary circumstances).

A rather different approach was, however, adopted by the Privy Council in *Attorney-General of the Virgin Islands* v. *Global Water Associates Ltd* [2020] UKPC 18, [2021] AC 23. The Government of the British Virgin Islands entered into two contracts with Global Water Associates Ltd ('GWA') relating to a proposed water reclamation treatment plant. The first contract was a Design Build Agreement ('DBA') under which GWA agreed to design

and build the plant. The second contract was a Management, Operation and Maintenance Agreement ('MOMA') under which the government engaged GWA to manage, operate, and maintain the plant at the site. In breach of the DBA the government failed to provide a site to enable the installation of the plant. The plant was therefore not built. The issue before the Privy Council was whether GWA could recover its losses under the MOMA in its claim for damages for breach of the DBA. The Privy Council held that it could and that such losses were not too remote a consequence of the government's breach of the DBA.

The principal interest of the case for our purpose lies in the way in which the Privy Council treated the decision in *The Achilleas*. Rather than being seen as the central authority on the remoteness of damage, it was cast to the margins. Lord Hodge (at [26]) described the assumption of responsibility test as set out by Lord Hoffmann and Lord Hope as a 'further limitation on contractual damages' and (at [29]) as a 'further restriction on recoverability' as if it were a test that somehow operated independently of the normal remoteness rules. This is certainly not how Lord Hoffmann and Lord Hope understood the test and it is likely that the status and the scope of *The Achilleas* will be the subject of further judicial analysis.

Instead of relying upon *The Achilleas* Lord Hodge placed more reliance on authorities such as *The Heron II* and *Victoria Laundry*. On the basis of these authorities he concluded that the losses resulting from the inability of GWA to earn profits under the MOMA were within the reasonable contemplation of the parties to the DBA when they entered into the contract. This was so for a number of reasons. First, the two contracts were entered into between the same parties on the same day and they both related to the same plant and so were losses which could reasonably be supposed to have been in the contemplation of both parties at the time they made the contract as the probable result of the breach of it within the second limb of the rule in *Hadley* v. *Baxendale.* Secondly, the government when it entered into the DBA knew and intended that the performance of each party's obligations under the DBA would lead to the commencement of the MOMA. Thirdly, the terms of the two contracts were clearly closely related to one another. Fourthly, there was no express or implied term in the DBA which limited the government's liability in damages to GWA's loss of earnings under the DBA. The losses were therefore not too remote a consequence of the breach of contract. However, the influence of the case lies not so much in the application of these principles to the facts of the case but in the emphasis given by the Privy Council to the traditional tests set out in cases such as *The Heron II* and *Victoria Laundry* in preference to *The Achilleas*.

p. 889

23.8.2 Mitigation

The claimant must take reasonable steps to minimize the loss suffered by a breach of contract (*British Westinghouse Electric and Manufacturing Co Ltd* v. *Underground Electric Railways Co of London Ltd* [1912] AC 673). This is commonly expressed in the formula that a claimant is under a 'duty' to mitigate his loss. This terminology is, however, misleading. A claimant is not under a duty to mitigate his loss, in the sense that he can be sued if he fails to do so. The sanction for a failure to mitigate is that a claimant cannot recover damages in respect of losses attributable to his failure to do so. As Professor Bridge notes ('Mitigation of Damages in Contract and the Meaning of Avoidable Loss' (1989) 105 *LQR* 398, 399), the language of 'duty' is misleading, but it is 'well entrenched and difficult to substitute'.

There are two aspects to the mitigation doctrine. The first is that the claimant must not unreasonably increase the loss suffered as a result of the breach (*Banco de Portugal* v. *Waterlow & Sons Ltd* [1932] AC 452). The second is that the claimant must take reasonable steps to minimize his loss. The claimant need only take *reasonable* steps and, in this respect, the law does not make onerous demands of a claimant (*Pilkington* v. *Wood* [1953] Ch 770). The defendant, as a contract-breaker, is not in a position to ask the court to make onerous demands. As Tomlinson J observed in *Britvic Soft Drinks Ltd* v. *Messer UK Ltd* [2002] 1 Lloyd's Rep 20, 46 the law of contract adopts a 'tender approach to those who have been placed in a predicament by a breach of contract'. Whether or not an innocent party has taken reasonable steps is a question of fact. Where the claimant takes steps to mitigate the loss consequent on the defendant's breach of contract and these steps are successful, the defendant is entitled to the benefit which accrues from the claimant's action and is liable for the loss as reduced by the claimant's actions (*Thai Airways International Public Co Ltd* v. *KI Holdings Co Ltd* [2015] EWHC 1250 (Comm)). But where the step taken by the claimant is an independent act which does not reduce the particular loss in respect of which the claimant is seeking to recover damages, a court may conclude that it is not to be regarded as an act of mitigation so that the claimant is not required to bring into account any benefit which accrues to it from the step which it has taken (see *Globalia Business Travel SAU of Spain* v. *Fulton Shipping Inc of Panama* [2017] UKSC 43, [2017] 1 WLR 2581, where it was held that a ship owner was not obliged to bring into account the capital gain which it had realized from the sale of the ship in order to offset the loss of income which it had suffered on the hire of the vessel as a result of its wrongful termination by the hirer).

Three points should be noted about the doctrine of mitigation. The first is that it amounts to a substantial qualification to the protection which the law affords to the claimant's performance interest. It means that, in the case where the claimant can reasonably obtain substitute performance in the marketplace, the claimant must go out and obtain that performance: he cannot sit back and wait for the defendant to perform in accordance with the terms of the contract. Of course, the law does not actually compel the claimant to go out into the marketplace and purchase substitute performance but the fact that the claimant cannot recover damages in respect of losses attributable to his failure to mitigate gives him a substantial incentive to do so. The claimant who goes out into the marketplace and purchases substitute performance will be entitled to recover as damages the difference between the price under the substitute transaction and the contract price. In this way the claimant can obtain performance at the price which was agreed in the contract but not from the party who promised to provide it.

Secondly, the doctrine of mitigation can have the effect of requiring the innocent party to consider, and
p. 890 possibly accept, an offer of alternative performance by the party in breach. ↵ Such was the case in one of the leading mitigation cases, *Payzu Ltd* v. *Saunders* [1919] 2 KB 581. The defendants entered into a contract with the plaintiffs under which they agreed to sell to the plaintiffs a quantity of silk, to be delivered in instalments. The contract provided that payment was to be made within one month following delivery of each instalment. The plaintiffs failed to pay the first instalment on time. This led the defendants to the erroneous conclusion that the plaintiffs were unable to pay at all (when in fact the cause of late payment was simply that they had had difficulty in getting the cheque signed by one of their directors). Fearing that the plaintiffs were facing insolvency, the defendants wrote to the plaintiffs and informed them that they would not make any further deliveries unless the plaintiffs paid for each instalment in cash on delivery. The plaintiffs refused to accept these terms. They brought an action for damages and sought to recover the difference between the contract price and the market price of the silk (at the time the market price was rising). It was held that the plaintiffs were not entitled to recover the difference in price on the ground that their rejection of the defendants' offer

to supply the silk on cash terms constituted a failure to mitigate their loss. Scrutton LJ stated that, in a case involving a commercial contract, it is generally reasonable to expect a party to consider and accept a reasonable offer made by the party in breach of contract (the position is otherwise in the case of a contract for personal services: see *Clayton-Greene* v. *De Courville* (1920) 36 TLR 790).

Payzu was taken a step further in *Sotiros Shipping Inc* v. *Sameiet Solholt (The Solholt)* [1983] 1 Lloyd's Rep 605 (CA), [1981] 2 Lloyd's Rep 574 (Staughton J). The buyers of a ship lawfully terminated a contract on the ground that the sellers were late in tendering delivery of the vessel. The contract price was $5 million. At the time of the breach the market price had risen to $5.5 million and the sellers later sold the vessel for $5.8 million. The buyers' claim for damages assessed by reference to the difference between the contract price and the market price was rejected on the ground that they had failed to mitigate their loss. There was no evidence that the sellers had offered to sell the ship to the buyers for $5 million after the termination of the contract, but Staughton J, the judge at first instance, held that the buyers had failed to mitigate because they should have offered to buy the vessel for $5 million rather than claim $500,000 in damages. The Court of Appeal dismissed the buyers' appeal. While they clearly had doubts about the decision of Staughton J, they were not prepared to interfere with his finding that the buyers had failed to act reasonably. While the result in *The Solholt* has received support on the basis that it recognizes the value of the re-negotiation of contracts, it can be criticized on three substantial grounds. First, it rendered the buyer's right to reject the vessel illusory. There seems to be no point in exercising a right to reject if the buyer then has to make an offer to purchase the rejected goods at the contract price (at least in the case of a rising market). Secondly, it entitled the sellers to retain the profits attributable to the rise in the market price of the vessel. They were able to keep the difference between the contract price of $5 million and the price of $5.8 million for which they eventually sold the vessel when they should have been entitled to retain the difference between the market price at the date of the breach ($5.5 million) and the price for which they sold the vessel ($5.8 million). In effect, they were enriched to the extent of $500,000 by their breach of contract. Thirdly, mitigation relates to the avoidance of losses and, on the facts of *The Solholt*, the loss had already occurred at the date of breach (in the sense that the market price had already moved) and the question for the court was which party was to take the benefit of the rise in the market price. On the facts it was held that it was the sellers, the party in breach, who were entitled to retain the rise in the market price. As Professor Bridge has observed ((1989) 109 *LQR* 389, 421–422):

p. 891 ↵

> [I]f one had to speculate on the failure to recognise principle in *Payzu* and *The Solholt*, it would be on the ground that the law's insistence upon treating the possibility of mitigation as a question of fact, together with a preoccupation with the reasonableness of the plaintiff's conduct, has created an intellectual vacuum.

Given these criticisms, a court may be slow to require an innocent party to take the initiative in this way and may instead put the onus on the contract-breaker to put forward a properly formulated proposal to the innocent party which it could not reasonably refuse (*Manton Hire and Sales Ltd* v. *Ash Manor Cheese Co Ltd* [2013] EWCA Civ 548).

The final point to be noted in relation to the doctrine of mitigation is that it can be seen as part of a broader principle that a claimant must act reasonably. This principle can be seen at work in *Ruxley* (23.3) where Lord Lloyd stated he did not accept the submission that 'reasonableness is confined to the doctrine of mitigation'. The 'obligation' to act reasonably can extend into matters such as the measure of recovery to which the claimant is entitled (i.e. whether it is cost of cure or difference in value).

23.8.3 Contributory Negligence

A controversial issue has been the question whether or not it is possible to reduce the damages payable to the claimant on the ground that the claimant's carelessness has contributed to the losses that he has suffered. The problem here relates to the application of the Law Reform (Contributory Negligence) Act 1945 to contractual claims. The Act seems to have been drafted with tort claims in mind, particularly claims in the tort of negligence, and the consequence is that the concepts that it employs, particularly the notion of 'fault', do not translate easily into a contractual context.

In determining whether or not contributory negligence can be invoked as a defence by a defendant who is sued for damages for breach of contract, the courts in England and Wales distinguish between three different types of claim. The first is a case in which the defendant's liability arises from a breach of a contractual provision which does not depend on a failure to take reasonable care; that is to say the breach of a strict contractual duty. Contributory negligence is not available as a defence to such a claim. The second is a case in which liability arises from an express contractual obligation to take care which does not correspond to any duty which would exist independently of the contract. Once again, contributory negligence is not available as a defence to such a claim. The third case is one in which the liability for breach of contract is the same as, and coextensive with, a liability in tort independently of the existence of a contract. Contributory negligence is available as a defence to such a claim. The operation of these rules is illustrated by the following case:

Barclays Bank plc v. Fairclough Building Ltd
[1995] QB 214, Court of Appeal

The defendant contractors, Fairclough, agreed to carry out work for the plaintiff, Barclays Bank, at Millbrook Industrial Estate, Wythenshawe. A significant part of that work required the defendant to clean and treat some asbestos cement sheets. The contract did not specify the method by which the
p. 892 work was to be done, but it was a condition of the contract ↵ that all roofing work should be executed by a specialist firm of roofing contractors or by the defendant's own craftsmen if properly experienced in such work. The defendant sub-contracted the work to a sub-contractor who used high-pressure hoses to jet clean the sheets. As a result of the way in which the work was done the building became heavily contaminated with asbestos dust which necessitated extensive remedial works at a cost of approximately £4m. Neither the defendant, nor the sub-contractor, had taken any of the recommended precautions when using the high-pressure hose method of cleaning the asbestos roofs. The defendant accepted that it was seriously in breach of the terms of the contract. The defendant breached two of the main obligations under the contract. First, there was a clear breach of the defendant's obligation to carry out the work in accordance with the specification and to achieve the standard specified. The defendant's failure in this respect was a breach of a strict obligation and not simply a failure to exercise reasonable care and skill. Secondly, the defendant's failure to comply with the requirements of the Asbestos Regulations of 1987 was itself a breach of contract. The defendant alleged that the plaintiff had been guilty of contributory negligence in that, through its safety officer and its supervising officer, it should have drawn the defendant's attention to the dangers and the supervising officer could and should have insisted on compliance with the terms of the contract.

The plaintiff brought an action to recover damages for the losses that it had suffered. The trial judge awarded the plaintiff substantial damages but reduced the award by 40 per cent under sections 1(1) and 4 of the Law Reform (Contributory Negligence) Act 1945 on the ground that the plaintiff had been guilty of contributory negligence. The plaintiff appealed to the Court of Appeal which allowed the appeal and held that the damages payable to the plaintiff did not fall to be reduced under the 1945 Act.

Beldam LJ

Breach of contract and contributory negligence

The common law rule that in an action in tort a plaintiff whose own fault contributed with the defendant's to cause his damage could recover nothing was perceived to be unfair and, as a result of the Law Revision Committee's Eighth Report (Contributory Negligence) (1939) (Cmd. 6032), the Law Reform (Contributory Negligence) Act 1945 was passed. Its purpose was to enable a court in actions of tort to apportion responsibility for the damage suffered by the plaintiff where there had been fault by both parties. It is the definition of 'fault' under section 4 which has since 1945 given rise to continuing debate and uncertainty whether the court's ability to apportion damages applies to a case in which the plaintiff's cause of action lies in contract. After nearly half a century of extensive

academic analysis, inconclusive discussion in a number of decided cases and conflicting Commonwealth decisions, the position remained uncertain and in 1989 the Law Commission published Working Paper No 114, Contributory Negligence as a Defence in Contract. In this consultation paper the competing arguments based on the interpretation of section 4 and the state of the law as it then appeared to be were fully examined. After consultation the Commission reported its recommendations in December 1993, Contributory Negligence as a Defence in Contract (Law Com. No 219). In the light of this extensive review of the law, a short summary of the position is in my view sufficient for the purposes of the present case.

Section 4 of the Act defines 'fault':

> '"fault" means negligence, breach of statutory duty or other act or omission which gives rise to a liability in tort or would, apart from this Act, give rise to the defence of contributory negligence; ... '

p. 893 ↵ It is generally agreed that the first part of the definition relates to the defendant's fault and the second part to the plaintiff's but debate has focused on the words 'or other act or omission which gives rise to a liability in tort' in the first part and 'other act or omission which ... would, apart from this Act, give rise to the defence of contributory negligence' in the second part. It has been argued that, merely because the plaintiff frames his cause of action as a breach of contract, if the acts or omissions on which he relies could equally well give rise to a liability in tort the defendant is entitled to rely on the defence of contributory negligence. Examples frequently cited are claims for damages against an employer or by a passenger against a railway or bus company where the plaintiff may frame his action either in tort or in contract and the duty relied on in either case is a duty to take reasonable care for the plaintiff's safety. Contributory negligence has been a defence in such actions for many years. So it is argued that, in all cases in which the contractual duty broken by a defendant is the same as and is coextensive with a similar duty in tort, the defendant may now rely on the defence. An opposing view based on the second part of the definition is that, if the plaintiff framed his action for breach of contract, contributory negligence at common law was never regarded as a defence to his claim and so cannot be relied on under the Act of 1945.

Under the first part of the definition, if the plaintiff claims damages for breach of a contractual term which does not correspond with a duty in tort to take reasonable care, the defendant's acts or omissions would not give rise to a liability in tort and accordingly no question of contributory negligence could arise.

These arguments have led courts to classify contractual duties under three headings: (i) where a party's liability arises from breach of a contractual provision which does not depend on a failure to take reasonable care; (ii) where the liability arises from an express contractual obligation to take care which does not correspond to any duty which would exist independently of the contract; (iii) where the liability for breach of contract is the same as, and coextensive with, a liability in tort independently of the existence of a contract. This analysis was adopted by Hobhouse J in *Forsikringsaktieselskapet Vesta* v. *Butcher* [1986] 2 All ER 488 and by the Court of Appeal in the same

case [1989] AC 852, 860, 862, 866–867. The judgments in the Court of Appeal in that case assert that in category (iii) cases the Court of Appeal is bound by the decision in *Sayers* v. *Harlow Urban District Council* [1958] 1 WLR 623 to admit the availability of the defence.

Since I do not regard the case before the court as being in that category, I am content to accept that decision. To regard the definition of fault in section 4 as extending to cases such as employer's liability places no great strain on the construction of the words used. ...

On the other hand, in category (i) cases there is no decision in which contributory negligence has been held to be a partial defence. There are powerful dicta to the effect that it cannot be. ...

The defendant's argument that, because the plaintiff owed duties to its employees it was therefore under a duty in its own interest to see that the defendant fulfilled its obligations under the contract, is inconsistent with many cases in which it has been held that employers and others liable to third parties for failure of plant or equipment are entitled to rely on warranties given by their suppliers. ...

The present case

I have already stated my conclusion that in the present case the defendant was in breach of two conditions which required strict performance and did not depend on a mere failure to take reasonable care. Nevertheless it was argued by Mr Butcher [counsel for the defendant] in support of
p. 894 the respondent's notice that the defendant could have been held liable in tort ↵ for the same acts or omissions. By creating the asbestos dust it was guilty of nuisance. Further the settling of the dust on the storage racks and floors of the plaintiff's building amounted to trespass. I would reject these submissions.

On the other hand, Mr Elliott [counsel for the plaintiff] addressed arguments to the court that the defendant would not have been found liable to the plaintiff in negligence, for the only damage proved was economic loss. These arguments amply justified the fears expressed by the Law Commission in its 1993 report (Law Com. No 219) that actions for breach of a strict contractual obligation would become unduly complex if contributory negligence were admitted as a partial defence by introducing an element of uncertainty into many straightforward commercial disputes and increasing the issues to be determined.

In my judgment therefore in the present state of the law contributory negligence is not a defence to a claim for damages founded on breach of a strict contractual obligation. I do not believe the wording of the Law Reform (Contributory Negligence) Act 1945 can reasonably sustain an argument to the contrary. Even if it did, in the present case the nature of the contract and the obligation undertaken by the skilled contractor did not impose on the plaintiff any duty in its own interest to prevent the defendant from committing the breaches of contract. To hold otherwise would, I consider, be equivalent to implying into the contract an obligation on the part of the plaintiff inconsistent with the express terms agreed by the parties. The contract clearly laid down the extent of the obligations of the plaintiff as architect and of the defendant. It was the defendant who was to provide appropriate supervision on site, not the architect. ...

For the reasons I have given, I would allow the appeal.

Simon Brown LJ

I for my part would accept Hobhouse J's view expressed in *Forsikringsaktieselskapet Vesta* v. *Butcher* [1986] 2 All ER 488, 509–510, that apportionment of blame and liability is open to the court in any ordinary category (iii) case, unless the parties by their contract have varied that position, because, as he explained:

> 'there is independently of contract a status or common law relationship which exists between the parties and which can then give rise to tortious liabilities which fall to be adjusted in accordance with the Act of 1945.'

In short, the contract in such cases really adds nothing to the common law position. ...

But when, as in a category (i) case, the contractual liability is by no means immaterial, when rather it is a strict liability arising independently of any negligence on the defendant's part, then there seem to me compelling reasons why the contract, even assuming it is silent as to apportionment, should be construed as excluding the operation of the Act of 1945. The very imposition of a strict liability on the defendant is to my mind inconsistent with an apportionment of the loss. And not least because of the absurdities that the contrary approach carries in its wake. Assume a defendant, clearly liable under a strict contractual duty. Is his position to be improved by demonstrating that besides breaching that duty he was in addition negligent? Take this very case. Is this contract really to be construed so that the defendant is advantaged by an assertion of its own liability in nuisance or trespass as well as in contract? Are we to have trials at which the defendant calls an expert to implicate him in tortious liability, whilst the plaintiff's expert seeks paradoxically to exonerate him? The answer to all these questions is surely 'No'. Whatever arguments exist for apportionment in other categories of case—
p. 895 and these are persuasively deployed in the 1993 Law Commission Report (Law Com. ↵ No 219)—to my mind there are none in the present type of case and I for my part would construe the contract accordingly. For these reasons in addition to those given by Beldam LJ, I, too, would allow this appeal.

Nourse LJ delivered a concurring judgment.

Commentary

In many ways, the litigation in *Fairclough* demonstrates the controversies that have existed in this area of law. The law sometimes compels the parties to take up unusual positions. For example, it was the defendant in *Fairclough* who argued that it was liable to the plaintiff in tort and it did so for the purpose of seeking to invoke the defence of contributory negligence. By contrast, the plaintiff argued that the defendant was not liable in tort so that it could avoid the application of the defence. It is, to say the least, very odd to give an incentive to a defendant to admit a liability for the purpose of seeking to reduce his liability (or, to view the same issue from

the perspective of the claimant, to put the claimant in the position of denying that he has a particular claim for the purpose of increasing the size of his claim against the defendant). But this is the position which English law has adopted.

A different approach has been adopted in Australia where the High Court in *Astley* v. *Austrust Limited* (1999) 197 CLR 1 held that contributory negligence is not available as a defence to a claim for breach of contract. The High Court so concluded for a number of reasons, including the historical development of the law (where it was believed that contributory negligence had not, prior to 1945, been available as a defence to a breach of contract claim), the wording of the Australian equivalent of the 1945 Act, and the fact that a claimant in a contractual claim has paid for the defendant's performance and so should not be obliged to take reasonable care in order to ensure that the defendant carries out its contractual obligations or be obliged to take reasonable care to ensure that loss is not suffered as a result of the defendant's failure to perform its contractual obligations.

This difference in approach between common law systems has resulted in fresh consideration being given to this area of law by the Privy Council in *Primeo Fund v Bank of Bermuda (Cayman) Ltd* [2023] UKPC 40 where the approach in *Astley* was rejected (see [337]) and the English approach as set out in *Fairclough* affirmed. By reference to cases arising out the employer/employee relationship and between railway companies and their passengers ([341]) the Privy Council demonstrated that, prior to 1945, contributory negligence had operated as a complete defence in cases where the duty of care sued upon was the same in contract and in tort. Further, it was held that the reference to the 'fault' of the defendant in the 1945 Act is a reference to the conduct of the defendant which gives rise to the cause of action and not to the cause of action upon which the claimant has chosen to base its claim. Thus, it is not the characterisation of the claimant's cause of action that is the critical factor. Rather, it is the conduct of the defendant which must be capable of giving rise to a liability in tort ([333]). Provided that the conduct of the defendant is such as to be capable of giving rise to a liability in tort, the defence of contributory negligence is potentially applicable whether the claimant chooses to bring its claim in contract or in tort. In other words, a claimant cannot avoid the potential application of the defence of contributory negligence by choosing to bring its claim in contract rather than tort. Thus the defence of contributory negligence is in principle available where a claim is based on the breach of a contractual duty of
p. 896 care which is concurrent with a duty in tort ([391]). In this way contributory negligence can operate as ↵ a partial defence in cases of concurrent liability and the court is not left in the position where its only choice is to allow the claim in full or to deny the claim in its entirety. The availability of contributory negligence as a defence in cases of this type enables the court to reach a more proportionate conclusion which takes account of the conduct of both the claimant and the defendant.

23.9 Negotiating Damages and Account of Profits

A claimant may seek to recover damages assessed by reference to the sum that he or she could hypothetically have received in return for releasing the defendant from the obligation which it failed to perform. Or a claimant could seek to recover the profit which the defendant has made as a result of its breach of contract. Both types of claim have given rise to a considerable degree of controversy in recent times. In relation to the first of these claims, the controversy has centred on the nature of the claim (is it a claim brought in respect of a loss which has been suffered by the claimant or is it to recover a share of the profit which the defendant has

made?) and the circumstances in which it can be brought. The controversy in relation to the latter claim is whether or not a claimant is ever entitled to recover the entirety of the profit made by the defendant as a result of its breach of contract. The House of Lords in *Attorney-General* v. *Blake* [2001] 1 AC 268 held on the rather unusual facts of that case that the Attorney-General was entitled to recover all of the profit made by Mr Blake as a result of his breach of contract, but the case has since been confined within very narrow limits and it is probably unlikely that it will be followed, at least in the case where the parties to the contract are both commercial parties engaged in an ordinary business transaction. Accordingly, we shall focus attention on the first of the two claims, now known as a claim for negotiating damages in the light of the decision of the Supreme Court in the following case:

One Step (Support) Ltd v. Morris-Garner
[2018] UKSC 20, [2019] AC 649, Supreme Court

The claimant company brought an action against two defendants. The first defendant had been an employee and a 50 per cent shareholder in the claimant, while the second defendant had been an employee of the claimant. The claimant sought to recover damages in respect of breaches by the defendants of three-year covenants into which they had entered with the claimant in December 2006, under which the defendants had agreed not to compete with the claimant, solicit its clients, or make use of its confidential information. The defendants breached these covenants by setting up a new company in 2007 which did in fact compete with the claimant. On discovering the existence of the company in February 2008, the claimant threatened to bring proceedings against the defendants for an injunction but in the event did not proceed further with the claim. After the expiry of the three-year period, the claimant commenced proceedings against the defendants in July 2012. The company set up by the defendants in 2007 meanwhile had done extremely well, and the defendants sold their shares in that company for £12.8 million in September 2010. On the other hand, the claimant's business 'experienced a significant downturn'. The claimant's expert estimated that the loss which the claimant had sustained as a result of the defendants' ↵ breaches was between £3.4 million and £4.6 million. However, the same expert estimated that the fee which the claimant would have obtained for the release of the defendants from their covenants was between £5.6 million and £6.3 million. The claimant therefore sought to recover damages assessed by reference to the fee which it would have obtained from releasing the defendants from their obligations under the covenants. The claimant was successful both at first instance and in the Court of Appeal but it failed in its claim before the Supreme Court, who held that the claimant was entitled to recover in respect of the loss which it could prove it had suffered as a result of the defendants' breaches but that it was not entitled to recover negotiating damages.

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Lord Reed [with whom Lady Hale, Lord Wilson and Lord Carnwath agreed]

1. This appeal raises an important question in relation to the law of damages: in what circumstances can damages for breach of contract be assessed by reference to the sum that the claimant could hypothetically have received in return for releasing the defendant from the obligation which he failed to perform? ...

   [Lord Reed stated that the term 'negotiating damages' would be used to denote this type of claim and proceeded to examine in some detail the authorities and the historical development of this area of law and continued]

91. The use of an imaginary negotiation can give the impression that negotiation damages are fundamentally incompatible with the compensatory purpose of an award of contractual damages. Damages for breach of contract depend on considering the outcome if the contract had been performed, whereas an award based on a hypothetical release fee depends on considering the outcome if the contract had not been performed but had been replaced by a different contract. That impression of fundamental incompatibility is, however, potentially misleading. There are certain circumstances in which the loss for

which compensation is due is the economic value of the right which has been breached, considered as an asset. The imaginary negotiation is merely a tool for arriving at that value. The real question is as to the circumstances in which that value constitutes the measure of the claimant's loss.

92. … such circumstances can exist in cases where the breach of contract results in the loss of a valuable asset created or protected by the right which was infringed, as for example in cases concerned with the breach of a restrictive covenant over land, an intellectual property agreement or a confidentiality agreement. … The claimant has in substance been deprived of a valuable asset, and his loss can therefore be measured by determining the economic value of the asset in question. The defendant has taken something for nothing, for which the claimant was entitled to require payment.

93. It might be objected that there is a sense in which any contractual right can be described as an asset, or indeed as property. In the present context, however, what is important is that the contractual right is of such a kind that its breach can result in an identifiable loss equivalent to the economic value of the right, considered as an asset, even in the absence of any pecuniary losses which are measurable in the ordinary way. That is something which is true of some contractual rights, such as a right to control the use of land, intellectual property or confidential information, but by no means of all. For example, the breach of a non-compete obligation may cause the claimant to suffer pecuniary loss resulting from the wrongful competition, such as a loss of profits and goodwill, which is measurable by conventional means, but in the absence of such loss, it is difficult to see how there could be any other loss.

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94. It is not easy to see how, in circumstances other than those of the kind described in paras 91–93, a hypothetical release fee might be the measure of the claimant's loss. It would be going too far, however, to say that it is only in those circumstances that evidence of a hypothetical release fee can be relevant to the assessment of damages. If, for example, in other circumstances, the parties had been negotiating the release of an obligation prior to its breach, the valuations which the parties had placed on the release fee, adjusted if need be to reflect any changes in circumstances, might be relevant to support, or to undermine, a subsequent quantification of the losses claimed to have resulted from the breach. It would be a matter for the judge to decide whether, in the particular circumstances, evidence of a hypothetical release fee was relevant and, if so, what weight to place upon it. However, the hypothetical release fee would not itself be a quantification of the loss caused by a breach of contract, other than in circumstances of the kind described in paras 91–93 above.

95. The foregoing discussion leads to the following conclusions:

    (1) Damages assessed by reference to the value of the use wrongfully made of property (sometimes termed 'user damages') are readily awarded at common law for the invasion of rights to tangible moveable or immoveable property (by detinue, conversion or trespass). The rationale of such awards is that the person who makes wrongful use of property, where its use is commercially valuable, prevents the owner

from exercising a valuable right to control its use, and should therefore compensate him for the loss of the value of the exercise of that right. He takes something for nothing, for which the owner was entitled to require payment.

(2) Damages are also available on a similar basis for patent infringement and breaches of other intellectual property rights.

(3) Damages can be awarded under Lord Cairns' Act in substitution for specific performance or an injunction, where the court had jurisdiction to entertain an application for such relief at the time when the proceedings were commenced. Such damages are a monetary substitute for what is lost by the withholding of such relief.

(4) One possible method of quantifying damages under this head is on the basis of the economic value of the right which the court has declined to enforce, and which it has consequently rendered worthless. Such a valuation can be arrived at by reference to the amount which the claimant might reasonably have demanded as a quid pro quo for the relaxation of the obligation in question. The rationale is that, since the withholding of specific relief has the same practical effect as requiring the claimant to permit the infringement of his rights, his loss can be measured by reference to the economic value of such permission.

(5) That is not, however, the only approach to assessing damages under Lord Cairns' Act. It is for the court to judge what method of quantification, in the circumstances of the case before it, will give a fair equivalent for what is lost by the refusal of the injunction.

(6) Common law damages for breach of contract are intended to compensate the claimant for loss or damage resulting from the non-performance of the obligation in question. They are therefore normally based on the difference between the effect of performance and non-performance upon the claimant's situation.

(7) Where damages are sought at common law for breach of contract, it is for the claimant to establish that a loss has been incurred, in the sense that he is in a less favourable situation, either economically or in some other respect, than he would have been in if the contract had been performed.

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(8) Where the breach of a contractual obligation has caused the claimant to suffer economic loss, that loss should be measured or estimated as accurately and reliably as the nature of the case permits. The law is tolerant of imprecision where the loss is incapable of precise measurement, and there are also a variety of legal principles which can assist the claimant in cases where there is a paucity of evidence.

(9) Where the claimant's interest in the performance of a contract is purely economic, and he cannot establish that any economic loss has resulted from its breach, the normal inference is that he has not suffered any loss. In that event, he cannot be awarded more than nominal damages.

(10) Negotiating damages can be awarded for breach of contract where the loss suffered by the claimant is appropriately measured by reference to the economic value of the right which has been breached, considered as an asset. That may be the position where the breach of contract results in the loss of a valuable asset created or protected by the right which was infringed. The rationale is that the claimant has in substance been deprived of a valuable asset, and his loss can therefore be measured by determining the economic value of the right in question, considered as an asset. The defendant has taken something for nothing, for which the claimant was entitled to require payment.

(11) Common law damages for breach of contract cannot be awarded merely for the purpose of depriving the defendant of profits made as a result of the breach, other than in exceptional circumstances, following *Attorney General* v. *Blake*.

(12) Common law damages for breach of contract are not a matter of discretion. They are claimed as of right, and they are awarded or refused on the basis of legal principle. …

98. This is a case brought by a commercial entity whose only interest in the defendants' performance of their obligations under the covenants was commercial. Indeed, a restrictive covenant which went beyond what was necessary for the reasonable protection of the claimant's commercial interests would have been unenforceable. The substance of the claimant's case is that it suffered financial loss as a result of the defendants' breach of contract. The effect of the breach of contract was to expose the claimant's business to competition which would otherwise have been avoided. The natural result of that competition was a loss of profits and possibly of goodwill. The loss is difficult to quantify, and some elements of it may be inherently incapable of precise measurement. Nevertheless, it is a familiar type of loss, for which damages are frequently awarded. It is possible to quantify it in a conventional manner. …

99. The case is not one where the breach of contract has resulted in the loss of a valuable asset created or protected by the right which was infringed. Considered in isolation, the first defendant's breach of the confidentiality covenant might have been considered to be of that character, but in reality the claimant's loss is the cumulative result of breaches of a number of obligations, of which the non-compete and non-solicitation covenants have been treated as the most significant. …

100. The judge has ordered a hearing on quantum. That hearing should now proceed, but it should not be, as he ordered, an assessment of the amount which would notionally have been agreed between the parties, acting reasonably, as the price for releasing the defendants from their obligations. The object of the exercise is that the judge should measure, as accurately as he can on the available evidence, the financial loss which the claimant has actually sustained. How that assessment is best carried out is, in the first instance, a matter for the judge to consider, proceeding in accordance with this judgment. If evidence is led in relation to a hypothetical release fee, it is for the judge to determine its

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> relevance and weight, if any. It is important to understand, however, that such a fee is not itself the measure of the claimant's loss in a case of the present kind, for the reasons which have been explained.
>
> ***Lord Sumption*** delivered a concurring judgment in which he stated that his reasons 'were not in all respects the same' as those of Lord Reed but that their conclusions appeared to him 'to be closely aligned'. ***Lord Carnwath*** gave a judgment which agreed with the judgment of Lord Reed and which also sought to examine the differences as he saw it between the judgment of Lord Reed and that of Lord Sumption.

Commentary

The heart of Lord Reed's judgment is to be found in his 12-point summary in paragraph 95. The importance of the summary extends beyond his analysis of the circumstances in which a claimant may be entitled to recover negotiating damages. Thus he affirms (point 12) that damages for breach of contract are awarded as a matter of right, not discretion. A claimant who brings an action for damages for breach of contract is thus asserting a right, not seeking the discretionary assistance of the court. He also affirms that damages for breach of contract are 'intended to compensate the claimant for loss or damage' (point 6) so that in the case where the claimant's interest in the performance of the contract is purely financial and it cannot prove that it has suffered loss as a result of the defendant's breach of contract, then in such a case the claimant 'cannot be awarded more than nominal damages' (point 9). The focus of the claim for damages must therefore ordinarily be on demonstrating that the claimant has suffered loss as a result of the defendant's breach of contract. While this may create difficulties for a claimant in certain cases, the claimant must nevertheless maintain its focus on the identification of the loss it claims that it has suffered and adduce before the court the best evidence it has of that loss. In such a case, the court can be expected to be 'tolerant of imprecision where the loss is incapable of precise measurement' (point 8), but the difficulty experienced by the claimant in proving its loss does not of itself justify the court in seeking to award damages on an entirely different basis, namely by reference to the profit which the defendant has made from the breach. Instead, the court must do the best it can on the evidence before it to identify and measure the loss which has been suffered by the claimant.

Turning to the availability of negotiating damages, the critical points are points 1–5 and 10 of Lord Reed's summary at paragraph 95. The two situations in which a claimant is most likely to be able to recover 'negotiating damages' are where the defendant takes and makes use of the claimant's property without the claimant's consent (the so-called 'user damages' cases referred to in point 1) and where the court exercises its jurisdiction under section 50 of the Senior Courts Act 1981 (a jurisdiction which previously existed under what was known as Lord Cairns' Act) to award the claimant damages in lieu of specific performance or an injunction (see point 3).

It is important to note that Lord Reed viewed these claims as loss claims, not as claims in which the claimant sought to recover the gain, or a share of the gain, made by the defendant from its breach of contract. This was previously a point of contention, with many commentators pointing out that there was no real loss in these cases and that what the courts were really doing was to enable a claimant to recover a share of the profit made by the defendant as a result of its breach of contract. The reason often given for not analysing these claims as
p. 901 loss claims was that the claimant in many cases might not have been willing to permit ↵ the defendant to

breach its obligations, so that it was a fiction to simulate a sale of the right as between a willing seller and a willing buyer. Lord Reed addresses this point in paragraph 91 of his judgment, where he refers to an 'imaginary negotiation' between the parties. Nevertheless, he maintains that the claim is best analysed as a loss claim, albeit he recognized at an earlier point in his judgment that the notion of loss as it is used here differs from the conventional use of the word loss. He explained the difference in its application to user damages (at [30]) in the following terms:

> In these cases, the courts have treated user damages as providing compensation for loss, albeit not loss of a conventional kind. Where property is damaged, the loss suffered can be measured in terms of the cost of repair or the diminution in value, and damages can be assessed accordingly. Where on the other hand an unlawful use is made of property, and the right to control such use is a valuable asset, the owner suffers a loss of a different kind, which calls for a different method of assessing damages. In such circumstances, the person who makes wrongful use of the property prevents the owner from exercising his right to obtain the economic value of the use in question, and should therefore compensate him for the consequent loss. Put shortly, he takes something for nothing, for which the owner was entitled to require payment.

The circumstances in which Lord Reed expressly envisaged that negotiating damages would be an appropriate remedy included (at [92]) the breach of a restrictive covenant over land, the breach of an intellectual property agreement, or the breach of a confidentiality agreement. These are likely to be the core cases in which negotiating damages are awarded, but Lord Reed was careful not to rule out other potential applications of the principle, albeit he stated that it was 'not easy' to see how negotiating damages might be available in circumstances beyond those outlined in paragraphs 91–93 of his judgment, although he does give a possible example of such a case in the latter half of paragraph 94. The judgment of Lord Reed on the latter point is, however, not entirely easy to decipher. The principal difficulty lies in discerning when for this purpose a contractual right is to be viewed as 'a valuable asset' which can be protected by an award of negotiating damages. It is clear from the opening sentence of paragraph 93 that Lord Reed did not regard each and every contractual right as an asset or as property. But he does not tell us in clear terms which contractual rights will be viewed as an asset and which will not. However, it may be that the problem is greater in theory than in practice because the clear inference to be drawn from the speech of Lord Reed is that the courts will be very slow to award negotiating damages in a breach of contract case outside of the categories recognized in paragraphs 91–93, and that they are unlikely to view a mere contractual right as a 'valuable asset' which requires to be protected by the award of negotiating damages. Evidence for the latter proposition can be derived from *Priyanka Shipping Ltd* v. *Glory Bulk Carriers Pty Ltd* [2019] EWHC 2804 (Comm), [2019] 1 WLR 6677, where the breach by a purchaser of a ship of a negative covenant not to use a ship for any purpose other than demolition was held not to fall within any of the categories recognized in *Morris-Garner* so that negotiating damages were not recoverable in respect of the purchaser's subsequent use of the vessel. Although the judge granted the seller an injunction to prohibit further use by the purchaser of the vessel, this was of limited utility in relation to the purchaser's use of the vessel prior to the grant of the injunction, where the seller was confined to a claim for nominal damages given that it was not entitled to recover negotiating damages and its pleaded case did not establish that it had suffered recoverable financial loss as a result of the purchaser's breach of its undertaking.

p. 902 ↵ Lord Sumption, in his concurring judgment, adopted a rather different approach. He distinguished between three different categories of case. The first (at [110]–[111]) is where damages are 'not limited to pecuniary loss, because the claimant has an interest in the observance of his rights which extends beyond financial reparation'. Cases in this category include the invasion of property rights where the law treats the exclusive dominion over the asset in question as having a pecuniary value independent of any pecuniary detriment that he may have suffered by the breach of duty, so that the user-rent is simply the measure of that value. Lord Sumption's second category (at [112]–[114]) consists of those cases 'where the relevant obligation was in principle specifically enforceable, and the release fee was the price of non-enforcement'. His third category (at [115]–[122]) is the most difficult and consists of cases in which 'the claimant has suffered (or may be assumed to have suffered) pecuniary loss, and the notional release fee is treated as evidence of that loss'. The paradigm case in this category was stated to be the award of damages for patent infringement, but Lord Sumption did not confine this category to 'property rights' traditionally so called, so that this category can extend to 'straightforward cases of breach of contract, where no question arose of the invasion of proprietary rights'. There are clearly overlaps between the approach of Lord Sumption and that adopted by Lord Reed (and Lord Carnwath attempted to sketch the difference between the two approaches at [127]–[131], albeit Lord Reed at [101] declined to make such a comparison on the ground that their judgments 'speak for themselves'). To the extent that there is a difference between the two approaches (and that of Lord Sumption does appear to be broader than that of Lord Reed) it is the judgment of Lord Reed that will prevail, given that it commanded the majority support of the court.

The final issue to note relates to the availability of an account of profits as a remedy for breach of contract. An account of profits differs from negotiating damages in that an account of profits aims to strip the defendant of the entirety of the profit which the defendant has made from the breach of contract, while negotiating damages, as we have seen, are now properly classified as loss claims. It is, however, true that negotiating damages may operate in practice to reduce the profit which the defendant will make from what would otherwise have been its breach of contract (in the sense that the defendant will be required to pay a fee to the defendant and so reduce the profitability of its proposed course of action). Nevertheless, negotiating damages differ from an account of profits in that the latter have the effect of denying to the defendant the entirety of the profit made from the breach, whereas negotiating damages will only deprive the defendant of a share of that profit and the size of the share will depend on the outcome of any hypothetical bargain constructed by the court.

Given that an account of profits aims to deprive the defendant of the entirety of its profit from the breach of contract, it is a very powerful remedy. It could be said to be punitive in effect but it does differ from punitive damages in that an account of profits cannot exceed the profit made by the defendant from the breach, whereas there is no such ceiling in the case of punitive damages. The exceptional nature of the remedy of an account of profits was referred to by Lord Reed at point 11 in paragraph 95 of his judgment. There he stated that, other than in 'exceptional circumstances', common law damages for breach of contract cannot be awarded merely for the purpose of depriving the defendant of profits made as a result of the breach of contract. The reference to 'exceptional circumstances' is to the controversial decision of the House of Lords in *Attorney General* v. *Blake* [2001] 1 AC 268, where the Attorney-General was held to be entitled to recover the entirety of the profits made by the spy, George Blake, from his breach of contract in writing an autobiography
p. 903 and including within it information which he had given an undertaking to the Crown that ↵ he would not divulge. Lord Reed (at [64]–[82]) identified a number of difficulties with the speech of Lord Nicholls in *Blake*

and stated that some of it was 'not altogether easy to interpret'. But at the end of the day the 'soundness' of *Blake* was not in issue before the Supreme Court and so Lord Reed contented himself by stating (at [82]) that 'what *Blake* decided was that in exceptional circumstances an account of profits can be ordered as a remedy for breach of contract'.

In *Blake* itself the House of Lords sought to emphasize the exceptional nature of the award which they were making. However, they did not find it easy to explain exactly why the case was 'exceptional' nor is it easy to discern precisely when they envisaged that the remedy would be available in subsequent cases. Lord Nicholls in *Blake* did, however, state that the remedy of an account of profits will be available only where other contractual remedies are inadequate. Further, the claimant must generally have a 'legitimate interest' in preventing the defendant making or retaining its profit and, in deciding whether or not to order an account of profits, a court must have regard to 'all the circumstances of the case'. However, in the light of the more sceptical approach adopted by Lord Reed in *Morris-Garner*, it is probably unlikely that courts in future cases will award an account of profits where there has been a breach of an ordinary commercial contract concluded between two commercial parties.

23.10 Punitive Damages

It was held by the House of Lords in 1909 that punitive damages cannot be recovered for a breach of contract (*Addis* v. *Gramophone Co Ltd* [1909] AC 488). This absolute ban on the recovery of punitive damages for breach of contract is under some pressure as a result of the decision of the House of Lords in *Kuddus* v. *Chief Constable of Leicestershire Constabulary* [2001] UKHL 29, [2002] 2 AC 122, where it was held that, in order to recover punitive damages, it is no longer necessary for a claimant in a tort action to establish that punitive damages had been awarded in respect of that particular cause of action prior to the decision of the House of Lords in *Rookes* v. *Barnard* [1964] AC 1129. Instead, the entitlement of a claimant to recover punitive damages in the future is likely to turn on whether or not they fall within the two categories of case recognized by Lord Devlin in *Rookes*, namely oppressive, arbitrary, or unconstitutional action by servants of the government and cases in which the defendant's conduct has been calculated by him to make a profit for himself which may well exceed the compensation payable to the claimant. The scope of these categories may change slightly over time but they are likely to form the foundation for the modern law.

There are two issues here for contract law. The first is whether or not the courts will take the step of recognizing that a breach of contract can, in principle, give rise to a claim for punitive damages (on which, see R Cunnington, 'Should Punitive Damages be Part of the Judicial Arsenal in Contract Cases?' (2006) 26 *Legal Studies* 369). The second issue only arises if it is decided that the law should take the step of recognizing that punitive damages can be recovered in a breach of contract claim; this issue relates to the circumstances in which a claim for punitive damages should be available.

As to the first question, it is not at all obvious that the courts should take the step of recognizing that the courts can award punitive damages for a breach of contract. Breach of contract was never the subject of the arbitrary constraints imposed by *Rookes* because the source of the conclusion that punitive damages could not
p. 904 be recovered was not *Rookes* but ↵ the decision of the House of Lords back in *Addis*. It was the product of a considered decision, not the consequence of an arbitrary freezing of the law in 1964. On this basis contract can

be distinguished from other wrongs. It is also the case that the introduction of punitive damages might require the re-consideration of other rules of contract law, such as the rule which invalidates penalty clauses (on which see 23.11), the restricted availability of specific performance, and the reluctance to view contractual default as reprehensible or to regard the motive for breach as materially relevant (see S Rowan, 'Reflections on the Introduction of Punitive Damages for Breach of Contract' (2010) 30 *OJLS* 495). Nevertheless, the pressure to recognize that a breach of contract can, in principle, give rise to a claim for punitive damages has not gone away. The Supreme Court of Canada has recognized that punitive damages may be awarded in respect of a breach of contract upon proof of an independent actionable wrong arising out of the same facts as the breach (see *Royal Bank of Canada* v. *W Got & Associates Electric Ltd* (2000) 178 DLR (4th) 385 and *Whiten* v. *Pilot Insurance Co* [2002] SCC 18 and, more generally, J Edelman, 'Exemplary Damages for Breach of Contract' (2001) 117 *LQR* 539). Will the English courts eventually reach this conclusion? They have not done so yet (*Devenish Nutrition Ltd* v. *Sanofi-Aventis SA* [2008] EWCA Civ 1086, [2009] Ch 390, [143]) but it may be that in time they will. As Lord Nicholls stated in *A* v. *Bottrill* [2002] UKPC 44, [2003] 1 AC 449, [26], in recognizing that punitive damages can, in principle, be recovered in a case where the wrong committed by the defendant was neither intentional nor reckless, 'Never say never is a sound judicial admonition'. A refusal to recognize that a breach of contract can give rise to punitive damages may simply encourage claimants to characterize the breach as some other cause of action for the purpose of seeking punitive damages. This subterfuge will bring little credit to the law. The logic behind the abolition of the 'cause of action' test may eventually bring down the rule that a breach of contract can never give rise to a claim for punitive damages.

This leads us on to the second question. When will punitive damages be available in a breach of contract case? The answer, it is suggested, will be 'very rarely'. As both Lord Nicholls and Lord Scott pointed out in *Kuddus* (at [67] and [109] respectively), the effect of *Attorney-General* v. *Blake* (to the extent that it remains good law, on which see 23.9) may well be to undermine Lord Devlin's second category in *Rookes* on the basis that 'the profit made by a wrongdoer can be extracted from him without the need to rely on … exemplary damages' ([109]). This being the case, punitive damages are only likely to be available where the breach of contract by the defendant is 'so outrageous, his disregard of the plaintiff's rights so contumelious, that something more is needed to show that the law will not tolerate such behaviour' ([63]). Such cases are likely to be few and far between. In particular, the mere fact that the defendant has broken his contract with the claimant in order to pursue a more profitable relationship with another party will not suffice to entitle the claimant to punitive damages. Much more will be required before a finding can be made that a defendant has behaved in an 'outrageous' fashion.

23.11 Agreed Damages Clauses

It is open to contracting parties to make their own provision for the consequences of a breach of contract. Thus they can insert into the contract a clause which quantifies, or liquidates, the sum payable on the occurrence of a breach of contract. Lord Leggatt in *Triple Point Technology Inc* v. *PTT Public Co Ltd* [2021] UKSC 29, [2021] AC 1148, [74] explained the function of such clauses as follows:

p. 905 ↵

> A liquidated damages clause is a clause in a contract which stipulates what amount of money will be payable as damages for loss caused by a breach of the contract irrespective of what loss may actually be suffered if a breach of the relevant kind (typically, delay in performance of the contract) occurs. Liquidated damages clauses are a standard feature of major construction and engineering contracts and commonly provide for damages to be payable at a specified rate for each week or day of delay in the completion of work by the contractor after the contractual completion date has passed. Such a clause serves two useful purposes. First, establishing what financial loss delay has caused the employer would often be an intractable task capable of giving rise to costly disputes. Fixing in advance the damages payable for such delay avoids such difficulty and cost. Second, such a clause limits the contractor's exposure to liability of an otherwise unknown and open-ended kind, while at the same time giving the employer certainty about the amount that it will be entitled to recover as compensation. Each party is therefore better able to manage the risk of delay in the completion of the project.

These functions are clearly beneficial. But there are potential drawbacks, particularly where the sum agreed by the parties is exorbitant. In order to guard against abuse, the courts have reserved to themselves the power to regulate these clauses. If the term in the contract making provision for the payment of damages is exorbitant and unconscionable and is held to be a penalty clause, it will not be enforced and the innocent party will be confined to a claim for damages for the recoverable loss which it can prove it has suffered as a result of the breach. On the other hand, if the term is held to be a valid agreed damages clause then it will fix the liability of the party in breach, in the sense that the sum stipulated in the clause will be the sum that must be paid, irrespective of the loss that is actually suffered on the facts of the case. It can be seen from this brief description that the vital distinction is between a valid agreed damages clause (which is enforceable) and a penalty clause (which is not). Although the distinction may seem easy to state, it has proved to be difficult to draw in practice. As Lords Neuberger and Sumption recently stated in *Cavendish Square Holding BV* v. *Talal El Makdessi* [2015] UKSC 67, [2016] AC 1172, [3], the 'penalty rule in England is an ancient, haphazardly constructed edifice which has not weathered well'.

The rule was established principally by two important decisions of the House of Lords at the beginning of the twentieth century, namely *Clydebank Engineering and Shipbuilding Co* v. *Don Jose Yzquierdo y Castaneda* [1905] AC 6 and *Dunlop Pneumatic Tyre Co Ltd* v. *New Garage and Motor Co Ltd* [1915] AC 79. Indeed, the speech of Lord Dunedin in the latter case achieved what Lords Neuberger and Sumption referred to as 'the status of a quasi-statutory code in the subsequent case law' (*Cavendish Square Holding BV* at [22]). The core elements of Lord Dunedin's speech are to be found in the following passage:

1. Though the parties to a contract who use the words ‘penalty’ or ‘liquidated damages’ may prima facie be supposed to mean what they say, yet the expression used is not conclusive. The Court must find out whether the payment stipulated is in truth a penalty or liquidated damages. This doctrine may be said to be found passim in nearly every case.

2. The essence of a penalty is a payment of money stipulated as in terrorem of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage (*Clydebank Engineering and Shipbuilding Co* v. *Don Jose Ramos Yzquierdo y Castaneda* [1905] AC 6).

p. 906

3. The question whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged as at the time of the making of the contract, not as at the time of the breach (*Public Works Commissioner* v. *Hills* [1906] AC 368 and *Webster* v. *Bosanquet* [1912] AC 394).

4. To assist this task of construction various tests have been suggested, which if applicable to the case under consideration may prove helpful, or even conclusive. Such are:

   (a) It will be held to be penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach. (Illustration given by Lord Halsbury in the *Clydebank Case* [1905] AC 6.)

   (b) It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid (*Kemble* v. *Farren* 6 Bing 141). This though one of the most ancient instances is truly a corollary to the last test. Whether it had its historical origin in the doctrine of the common law that when A. promised to pay B. a sum of money on a certain day and did not do so, B. could only recover the sum with, in certain cases, interest, but could never recover further damages for non-timeous payment, or whether it was a survival of the time when equity reformed unconscionable bargains merely because they were unconscionable,—a subject which much exercised Jessel MR in *Wallis* v. *Smith* 21 Ch D 243—is probably more interesting than material.

   (c) There is a presumption (but no more) that it is penalty when ‘a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage’ (Lord Watson in *Lord Elphinstone* v. *Monkland Iron and Coal Co* 11 App Cas 332).

   On the other hand:

   (d) It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties (*Clydebank* Case [1905] AC 6, 11, Lord Halsbury; *Webster* v. *Bosanquet* [1912] AC 394, 398, Lord Mersey).

In *Cavendish Square Holding BV* Lords Neuberger and Sumption expressed the view (at [22]) that this status as a 'quasi-statutory code' was 'unfortunate' and not what Lord Dunedin had himself intended. Although Lord Dunedin's speech has given rise to some difficulty in subsequent case-law, the first and the third of his propositions have not proved to be particularly controversial. The first proposition is that the parties' choice of label is relevant but not conclusive so that the courts can override the label used by the parties if satisfied that it does not reflect the 'true' nature of the transaction that has been concluded by the parties. The third proposition is that the court must focus attention on the time of entry into the contract and not the time of breach, nor the date of the hearing. This enables the parties to know where they stand in the sense that the validity of the clause does not hinge upon future, unknown events. Thus the fact that, with the benefit of hindsight, we can see that the figure chosen by the parties was incorrect does not lead to the conclusion that the clause must be penal. It is the intention of the parties at the moment of entry into the contract that is
p. 907 decisive. ↵ Nevertheless, there may be cases in which the courts will have regard to events subsequent to the making of the contract for the purpose of ascertaining the intended scope of the clause. In *Philips Hong Kong Ltd* v. *Attorney-General of Hong Kong* (1993) 61 BLR 41 Lord Woolf stated (at p. 59) that what actually happened can 'provide valuable evidence as to what could reasonably be expected to be the loss at the time the contract was made'.

By contrast, the second and the fourth propositions (the latter consisting of four sub-propositions) have been more problematic. There are two problems with the second proposition. The first is that it is not clear that the phrase 'in terrorem' is a helpful one given that commercial parties are unlikely to be put in genuine fear as a result of the appearance of an agreed damages clause in a contract. The second is that a clause may be neither a 'genuine covenanted pre-estimate of loss' nor a clause 'stipulated as in terrorem of the offending party'. For example, the figure stipulated in the clause may be higher than a pre-estimate of loss but not so high as to be 'in terrorem'. In such a case, is the clause a penalty clause or not?

The fourth proposition consists of a series of tests that, depending on the facts, 'may prove helpful, or even conclusive'. These tests work tolerably well in cases where the parties enter into a contract with a view to obtaining a measurable financial return. In such a case, if the stipulated sum significantly exceeds the anticipated financial return, the clause is likely to be classified as a penalty. More difficult is the case where the contract was not entered into with the object of obtaining an easily identifiable financial return. An example in the latter category might be a public authority entering into a contract for the improvement of the transport infrastructure in its region. In the event that the contractor completes the works late, how is a court to assess the loss likely to be suffered by the public authority and then ascertain whether the clause is a valid liquidated damages clause or a penalty clause? A case of this type would appear to fall within paragraph 4(d) of Lord Dunedin's summary so that the parties should be given a considerable degree of latitude in fixing the damages payable without falling foul of the penalty rule (see, for example, *Philips Hong Kong Ltd* v. *Attorney-General of Hong Kong* (1993) 61 BLR 41).

The difficulties involved in applying Lord Dunedin's tests to 'more complex cases' (per Lords Neuberger and Sumption in *Cavendish Square Holding BV* at [22]) led some judges to develop a different test in which the important question to be answered was whether the clause was 'commercially justifiable' (see, for example, *Lordsvale Finance plc* v. *Bank of Zambia* [1996] QB 752 and *Murray* v. *Leisureplay plc* [2005] EWCA Civ 963, [2005] IRLR 946). If the clause was 'commercially justifiable' then it was not a penalty clause. The development of this test injected a greater degree of uncertainty into the law. The lack of clarity as to the test to be applied led

to questions about the scope of the rule and indeed the justification for its very existence. These concerns were addressed directly by the Supreme Court when it heard the conjoined appeals in *Cavendish Square Holding BV* v. *Talal El Makdessi* and *ParkingEye Ltd* v. *Beavis* [2015] UKSC 67, [2016] AC 1172. In short the Supreme Court decided that the penalty clause rule should neither be abolished nor extended but it recast the test to be applied when seeking to distinguish a liquidated damages clause from a penalty clause.

We shall first consider the test which is to be applied by a court in order to differentiate between a liquidated damages clause and a penalty clause before turning to discuss the scope of the penalty rule and the justifications that have been given in support of its continued existence.

The test to be applied when seeking to distinguish between a liquidated damage clause and a penalty clause was variously described by the Supreme Court Justices in *Cavendish Square Holding BV*. Lords Neuberger and Sumption stated (at [31]–[32]) that:

p. 908 ↵

> [t]he real question when a contractual provision is challenged as a penalty is whether it is penal, not whether it is a pre-estimate of loss. These are not natural opposites or mutually exclusive categories. A damages clause may be neither or both. The fact that the clause is not a pre-estimate of loss does not therefore, at any rate without more, mean that it is penal. To describe it as a deterrent (or, to use the Latin equivalent, *in terrorem*) does not add anything. A deterrent provision in a contract is simply one species of provision designed to influence the conduct of the party potentially affected. It is no different in this respect from a contractual inducement. Neither is it inherently penal or contrary to the policy of the law. The question whether it is enforceable should depend on whether the means by which the contracting party's conduct is to be influenced are 'unconscionable' or (which will usually amount to the same thing) 'extravagant' by reference to some norm.
>
> The true test is whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation. The innocent party can have no proper interest in simply punishing the defaulter. His interest is in performance or in some appropriate alternative to performance. In the case of a straightforward damages clause, that interest will rarely extend beyond compensation for the breach, and we therefore expect that Lord Dunedin's four tests would usually be perfectly adequate to determine its validity. But compensation is not necessarily the only legitimate interest that the innocent party may have in the performance of the defaulter's primary obligations. This was recognised in the early days of the penalty rule, when it was still the creature of equity, and … it is recognised in the more recent decisions about commercial justification.

Lord Mance sought to draw the distinction in the following terms (at [152]):

> [T]he dichotomy between the compensatory and the penal is not exclusive. There may be interests beyond the compensatory which justify the imposition on a party in breach of an additional financial burden. The maintenance of a system of trade, which only functions if all trading partners adhere to it (*Dunlop*), may itself be viewed in this light; so can terms of settlement which provide on default for payment of costs which a party was prepared to forego if the settlement was honoured …; likewise, also the revision of financial terms to match circumstances disclosed or brought about by a breach (*Lordsvale* and other cases). What is necessary in each case is to consider, first, whether any (and if so what) legitimate business interest is served and protected by the clause, and, second, whether, assuming such an interest to exist, the provision made for the interest is nevertheless in the circumstances extravagant, exorbitant or unconscionable. In judging what is extravagant, exorbitant or unconscionable, I consider (despite contrary expressions of view) that the extent to which the parties were negotiating at arm's length on the basis of legal advice and had every opportunity to appreciate what they were agreeing must at least be a relevant factor.

Finally, Lord Hodge adopted the following test (at [255]):

> I therefore conclude that the correct test for a penalty is whether the sum or remedy stipulated as a consequence of a breach of contract is exorbitant or unconscionable when regard is had to the innocent party's interest in the performance of the contract. Where the test is to be applied to a clause fixing the level of damages to be paid on breach, an extravagant disproportion between the stipulated sum and the highest level of damages that could possibly arise from the breach would
p. 909 amount to a penalty and thus be unenforceable. ↵ In other circumstances the contractual provision that applies on breach is measured against the interest of the innocent party which is protected by the contract and the court asks whether the remedy is exorbitant or unconscionable.

It can be seen that there are common elements to these accounts of the test that is to be applied by the court. The first is the emphasis on the need for the sum to be 'extravagant' or 'unconscionable' before the term will be held to be a penalty. This strongly suggests that the standard of review is not particularly high. The reason for this is that 'the penalty rule is an interference with freedom of contract' (*Cavendish Square Holding BV* at [33]) and, as such, must be kept within narrow bounds. While the rule 'does not normally depend for its operation on a finding that advantage was taken of one party', Lords Neuberger and Sumption pointed out (at [35]) that:

> for all that, the circumstances in which the contract was made are not entirely irrelevant. In a negotiated contract between properly advised parties of comparable bargaining power, the strong initial presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach. In that connection, it is worth noting that in *Philips Hong Kong* at pp 57–59, Lord Woolf specifically referred to the possibility of taking into account the fact that 'one of the parties to the contract is able to dominate the other as to the choice of the terms of a contract' when deciding whether a damages clause was a penalty. In doing so, he reflected the view expressed by Mason and Wilson JJ in [*AMEV-UDC Finance Lyd* v. *Austin* (1986) 162 CLR 170, 194] that the courts were thereby able to 'strike a balance between the competing interests of freedom of contract and protection of weak contracting parties' (citing Atiyah, *The Rise and Fall of Freedom of Contract* (1979), Chapter 22). However, Lord Woolf was rightly at pains to point out that this did not mean that the courts could thereby adopt 'some broader discretionary approach'.

On this basis, the rule should have relatively limited impact on contract terms agreed between commercial parties who are of roughly equal bargaining power and have access to skilled legal advice.

The second point to note is the reference to the 'legitimate' interests of the party seeking to enforce the clause. In adopting this language the Supreme Court explicitly recognized that the interest of a contracting party is not necessarily a financial one. Thus Lords Neuberger and Sumption stated (at [28]) that:

> [a] damages clause may properly be justified by some other consideration than the desire to recover compensation for a breach. This must depend on whether the innocent party has a legitimate interest in performance extending beyond the prospect of pecuniary compensation flowing directly from the breach in question.

There are likely to be many cases where the only legitimate interest of a contracting party is a financial one. As Lord Hodge observed (at [249]): 'where the obligation which has been breached is to pay money on a certain date, the innocent party's interests are normally fully served by the payment of the stipulated sum together with interest and the costs of recovery.' But in other cases the legitimate interest may extend beyond the purely financial and, as Lord Mance observed (at [152]), encompass broader interests such as the maintenance of its business systems or pricing structure (contrast *Denka Advantech Pte Ltd* v. *Seraya Energy Pte*
p. 910 *Ltd* ↵ [2020] SGCA 119, [2021] BLR 340, [185] where the Court of Appeal of Singapore held that the only legitimate interest with which the penalty clause rule is concerned is that of compensation). While the identification of a 'legitimate' interest may not always be straightforward, it is a standard that is used elsewhere in the law of contract (see in particular the judgment of lord Reid in *White & Carter (Councils) Ltd* v. *McGregor* [1962] AC 413, 22.6) and it recognizes the reality that parties do not enter into contracts with the sole aim of improving their financial position.

Having identified the factors that the courts take into account in seeking to differentiate between a liquidated damages clause and a penalty clause, what is the scope of the rule? In other words, to what terms does the rule apply? The short answer is that it applies to an obligation that is triggered by a breach of contract. The classic example is a sum of money that is payable on a breach of contract. But it also encompasses an obligation to transfer property on a breach of contract (*Cavendish Square Holding BV* at [16], [157]–[159] and [230]), a term

which permits the innocent party to withhold payments on a breach (*Cavendish Square Holding BV* at [154]–[156] and [226]) and, potentially a clause which requires a purchaser to pay an extravagant non-refundable deposit (*Cavendish Square Holding BV* at [16] and [234]). The inclusion of clauses that entitle a party to withhold money on breach raises the question of where the dividing line is to be drawn between the penalty rule and the rules relating to relief against forfeiture. Lord Hodge (at [227]) saw no difficulty in concluding that a clause could fall within both rules. He stated:

> There is no reason in principle why a contractual provision, which involves forfeiture of sums otherwise due, should not be subjected to the rule against penalties, if the forfeiture is wholly disproportionate either to the loss suffered by the innocent party or to another justifiable commercial interest which that party has sought to protect by the clause. If the forfeiture is not so exorbitant and therefore is enforceable under the rule against penalties, the court can then consider whether under English law it should grant equitable relief from forfeiture, looking at the position of the parties after the breach and the circumstances in which the contract was broken. This was the approach which Dillon LJ adopted in *BICC plc* v. *Burndy Corpn* [1985] Ch 232 and in which Ackner LJ concurred. The court risks no confusion if it asks first whether, as a matter of construction, the clause is a penalty and, if it answers that question in the negative, considers whether relief in equity should be granted having regard to the position of the parties after the breach.

Lord Mance (at [160]–[161]), Lord Clarke (at [291]) and Lord Toulson (at [294]) reached the same conclusion on the latter point (Lords Neuberger and Sumption reserved their opinion at [18]).

The common denominator in all of these cases is that the penalty clause rule only applies in the context of a breach of contract. This has been established law in England for many years (see, for example, *Export Credit Guarantee Department* v. *Universe Oil Products Ltd* [1983] 1 WLR 399). On this basis the rule has no application to a sum that is payable on an event which is not a breach of contract. The reasons for so confining the penalty clause rule have long been open to question. Thus Lord Denning in *Campbell Discount Ltd* v. *Bridge* [1962] AC 600, 629 observed that the insistence upon the need for a breach means that equity commits itself to the 'absurd paradox' that it will protect the party who breaks his contract but not the party who honestly admits his inability to perform his obligations under the contract and exercises his contractual right to bring the contract to an end. Further, the High Court of Australia in *Andrews* v. *Australia and New Zealand Banking Group* p. 911 *Ltd* (2012) 247 CLR 205, ↵ [2013] BLR 111 rejected this 'breach limitation' and held that, as a matter of Australian law, the penalty clause jurisdiction is not confined to cases in which a sum of money is payable upon a breach of contract. The Supreme Court considered such an extension of the penalty rule in *Cavendish Square Holding BV* but rejected it (as did the Court of Appeal of Singapore in *Denka Advantech Pte Ltd* v. *Seraya Energy Pte Ltd* [2020] SGCA 119, [2021] BLR 340, [185]). Lords Neuberger and Sumption stated (at [13]) that 'there is a fundamental difference between a jurisdiction to review the fairness of a contractual obligation and a jurisdiction to regulate the remedy for its breach … The penalty rule regulates only the remedies available for breach of a party's primary obligations, not the primary obligations themselves' (see to similar effect Lord Mance at [130]). The difficulty the 'breach limitation' introduces is that it can be bypassed by clever drafting (see Lord Mance at [130]) in that, while a secondary obligation providing a contractual alternative to damages at law is within the rule, a conditional primary obligation is outside its scope (see Lords Neuberger and Sumption at [14] and see also *Vivienne Westwood Ltd* v. *Conduit Street Development Ltd* [2017] EWHC 350 (Ch)).

This sharp distinction may not be apparent to the uninitiated. However, there may be an escape route for such parties. Lord Hodge (at [258]) stated that, in the case where the parties have 'circumvented' the rule but 'the substance of the contractual arrangement is the Imposition of punishment for breach of contract, the concept of a disguised penalty may enable a court to intervene' (see also the reference to 'the substance of the term and not on its form or on the label which the parties have chosen to attach to it' in the judgment of Lords Neuberger and Sumption at [15]). In thus acknowledging the possibility of the recognition of a 'disguised penalty' the Supreme Court may have opened up a means by which the penalty rule can be extended in a way that may undermine certainty in commercial transactions. The debate here would appear to be a classic 'form and substance' debate. If the courts focus exclusively on the form of the clause, then a clause which seeks to define or modify the primary obligations of the parties should be outside the scope of the penalty clause rule. But a focus on the substance of the clause may lead to a different conclusion given that the effect of a clause which defines or modifies a primary obligation may be largely identical to a clause which makes provision for the breach of a primary obligation. The difficulty which the courts have created for themselves is that they have developed a test when seeking to determine the scope of the penalty clause rule which is one of form (namely does the clause define the primary obligations of the parties or does it impose a secondary obligation to pay damages upon breach of a primary obligation?) but then they treat the question of form as if it were one of substance when it comes to determining the potential scope of the penalty clause rule (see *Cavendish* at [15]). It is far from clear that this is a tenable position to adopt.

The final point to consider is why the Supreme Court did not take the step of abolishing the penalty clause rule entirely. This was one of the submissions that was made to them, but they rejected it for a number of reasons. First, the rule is 'a long-standing principle of English law' ([37] and [162]). Secondly, it is a rule that is 'common to almost all major systems of law, at any rate in the western world' ([37], [164]–[166], and [263]–[265]). Thirdly, although statute has intervened to regulate many unfair contract terms, 'statutory regulation is very far from covering the whole field' ([38]). Fourthly, given the incomplete statutory coverage, there is a need to retain the ability to regulate agreed damages clauses given the 'significant imbalances in negotiating power' that continue to exist in the commercial world ([262]). Fifthly, the limited nature of the rule has the consequence that it does not prevent parties from 'reaching sensible arrangements to fix the consequences of a breach of contract and thus avoid expensive disputes' ([266]). Sixthly, to the extent that the rule was said to
p. 912 give rise to anomalies, these anomalies were 'better addressed' by 'a realistic appraisal of the ↵ substance of contractual provisions operating upon breach' and 'by taking a more principled approach to the interests that may properly be protected by the terms of the parties' agreement' ([39]).

Similarly, the submission that the penalty rule should no longer apply to commercial transactions in which the parties were of equal bargaining power and each acted on skilled legal advice was rejected because it would require the court to define what for this purpose counts as a 'commercial' transaction, what amounts to 'equal bargaining power' and 'skilled legal advice' ([168] and [267]). For the reasons given earlier, the rule may not often strike down agreed damages clauses in such contracts, but such parties are not exempt from the penalty rule. Thus the penalty rule continues to be a part of English contract law so that, while contracting parties retain significant contractual freedom in relation to the agreement of the sum that is payable in the event of a breach of contract, the courts in turn have retained their historic jurisdiction to render unenforceable a term which purports to make payable on a breach of contract a sum which is extravagant, exorbitant, or unconscionable when regard is had to the innocent party's legitimate interest in the performance of the contract.

23.12 Deposits and Part Payments

Rather than include in the contract a provision to the effect that a particular sum is payable on a breach of contract, the contract may provide that a sum of money is to be paid up front and that it will not be returned in the event of a failure by the party making the payment to perform his contractual obligations. One obvious advantage of this type of clause is that it is not necessary to initiate legal proceedings in order to recover the agreed sum because it is paid in advance. The onus is put on the party who has paid the money to take steps to recover the prepayment. The entitlement of the party in breach to recover his prepayment will depend upon the nature of the prepayment that has been made. Where the money has been paid by way of a deposit, it is less likely to be recoverable than in the case where it is a part payment of the contract price.

A deposit is a security and is generally irrecoverable, whereas a part payment is simply a part payment of the price and is recoverable by the party in breach in the event of termination of the contract. Whether a payment is made by way of deposit or part payment of the price is a question of construction and, in cases of doubt, it will generally be regarded as a part payment (*Dies* v. *British and International Mining and Finance Co* [1939] 1 KB 715).

The general rule is that a part payment is recoverable by the party in breach subject to his liability in damages for the loss caused to the innocent party by his breach of contract (see *Dies*). However, the right of the party in breach to recover his prepayment is not unqualified. In a case where it is clear from the contract that the payee will have to incur reliance expenditure before completing his performance of the contract, then, in the absence of a stipulation in the contract to the contrary, the part payment will generally be irrecoverable (*Hyundai Shipbuilding and Heavy Industries Ltd* v. *Papadopoulos* [1980] 1 WLR 1129). Indeed, it may be the case that a prepayment is only recoverable where the payer can demonstrate that it has been paid for a consideration that has totally failed.

The general rule in relation to deposits is that they are not recoverable by the party in breach. The function of a deposit is to serve as a security against a breach of contract and so, were it to be recoverable upon a breach, it would defeat its function as a security. The right of the recipient to retain the deposit is not, however, unqualified. The right of a payee to retain a deposit was qualified by the Privy Council in the following case:

p. 913 ***Workers Trust and Merchant Bank Ltd v. Dojap Investments Ltd***
[1993] AC 573, Privy Council

Vendors of property sought to forfeit a deposit of 25 per cent of the purchase price when the purchaser failed to pay the balance of the purchase price within the fourteen days stipulated in the contract, time being of the essence of the contract. The purchasers did tender the balance of the purchase price with interest a week later but the vendors returned the cheque and purported to forfeit the deposit of almost Jamaican $3 million. The Privy Council held that the vendors were not entitled to retain the deposit and ordered that it be repaid to the purchasers after subtracting from it any loss which the vendors could prove they had suffered as a result of the purchasers' breach.

Lord Browne-Wilkinson

In general, a contractual provision which requires one party in the event of his breach of the contract to pay or forfeit a sum of money to the other party is unlawful as being a penalty, unless such provision can be justified as being a payment of liquidated damages being a genuine pre-estimate of the loss which the innocent party will incur by reason of the breach. One exception to this general rule is the provision for the payment of a deposit by the purchaser on a contract for the sale of land. Ancient law has established that the forfeiture of such a deposit (customarily 10 per cent. of the contract price) does not fall within the general rule and can be validly forfeited even though the amount of the deposit bears no reference to the anticipated loss to the vendor flowing from the breach of contract.

This exception is anomalous and at least one textbook writer has been surprised that the courts of equity ever countenanced it: see Farrand, *Contract and Conveyance*, ^{4t}h ed. (1983), p. 204. The special treatment afforded to such a deposit derives from the ancient custom of providing an earnest for the performance of a contract in the form of giving either some physical token of earnest (such as a ring) or earnest money. The history of the law of deposits can be traced to the Roman law of arra, and possibly further back still: see *Howe* v. *Smith* (1884) 27 Ch D 89, 101–102, per Fry LJ. Ever since the decision in *Howe* v. *Smith*, the nature of such a deposit has been settled in English law. Even in the absence of express contractual provision, it is an earnest for the performance of the contract: in the event of completion of the contract the deposit is applicable towards payment of the purchase price; in the event of the purchaser's failure to complete in accordance with the terms of the contract, the deposit is forfeit, equity having no power to relieve against such forfeiture.

However, the special treatment afforded to deposits is plainly capable of being abused if the parties to a contract, by attaching the label 'deposit' to any penalty, could escape the general rule which renders penalties unenforceable. There are two authorities which indicate that this cannot be done. In *Stockloser* v. *Johnson* [1954] 1 QB 476, Denning LJ in considering the power of the court to relieve against forfeiture said, obiter, at p. 491:

> 'Again, suppose that a vendor of property, in lieu of the usual 10 per cent. deposit, stipulates for an initial payment of 50 per cent. of the price as a deposit and part payment; and later, when the purchaser fails to complete, the vendor resells the property at a profit and in addition claims to forfeit the 50 per cent. deposit. Surely the court will relieve against the forfeiture. The vendor cannot forestall this equity by describing an extravagant sum as a deposit, any more than he can recover a penalty by calling it liquidated damages.'

In *Linggi Plantations Ltd* v. *Jagatheesan* [1972] 1 MLJ 89 Lord Hailsham of St Marylebone LC delivered
p. 914 the judgment of the Board which upheld the claim to forfeit a normal ↵ 10 per cent. deposit even though the vendor had in fact suffered no loss. He referred on a number of occasions to a requirement that the amount of a deposit should be 'reasonable' and said, at p. 94:

> 'It is also no doubt possible that in a particular contract the parties may use language normally appropriate to deposits properly so-called even to forfeiture which turn out on investigation to be purely colourable and that in such a case the real nature of the transaction might turn out to be the imposition of a penalty, by purporting to render forfeit something which is in truth part payment. This no doubt explains why in some cases the irrecoverable nature of a deposit is qualified by the insertion of the adjective "reasonable" before the noun. But the truth is that a reasonable deposit has always been regarded as a guarantee of performance as well as a payment on account, and its forfeiture has never been regarded as a penalty in English law or common English usage.'

In the view of their Lordships these passages accurately reflect the law. It is not possible for the parties to attach the incidents of a deposit to the payment of a sum of money unless such sum is reasonable as earnest money. The question therefore is whether or not the deposit of 25 per cent. in this case was reasonable as being in line with the traditional concept of earnest money or was in truth a penalty intended to act in terrorem.

Zacca CJ tested the question of 'reasonableness' by reference to the evidence before him that it was of common occurrence for banks in Jamaica selling property at auction to demand deposits of between 15 per cent. and 50 per cent. He held that, since this was a common practice, it was reasonable. Like the Court of Appeal, their Lordships are unable to accept this reasoning. In order to be reasonable a true deposit must be objectively operating as 'earnest money' and not as a penalty. To allow the test of reasonableness to depend upon the practice of one class of vendor, which exercises considerable financial muscle, would be to allow them to evade the law against penalties by adopting practices of their own.

However although their Lordships are satisfied that the practice of a limited class of vendors cannot determine the reasonableness of a deposit, it is more difficult to define what the test should be. Since a true deposit may take effect as a penalty, albeit one permitted by law, it is hard to draw a line between a reasonable, permissible amount of penalty and an unreasonable, impermissible penalty. In their Lordships' view the correct approach is to start from the position that, without logic but by long

> continued usage both in the United Kingdom and formerly in Jamaica, the customary deposit has been 10 per cent. A vendor who seeks to obtain a larger amount by way of forfeitable deposit must show special circumstances which justify such a deposit.
>
> [He considered the evidence advanced to support the validity of a deposit of 25 per cent and concluded]
>
> Their Lordships agree with the Court of Appeal that this evidence falls far short of showing that it was reasonable to stipulate for a forfeitable deposit of 25 per cent. of the purchase price or indeed any deposit in excess of 10 per cent. ...
>
> The question therefore arises whether the court has jurisdiction to relieve against the express provision of the contract that the deposit of 25 per cent. was to be forfeited. ... In the view of their Lordships, since the 25 per cent. deposit was not a true deposit by way of earnest, the provision for its forfeiture was a plain penalty. There is clear authority that in a case of a sum paid by one party to another under the contract as security for the performance of that contract, a provision for its forfeiture in the event of non-performance is a penalty from which the court will give relief by ordering repayment of the sum so paid, less any damage actually proved to have been suffered as a
> p. 915 result of non-completion: *Commissioner of Public Works* v. *Hills* ↵ [1906] AC 368. Accordingly, there is jurisdiction in the court to order repayment of the 25 per cent. deposit.
>
> The Court of Appeal took a middle course by ordering the repayment of 15 per cent. out of the 25 per cent. deposit, leaving the bank with its normal 10 per cent. deposit which it was entitled to forfeit. Their Lordships are unable to agree that this is the correct order. The bank has contracted for a deposit consisting of one globular sum, being 25 per cent. of the purchase price. If a deposit of 25 per cent. constitutes an unreasonable sum and is not therefore a true deposit, it must be repaid as a whole. The bank has never stipulated for a reasonable deposit of 10 per cent.: therefore it has no right to such a limited payment. If it cannot establish that the whole sum was truly a deposit, it has not contracted for a true deposit at all.

Commentary

Three points should be noted about this decision. First, it may begin the process of bringing the law relating to deposits closer to the law relating to liquidated damages clauses (see, for example, *UK Housing Alliance (North West) Ltd* v. *Francis* [2010] EWCA Civ 117, [2010] 3 All ER 519, [12], where Longmore LJ stated that the Privy Council 'applied the law on penalties since the sum was payable on breach'). However, the rules are not yet identical. It cannot be said that a 'reasonable' deposit must be a 'genuine pre-estimate of the loss' (to the extent that this is still the test when considering whether a clause is to be regarded as a penalty clause) but it would appear that a genuine pre-estimate of the loss will be a reasonable deposit. The reason it cannot be said that a deposit must be a genuine pre-estimate of the loss is that, in the case of contracts for the sale of land, a 10 per cent deposit is reasonable even in the case where it is not a genuine pre-estimate of the loss. The Supreme Court in *Cavendish Square Holding BV* v. *Talal El Makdessi* [2015] UKSC 67, [2016] AC 1172, [16] and [234] recognized that a clause which requires a purchaser to pay an extravagant non-refundable deposit may fall within the scope of the penalty rule. But the Supreme Court did not attempt fully to assimilate the penalty rule

and the rules relating to relief against forfeiture. Rather, they concluded that the penalty rule and the rule relating to relief from forfeiture could be applied sequentially. In other words, the court should first ask whether, as a matter of construction, the clause is a penalty and, if the answer to that question is in the negative, it should ask whether (where relevant) relief against forfeiture should be granted in equity having regard to the position of each of the parties after the breach (see Lord Clarke at [291], Lord Toulson at [294], Lord Hodge at [227], Lord Mance at [160]–[161]: Lords Neuberger and Sumption reserved their position on this point at [18] but referred to *Dojap* with approval at [16]).

The second point relates to the role of market practice in determining whether a deposit is reasonable. In the case of the sale of land, market practice is a substantial factor in support of the conclusion that a 10 per cent deposit is reasonable but market practice is not determinative (as can be seen from the reluctance of the Privy Council to concede that 25 per cent was a reasonable deposit because there was some evidence of a practice of taking such a deposit). Thirdly, the case underlines the danger of asking for too big a deposit. The court will not re-write the terms of the deposit. Instead it will strike down an unreasonable deposit and relegate the claimant to a claim for damages. This being the case, it is better to err on the side of caution. One view is to say that a party should not ask for more than a genuine pre-estimate of his loss because, if he does so, he runs the risk that the deposit will be unreasonable. If this is the case, the law relating to liquidated damages clauses and deposits may be closer in substance than we are often led to believe.

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