claiming damages, is discussed in some detail. The authors criticise Lord Reid's analogy with penalties arguing persuasively that it is hard to characterise as a penalty, the contract price earned by the innocent party. Perhaps the better analogy might be with the obligation of an innocent party to mitigate its damages so that a party who persists in the useless performance of a contract may incur needless damages and, arguably, not be compensated in such a case.

Another interesting part of the book is the discussion of privity of contract. The varying approaches to the restrictions of the privity doctrine adopted by the High Court in *Trident General Insurance Co Ltd v McNiece Bros Pty Limited* ([1988] 165 CLR 107) have made this a topical issue. The case is clearly and succinctly discussed and future developments are canvassed, although not in the detail that an enthusiast might wish. Nevertheless, the purpose of the book as outlined in the first paragraph of this review probably precludes a more detailed discussion.

As stated above, this is a comprehensive book. It deals successively with the history and theory of contract law, the formation of contracts, terms, parties, matters effecting contractual consent, illegality of contracts, performance breach, termination and remedies. It encompasses the law in all nine Australian jurisdictions as well as containing references to relevant law of other jurisdictions.

This is primarily an Australian book and reflects the fact that Australian contract law, at least, has come of age and the slavish adherence to English precedent is a thing of the past. Basically the book is a 'good read'. Its commendable clarity of expression and structure result in it being always clear and, at its best, enticing to read. The authors are to be congratulated on their achievement.

MARGARET STONE

Retrieving Reasons, Retrieving Rationality? A New Look at the Right to Withdraw for Breach of Contract

*Roger Brownsword**

I

In which circumstances should an innocent party to a commercial contract have the right to withdraw for breach?[1] In other words, when should the innocent party have the option of discharging itself (and the contract-breaker) from any further primary obligations under the contract?[2] Subject to a particular term being designated as a condition by virtue of legislation, precedent, or express agreement, and subject to the right to withdraw being expressly reserved, English law treats withdrawal as an exceptional form of relief, to be available only where damages would not be an adequate remedy. Accordingly, if we follow this approach, the critical question (in the absence of prior determination by law or by agreement)[3] is to identify just when and why damages would not adequately compensate the innocent party for the breach. This sounds straightforward enough. Yet, as is well known, the question of the right to withdraw for breach has, for some time, been a vexed matter in the English law of contract.[4]

To implement the principle that the right to withdraw for breach should be available only where damages would not be adequate, a

* Professor of Law, University of Sheffield. An earlier draft of this paper was given in September 1991 at the Second Annual Conference of the *Journal of Contract Law*. I am grateful to Michael Furmston, who responded on that occasion, as well as to the conferees for their constructive questions and comments. I am also grateful to my colleague, Robert Bradgate, for helpful suggestions concerning suggested reason 6. And, last but by no means least, I am indebted to John Carter for supplying me with detailed written comments on (and various materials concerning) that earlier draft.

1 There is a distinction between 'having the right to withdraw for breach' in the sense of (i) having the option to elect between withdrawal and continuation, and (ii) exercising the option in favour of withdrawal in a valid manner. The focus of this paper is on (i).

2 Cf Lord Diplock's oft cited dictum in *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827 at 849, to the effect that the expression 'breach of condition' should be reserved for situations where 'the contracting parties have agreed, whether by express words, or by implication of law, that *any* failure by one party to perform a primary obligation, irrespective of the gravity of the event that has in fact resulted from the breach, shall entitle the other party to elect to put an end to all primary obligations of both parties remaining unperformed . . .'

3 Of course, in standard form commercial contracts, provision for the right to withdraw will be commonplace.

4 The matter is vexed at more than one level. Quite apart from any surface doctrinal tensions, there are different views about how far the law should strive for calculability in the face of hard cases (see section II below). This is reflected in wholesale judicial disagreements as the law is applied to particular cases. For example, the Court of Appeal reversed Mocatta J in both *Maredelanto Cia Naviera SA v Bergbau-Handel GmbH: The Mihalis Angelos* [1971] 1 QB 164 and *Cehave NV v Bremer Handelsgesellschaft mbH: The Hansa Nord* [1976] QB 44. In the former, Mocatta J was

familiar litany of tests and approaches has been suggested. Thus, if we follow the traditional classification approach, the test is whether the breach goes to the root of the contract, or whether it strikes at an essential or a fundamental term;[5] if we apply the modern *Hong Kong*[6] approach — at any rate, as it is narrowly interpreted[7] — the question is whether the actual consequences of the breach have deprived the innocent party of substantially the whole benefit of what has been bargained for; while, if we adopt the test proposed by Buckley LJ in the *Decro Wall*[8] case, the question is whether 'the consequences of the breach [are] such that it would be unfair to the injured party to hold him to the contract and leave him to the remedy in damages as and when a breach or breaches may occur'.[9] In other words, the law suggests a number of criteria for assessing the adequacy of damages, in particular, the importance of the term which has been breached (given the surrounding contractual circumstances and the presumed intentions of the parties),[10] the seriousness of the actual consequences of the breach, and the fairness of denying to the innocent party the option of withdrawal.

Now, if one were to start afresh with this, the key issue surely would be whether the innocent party had *good reasons* for claiming a right to withdraw for breach, rather than settling for damages alone. Whilst it might be argued that this very idea is immanent in the existing law — in the sense that the various tests proposed are precisely attempts to identify situations where the innocent party would have good reasons for claiming a right to withdraw[11] — the fact of the matter is that the existing law fails to take into account, in an explicit and coherent way, the reasons

(cont) held to have relied mistakenly on the modern *Hong Kong* approach (see below, n 6 and 7) rather than the traditional classification approach, while in the latter he was held to have wrongly employed the traditional classification approach rather than the modern *Hong Kong* approach. More recently, and not untypically, in *Cie Commerciale Sucres et Denrees v C Czarnikow Ltd: The Naxos* [1990] 3 All ER 641, on the question of whether a particular term was a condition (giving the buyers the right to withdraw), whereas the arbitrator and the majority of the House of Lords held that it was, Gatehouse J and the majority of the Court of Appeal held that it was not.

5 See eg *Bettini v Gye* (1876) 1 QBD 183 at 188.

6 See *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26.

7 See Diplock LJ's judgment ibid, at pp 69–72. For a broader approach, in which less emphasis is placed on the actual events following the breach, and more weight is attached to 'the nature of the breach and its foreseeable consequences' see Upjohn LJ ibid, at p 64. See also *Bunge Corp v Tradax SA* [1981] 2 All ER 513 at 543 (Lord Scarman).

8 *Decro-Wall International SA v Practitioners in Marketing Ltd* [1971] 2 All ER 216.

9 [1971] 2 All ER 216 at 232.

10 For Bowen LJ's classic articulation of this idea, see *Bentsen v Taylor Sons and Co* [1893] 2 QB 274 at 281.

11 For example, in *Bettini v Gye* (1876) 1 QBD 183 at 188, it was implied that, in looking at whether a breach of a particular term went to the root of the contract, or rendered performance different in substance from that stipulated for, the question was whether damages would adequately compensate for the breach. This, it might be argued, was simply an elliptical way of saying that, where the breach goes to the root (or cannot be adequately compensated by the payment of damages), then the innocent party has good reason for claiming the option of withdrawal.

underlying the innocent party's claimed right to withdraw. What this signifies is not merely that the law is indifferent to the existence of good reasons for withdrawal, but also that it has no serious concern with bad reasons for withdrawal.

Such indifference to bad reasons has implications at two levels. First, it yields the settled principle that, *if the innocent party has the right to withdraw for breach*, then it is immaterial (in the absence of estoppel or the like) that bad legal reasons were cited at the time of withdrawal.[12] Thus, in *The Mihalis Angelos*,[13] for example, the innocent charterers were rescued from having wrongly relied on force majeure as a ground for withdrawal by the Court of Appeal holding that there was actually a breach of condition by the owners of the vessel. Secondly, and more importantly, it entails that a breach may be cited as the legal ground for withdrawal when the innocent party's reasons for seeking withdrawal are wholly unrelated to the breach. In other words, as Mellish LJ once put it, there is no requirement that the 'real reason'[14] for seeking release from a contract should coincide with the cited legal reason for withdrawal. Accordingly, an innocent party may be permitted to cite a breach as the legal reason for withdrawal when the real explanation lies in some collateral economic reason, for example, when a supplier wishes to withdraw on a rising market, or a buyer wishes to withdraw on a falling market. Indeed, *The Mihalis Angelos*, if not quite a case of economic opportunism, was just such a case of collateral economic motivation, the charterers wishing to escape from the charterparty, not because of the owners' breach, but because the supply of apatite (the intended cargo) had been interrupted by events beyond their control.

Against this background, the main idea of this paper is to explore the question of how the law might look if, in the absence of express legal provision or agreement, the starting point for judging whether damages were an adequate remedy was a consideration of the innocent party's reasons for claiming a right to withdraw for breach. In other words, how might the law look if it adopted a 'reason-centred regime', taking into account, explicitly and centrally, the innocent party's reasons for claiming a right to withdraw? Although this discussion is extremely tentative, it is apparent that a reason-centred regime would cut across the grain of English contract doctrine in at least two important respects. First, notwithstanding the reluctance of English contract lawyers to get involved with questions of intentionality, the culpability of the contract-breaker — the question of whether the breach was intentional, negligent, or entirely innocent — would be regarded as a material factor in

12 See J W Carter and D J Harland, *Contract Law in Australia*, 2nd ed Butterworths, 1991, para 1969.

13 *Maredelanto Cia Naviera SA v Bergbau-Handel GmbH: The Mihalis Angelos* [1971] 1 QB 164.

14 In *Shand v Bowes* (1876–7) 2 QBD 112 at 115, Mellish LJ observed that, if the defendant buyers' contention was accepted, then the consequence would be 'that purchasers would, without any real reason, frequently obtain an excuse for rejecting contracts when prices had dropped'. On appeal, however, the House was not impressed by this consideration, see *Bowes v Shand* (1877) 2 App Cas 455 at 465–6 (Lord Cairns LC), and 476 (Lord Hatherley).

assessing good reasons for withdrawal. Secondly, the distinction between withdrawal *'for breach'* as opposed to withdrawal following breach but *'for collateral economic reasons'*, far from being ignored, would be incorporated as a central doctrinal landmark. Moreover, since it will be contended that a purported withdrawal for breach which has actually been inspired by collateral economic reasons should be disallowed on the ground of bad faith, the reason-centred regime would nudge the English law of contract a little closer to adopting a principle of good faith. This latter point needs some expansion.

As has been intimated, where an innocent party seeks to withdraw for collateral economic reasons, the attraction of withdrawal is that it releases the party from the prices obtaining under the contract into a market with more favourable prices. Often, the price differential (between the contract and the market) will be very substantial so that large gains are to be made if only the innocent party can escape from the contract. By contrast, if the innocent party is restricted to a remedy in damages for the losses directly occasioned by the breach, no more than quite trivial sums may be recoverable. In many cases, therefore, the position is that the innocent party is not the least bit interested in recovering damages for the breach but sees great advantage in securing withdrawal. Prima facie, therefore, this seems like the perfect example of a situation where damages would not be an adequate remedy and where the innocent party would have compelling reasons for claiming the right to withdraw. However, this glosses over one of the fundamental premises of the reason-centred regime, namely that the right to withdraw for breach is precisely the right to withdraw *for breach*. What the reason-centred regime holds is *not* that the innocent party must have good reasons for preferring withdrawal to damages, but that the innocent party must have good reasons for saying that *the breach* is such that damages simply would not be adequate relief. Where the innocent party is motivated by collateral economic considerations, it is the nature of the market, not the nature of the breach, upon which the innocent party must found an argument that damages are not adequate; and this simply will not do. Accordingly, where the reason-centred regime is in place, good reasons for withdrawal must be interpreted, not as an understandable preference for withdrawal rather than damages, but as reasons which relate the inadequacy of damages to the particular breach.

In this paper, after reviewing some of the tensions and tendencies in the existing law (in section II), a sketch will be presented of a reason-centred regime, dealing first with the kind of reasons which would count as good reasons (prior determination by law or by agreement apart)[15] for having a right to withdraw for breach (in section III) and then with the question of pre-classification of terms (or prior

15 To avoid any misunderstanding, 'good reasons' must be read here as a term of art. Where the innocent party has the right to withdraw by virtue of a statutory provision, precedent, or agreement, there is, of course, good reason (in a broad sense) for claiming the right to withdraw. However, the phrase is used in this paper to point to a further category, the category of good reasons (in a technical sense), of grounds for the right to withdraw for breach.

determination of the availability of the right to withdraw) by express agreement or force of law (in section IV). By way of a conclusion, a brief comment will be offered on the rationality of a reason-centred legal regime for withdrawal for breach (in section V).

II

According to the present law, a right to withdraw for breach of a particular term may arise in one of four ways:

(1) the term in question is treated as a 'condition' in the strict sense by either statute or by precedent;
(2) the parties have expressly stipulated that the term in question shall be treated as a 'condition' in the strict sense (or the right to withdraw has been expressly reserved in the event of a particular breach);
(3) the term in question is to be treated as a 'condition' in the strict sense as a matter of necessary implication in the light of the parties' intentions;[16] or,
(4) the consequences of the breach are such as to deprive the innocent party of substantially the whole benefit of the bargain.[17]

Characteristically, when the concept of a 'condition' in the strict sense is explained, it is put as a term, any breach of which gives rise to the right to withdraw, even though the consequences of the breach might be quite trivial.[18] In other words, the relative gravity of the actual consequences of the breach is rendered an irrelevant consideration. In principle, however, it is important to grasp that there is a distinction between a condition so defined and a term any breach of which attracts a peremptory right to withdraw ('peremptory' in the sense that the innocent party, faced with a breach of the particular term, would have the right to withdraw *for any reason*). Such a peremptory right, of course, is not at all coextensive with a right to withdraw irrespective of the gravity of the actual consequences of the breach. In practice, though, English law tends to elide this distinction, treating the innocent party's reasons for seeking a right to withdraw as irrelevant in all cases, and the actual consequences of the breach as irrelevant where a particular term has been designated as a condition in the strict sense. If reasons are to be retrieved, in line with the general direction of this paper, the distinction between a condition in a strict sense (as currently understood) and a term which attracts a peremptory right to withdraw for breach also needs to be recovered.

It is generally recognised that the law on withdrawal for breach betrays a fundamental tension between the traditional classification approach and the modern *Hong Kong* approach. At one level, the problem is that

16 Seminally see *Bentsen v Taylor Sons and Co* [1893] 2 QB 274 and its application in the modern law; see eg the judgment of Kerr LJ in *Transcontinental Affiliates Ltd v State Trading Corp of India: The Sara D* [1989] 2 Lloyd's Rep 277.

17 Seminally see *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26.

18 For example, see *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827 at 849, (n 2 above). Similarly, see *The Naxos* [1989] 2 Lloyd's Rep 462 at 478 (CA), where Butler Sloss LJ says: 'But if this is a condition, any breach, however trivial, would entitle the party aggrieved to bring the contract to an end'.

the latter approach may be set up, not as a supplement to the traditional approach, but as a rival starting point. And, indeed, during the 1970s, there was something of a suspicion — fostered by cases such as *The Hansa Nord*[19] and *Reardon Smith v Hansen-Tangen*[20] — that the *Hong Kong* approach was making a takeover bid of just this kind. Accordingly, in *Bunge v Tradax*,[21] the House of Lords was at pains to emphasise the supplementary nature of the consequential approach. The *Hong Kong* approach, as Lord Roskill put it, was not 'directed to the determination of the question which terms of a particular contract are conditions'.[22] However, such formal rationalisation of doctrine cannot settle the tensions which remain as undercurrents in the law.

The point is that it is in the nature of the traditional approach, where a term may be classified as a condition in the strict sense, that the innocent party may have, unreasonably as it seems, the option of withdrawing (for example, the right to withdraw may arise in circumstances where the breach is quite unintentional or its consequences wholly trivial). Thus, for instance, in *The Chikuma*,[23] the House of Lords ruled that the appellant shipowners were entitled to withdraw their vessel when the respondent charterers, having previously paid the hire punctually, defaulted in a technical and quite minor way on the 81st payment. This, as Lord Bridge remarked, was 'yet another instance of a clause ... operating to produce what appears to be a harsh result'.[24] Similarly, in *Arcos v Ronaasen*,[25] which — at least in the context of sale of goods — is perhaps the most frequently cited illustration of this point,[26] the buyers were able to reject the timber for breach of condition even though they could have used it for precisely the intended purpose. Had a consequential test of the *Hong Kong* kind been applied, a quite different result would have been reached in these cases. However, once the law brings a consequential approach to bear on the question of

19 *Cehave NV v Bremer Handelsgesellschaft mbH: The Hansa Nord* [1976] QB 44.

20 *Reardon Smith Line Ltd v Yngvar Hansen-Tangen and Sanko SS Co Ltd: The Diana Prosperity* [1976] 3 All ER 570.

21 *Bunge Corp v Tradax SA* [1981] 2 All ER 513.

22 [1981] 2 All ER 513 at 551.

23 *Awilco A/S v Fulvia SpA di Navigazione; The Chikuma* [1981] 1 All ER 652.

24 [1981] 1 All ER 652 at 656. However, in *Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana* [1983] 2 AC 694 at 703, Lord Diplock suggested that, seen in the context of a volatile freight market, withdrawal of the vessel was not particularly harsh. He said: 'If it [ie the freight market] rises rapidly during the period of a time charter, the charterer is the beneficiary of the windfall which he can realise if he wants to by subchartering at the then market rates. What withdrawal of the vessel does is to transfer the benefit of the windfall from charterer to shipowner'. On the other hand, how plausible is this argument once one recalls that freight rates may fall, in which case the 'windfall' lies with the shipowner?

25 [1933] AC 470.

26 *Arcos* is commonly mentioned in the same breath as *Re Moore and Co Ltd and Landauer and Co* [1921] 2 KB 519, both cases offering illustrations of apparently harsh results flowing from a particular interpretation of s 13 of the Sale of Goods Act 1893 (as it then was). However, there is an important difference between the cases. Whereas *Arcos* is a blatant example of collateral economic opportunism (see text *below*), there is no indication in *Re Moore and Landauer* that the buyers were seeking to escape from the contract in order to buy in a falling market.

withdrawal for breach, it necessarily creates some uncertainty about the availability of the remedy in particular situations (and, of course, prior case law becomes much less helpful). So, to pose the issue in the standard way: the law can secure a measure of calculability (by favouring the classification approach) but at the price of some hard cases, or it can respond to hard cases (by employing the consequential approach) but at the price of jeopardising calculability, not to mention fairness (given the chill factor produced by the strictness and, to an extent, vagueness of the test), and weakening pressure for performance.[27] Thus, in *Schuler v Wickman*,[28] we find the House famously split over this dilemma, the majority favouring the consequential line, Lord Wilberforce dissenting in favour of general calculability and respect for the parties' express intentions.[29]

To this familiar tale, however, there is a further dimension to be added. It is possible to object to decisions such as those in *The Chikuma* and *Arcos v Ronaasen* on more than one ground. For the moment, let us concentrate on the latter case. As it has already been said, the popular objection to *Arcos* is that it was unreasonable to permit the buyers to reject when they could have used the timber for its intended purpose. However, there is a second line of objection. The fact is that, in *Arcos*, timber prices were falling as a result of which the buyers were keen to find a way out of the contract. Initially, when the shipping documents were tendered, the buyers purported to refuse them on the ground that the timber was not shipped 'during the Summer' as the contract provided. Having argued this without success at the ensuing arbitration, the buyers then purported to reject the timber when it arrived, this time on the ground that it did not correspond with its contractual description. Given that the timber was perfectly suitable for its intended purpose, the buyers were quite plainly looking for a breach in order to realise the economic opportunity afforded by the falling market.[30] In other words, the buyers were not rejecting *for breach* (except in the technical legal sense); the sellers' breach was merely a pretext for getting out of the bargain. Now, it would be quite wrong to suppose that the House in *Arcos* was unaware of what was really going on. On the contrary, it can be safely

27 Points strongly made by Megaw LJ in both *The Mihalis Angelos* [1971] 1 QB 164 and *Bunge v Tradax* [1981] 2 All ER 513 (CA), and powerfully underlined by Tony Weir, (1976) 35 *CLJ* 33.

28 *L Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235.

29 But cf *Mardorf Peach and Co Ltd v Attica Sea Carriers Corp of Liberia: The Laconia* [1977] AC 850 where the House, led by Lord Wilberforce, favoured certainty even if some hard cases might result (see esp Lord Salmon at 878 and Lord Fraser at 883).

30 It can be said, of course, that the question of intended purpose was immaterial since the buyers were rejecting for breach of s 13 of the Sale of Goods Act 1893 (as it then was) (ie for the failure of the timber to correspond with its contractual description). However, this begs the question of how s 13 should be interpreted, in particular how it should be read alongside the s 14 requirements. The point is that a literal interpretation of s 13, as in *Arcos*, can give buyers too easy a way out of contracts: see the observations of Lord Wilberforce in *Reardon Smith v Hansen-Tangen* [1976] 3 All ER 570 at 576. To avoid this, one has to argue for either a less literal reading of s 13 or some general restriction on the right to withdraw (the latter being the thrust of this article).

assumed that this feature of the case was perfectly well understood. Crucially, the House saw nothing wrong with the buyers taking advantage of the sellers' breach in this way. Indeed, Lord Atkin said explicitly that he accepted that it was permissible for a buyer to rely on a breach of condition in order to withdraw for collateral economic reasons on a falling market:[31]

> If a condition is not performed the buyer has a right to reject. I do not myself think that there is any difference between business men and lawyers on this matter. No doubt, in business, men often find it unnecessary or inexpedient to insist on their strict legal rights. In a normal market if they get something substantially like the specified goods they may take them with or without grumbling and a claim for an allowance. But in a falling market I find the buyers are often as eager to insist on their legal rights as courts of law are to maintain them. No doubt at all times sellers are prepared to take a liberal view as to the rigidity of their own obligations, and possibly buyers who in turn are sellers may also dislike too much precision. But buyers are not, as far as my experience goes, inclined to think that the rights defined in the code [i.e. the Sale of Goods Act] are in excess of business needs.

If, however, we take issue with Lord Atkin, the objection to the decision in *Arcos* is not so much that the buyers were allowed to act unreasonably or inefficiently[32] by rejecting goods which they could use, but that they were allowed to reject such goods in order to take advantage of a falling market. In short, the objection is that the buyers acted in bad faith.

More recently, in *The Hansa Nord*,[33] the court faced a particularly striking example of such advantage-taking. There, the buyers, having purported to reject a £100,000 cargo for alleged breach of condition, were able to repurchase the goods indirectly for a mere £30,000, before making use of them for a purpose not substantially different from that intended. Although Mocatta J upheld the Board of Appeal's decision in favour of the buyers, the Court of Appeal ruled that the buyers had no right to reject. To achieve this result, the Court of Appeal held, first, that the goods were of merchantable quality (because, despite their deficiency, they remained fit for their intended purpose); and, secondly, that the contractual provision requiring shipment in good condition was an intermediate (that is, *Hong Kong*) term, the consequences of the breach of which in this particular instance did not justify withdrawal. The nub of the decision, however, was the court's perception that it would be wrong to assist the buyers to make a killing of this kind. As Lord Denning MR observed:[34]

> It often happens that the market price falls between the making of the contract and the time for delivery. In such a situation, it is not fair that a buyer should be allowed to reject a whole consignment of goods just because a small quantity are not up to the contract quality or condition. The proper remedy is a price allowance and not complete rejection.

31 [1933] AC 470 at 480.

32 Cf George L Priest, 'Breach and Remedy for the Tender of Nonconforming Goods under the Uniform Commercial Code: An Economic Approach' (1978) 91 *Harvard Law Review* 960.

33 *Cehave NV v Bremer Handelsgesellschaft mbH: The Hansa Nord* [1976] QB 44.

34 [1976] QB 44 at 63.

There is more to this, however, than a one-off decision to combat a particularly spectacular example of sharp practice. *The Hansa Nord* takes a stand, not simply against bad faith, but, more generally, against economic opportunism within a contractual relationship. This is epitomised by Roskill LJ's remarks:[35]

> In my view, a court should not be over ready, unless required by statute or authority so to do, to construe a term in a contract as a 'condition' ... *In principle, contracts are made to be performed and not to be avoided according to the whims of market fluctuation* and where there is a free choice between two possible constructions I think the court should tend to prefer that construction which will ensure performance, and not encourage avoidance of contractual obligations.

On this view, contracts — even contracts in the commercial world — are matters of obligation, not vehicles for instrumental economic convenience. In other words, contracting parties commit themselves, by entering into contract with one another, to keep faith with the bargain even though more attractive economic opportunities might subsequently present themselves elsewhere. Crucially, even innocent parties in post-breach situations must be seen as having a *prima facie* obligation to perform rather than to avoid the contract.[36]

In *The Hansa Nord*, the implications of Roskill LJ's view seem to run in only one direction. The courts, as his Lordship says, must be wary of construing terms as conditions in a strict sense if the innocent party is simply citing the breach as a pretext for withdrawal, the real reasons being of a collateral economic kind. However, matters are not quite so simple. Two other considerations need to be borne in mind. First, if terms are rarely construed as conditions in a strict sense, the option of withdrawal will rarely be available, and this may weaken the incentive for would-be contract-breakers to take their contractual obligations seriously. Thus, in the recent case of *The Naxos*,[37] the majority of the House was concerned that the 'ready for delivery' provision (incorporated into a contract for the sale of sugar on the Assuc Sugar Contract No 2 form) should be construed as a condition in the strict sense lest sellers in such contracts might be encouraged to play the

35 [1976] QB 44 at 70–1.

36 For a time, a parallel line of reasoning was evident in relation to a number of cases where owners of vessels purported to withdraw from charters for breach of the punctual payment condition but, really, for collateral economic reasons: see eg *Empresa Cubana de Fletes v Lagonisi Shipping Co Ltd.: The Georgios C* [1971] 1 QB 488 at 502–3 (Lord Denning MR), and 505 (Phillimore LJ); and *The Laconia* [1976] 1 QB 835 at 848–9 (Lord Denning MR) (CA) and [1977] AC 850 at 874 (where Lord Simon seemed willing to countenance the development of a principle of unconscionability in order to protect charterers against owners taking unfair advantage of late payment when the breach 'might be due to pure accident and might occasion no real detriment to the owners'). However, the general view of the House in *The Laconia* was that the punctual payment provisions should be taken at face value, leaving the owners free to withdraw (see n 29 above). For confirmation of this approach in the context of charter parties, see *The Chikuma* [1981] 1 All ER 652; and for the House's refusal to apply the idea of forfeiture to protect charterers, see *Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana* [1983] 2 AC 694.

37 *Cie Commerciale Sucres et Denrees v Czarnikow Ltd: The Naxos* [1990] 3 All ER 641.

market and compensate their buyers only in damages.[38] Secondly, a presumption against withdrawal, whilst perhaps countering collateral economic opportunism, might be unfair to an innocent party who has perfectly respectable reasons for wishing to withdraw. It follows that any regime which treats contracts as matters of obligation must strive to satisfy two desiderata. On the one hand, it must sift out good reasons for withdrawal from bad reasons, eliminating withdrawal motivated by collateral economic considerations. On the other hand, it must maintain the option to withdraw as a security against non-performance (that is, in order to discourage breach). To put this slightly differently, the challenge is to devise a legal regime in which the option to withdraw operates as a security against breach but without this becoming an excuse in post-breach situations for the innocent party to discharge itself from its contractual obligations whenever market conditions so favour.

III

If the innocent party's reasons for withdrawal were to be treated as a focal consideration, in what circumstances would there be a right to withdraw for breach? Basically, a right to withdraw would be available where it was conferred by legislation or case law, or where it was so agreed by the parties; but, failing such special provision, the right to withdraw would depend upon the innocent party having good reasons for claiming the option of release from the contract, as opposed to settling for damages. In the next section, we will consider the possibility of peremptory and presumptive rights to withdraw being conferred by agreement or by force of law. Our immediate concern, however, is with the idea of the right to withdraw for good reason.

The fact that there has been a breach of contract raises the possibility that the innocent party might have the right to withdraw. The mere fact of breach, however, is not sufficient reason. Breach warrants compensatory damages, but not necessarily the option of withdrawal. What kind of reasons, then, might an innocent party advance to support an argument in favour of the right to withdraw? Without any claim to being exhaustive of possible good reasons, six arguable grounds for the right to withdraw may be suggested as follows:

(1) the contract-breaker evinces, through the breach, a lack of commitment to the contract as a source of obligation (for example, the breach is intentional/calculating, or fraud/dishonesty is involved);
(2) the breach raises concerns about the competence of the contract-breaker (for example, the breach involves negligence);
(3) the breach, although unintentional and non-negligent, renders performance under the contract radically different from that envisaged at formation;
(4) proving (or quantifying) losses flowing from the breach gives rise to difficulties which put the innocent party at risk;

38 [1990] 3 All ER 641 at 651; and, similarly, at the Court of Appeal stage of the case, see Kerr LJ [1989] 2 Lloyd's Rep 462 at 469. See also the observations of Bingham J in *Tradax Export SA v Italgrani di Francesco Ambrosio* [1983] 2 Lloyd's Rep 109 at 115.

(5) the breach gives rise to concern about the contract-breaker's ability to meet future claims; and,
(6) the breach gives rise to concern about the *innocent party's* own ability to perform either the contract in question or another associated contract.

Without arguing the point, let us suppose that an innocent party claiming a right to withdraw for good reason must make out a prima facie case under any one of these heads. Further, let us suppose that the right to withdraw only obtains where the innocent party (i) acts in good faith, and (ii) has reasonable grounds for believing that the particular supporting reason applies.[39] Accordingly, once a prima facie case has been made out, the onus shifts to the contract-breaker to rebut the innocent party's claim. This could be done by showing either a lack of good faith or a lack of reasonable grounds. The former might involve dishonesty or the like, but, crucially, if the innocent party has relied on collateral economic reasons — and, thus, is not seeking withdrawal '*for* breach' — this would constitute a lack of good faith and would disqualify withdrawal. With these brief comments on the burden and standard of proof, we can look more carefully at the six suggested good reasons for withdrawal upon which argument would centre, always remembering, of course, that these are possible reasons to be cited *in the absence of a right to withdraw being conferred by legislation, precedent, or agreement.*

1 The Breach Evinces a Failure to Treat Performance of the Contract as a Matter of Obligation

It is a jurisprudential commonplace that there is a distinction between treating a requirement as 'obligatory' that is, as categorically binding, as opposed to merely conforming with a requirement.[40] In relation to contractual requirements, the difference is that, if one treats those requirements as obligatory, one accepts that they are binding even though one would prefer on occasion to act otherwise. On the other hand, mere conformity with a contract indicates no greater commitment than a willingness to perform so long as it suits. Accordingly, where one enters upon a contract as a matter of obligation, one accepts a special kind of commitment, a commitment to stick with the contract even when it is no longer convenient or advantageous to do so. If this is how contracts are to be regarded — and this is precisely how Roskill LJ's view in *The Hansa Nord* suggests they are to be regarded — then the failure of one side to treat performance as obligatory is a particularly serious matter. Of course, in *The Hansa Nord*, the immediate thrust of Roskill LJ's remarks is that, in post-breach situations, the courts should be slow to grant the innocent party the option of withdrawal. Nevertheless, a

39 This seems a fair position to take. Not to ask for reasonable grounds would put the contract-breaker too much at the mercy of the innocent party's good faith (but possibly mistaken) reading of the situation. On the other hand, given that an unjustified withdrawal exposes the innocent party to a counter-claim by the contract-breaker, it would be unfair to insist on the innocent party having a correct reading of the situation.

40 See HLA Hart, *The Concept of Law*, Clarendon Press, 1961, esp pp 79–88.

failure by the contract-breaker to regard the contract as obligatory indicates a breakdown in the relationship and gives the innocent party good reason for seeking a right to withdraw, for such a failure surely goes beyond a matter of financial redress. Indeed, one might say that treating the contract as obligatory is precisely a condition precedent to the contract continuing in force.

The most obvious way in which one side could act inconsistently with this ideal is if the contract is broken intentionally or recklessly with a view to mere convenience or commercial advantage. The same holds for dishonesty or fraud. For example, in *The Mihalis Angelos*, at the date of the charterparty, 25 May, 1965, the vessel was seven or eight days out of Los Angeles with a cargo to be discharged in Hong Kong. The most optimistic estimate was that the vessel would arrive at Haiphong by 13 or 14 July. Yet, the owners represented that the vessel was expected to be ready by about 1 July. In the event, the vessel did not complete discharging its cargo in Hong Kong until 23 July and, thus, could not have arrived at Haiphong before 27 July. At best, this was a case of wishful thinking, or incompetence, by the owners; at worst it was a case of recklessness or dishonesty. If it was the latter, recklessness or dishonesty, the charterers surely had good reasons for withdrawal.[41]

2 The Breach Raises Concerns about the Competence of the Contract-breaker

Mere incompetence is not incompatible with the very idea of a contract as an affair of obligation. Nevertheless, where there is a negligent breach, the innocent party may argue that damages would not be an adequate remedy. Sometimes, the negligence will raise concerns which fall under one of the other heads for withdrawal. For example, it may raise concerns about the ability of the contract-breaker to satisfy a claim in damages. However, what if the case does not fall under one of these other heads? Can withdrawal be justified where there is a single instance of a negligent breach without, as it were, any aggravating features? For example, suppose that in *Schuler v Wickman* the agents had committed just one negligent breach of the visiting provision. Or, suppose that in the *Harbutt's Plasticine*[42] case the contractors' negligent breach had been discovered in time to prevent the conflagration. Would the innocent party have a right to withdraw in such circumstances?

Whilst it makes little sense to accuse a negligent contract-breaker of ignoring its obligations, nevertheless, the innocent party may take the view that even one negligent failure is one breach too many. In the

41 Two qualifications need to be made here. First, the fact that the charterers, in principle, might have had clear grounds for withdrawal should not be equated with their having clear grounds in practice. To state the obvious, the charterers might have had no grounds for believing that the owners had acted dishonestly or recklessly (see text below). Secondly, if, in fact, the charterers withdrew for collateral economic reasons, their action would be tainted by bad faith (ie they would not have good reasons for withdrawal). A rather nice point would then arise if, subsequently, they found that good reasons were available (eg if they secured evidence indicating that the owners' statement was dishonest).

42 *Harbutt's 'Plasticine' Ltd v Wayne Tank and Pump Co Ltd* [1970] 1 QB 447.

hypothesised circumstances of *Harbutt's Plasticine*, for example, the clients surely could argue with some plausibility that they simply could not afford to give the contractors a second chance to burn down the factory. On the other hand, in a case like *Schuler v Wickman*, even allowing for the manufacturers' punctiliousness, one negligent breach perhaps seems insufficient reason for having a right to withdraw. Nevertheless, it cannot be right to license negligent contract-breakers to pay or perform indefinitely, for contracts are, after all, for performance, not for compensation in lieu of performance. Accordingly, in a case of this kind, the appropriate remedy for the innocent party seems to be, not the right to withdraw, but a warning that, if there is a repetition of negligence, the option to withdraw will apply.[43]

Given that the strength of the innocent party's arguments in favour of having a right to withdraw for a negligent breach *per se* is liable to vary from one situation to another, an innocent party wishing to be assured of such a right should be advised to make appropriate express provision in the contract.

3 The Breach, Although Unintentional and Non-negligent, Renders Performance under the Contract Radically Different from that Envisaged at Formation

In *Behn v Burness*,[44] the statement in a charterparty, dated 19 October 1860, that the vessel, the *Martaban*, is 'now in the port of Amsterdam' was held by the Court of Exchequer Chamber to be a condition in the strict sense. Four days before, on 15 October, the vessel was en route to Amsterdam, and expected to arrive within 12 hours given favourable circumstances. However, because of strong gales and the absence of tug power, the vessel was unavoidably prevented from reaching a place of discharge in Amsterdam Docks until 23 October. This seems to have been a case of unintentional, non-negligent breach. Thus, the charterer had no reason to withdraw on the grounds that the owners were failing to treat the charter as obligatory; nor was this a case where a warning would be appropriate. It also appeared that this was not a case where the actual consequences of the breach occasioned any great loss to the innocent party, the lower court applying an embryonic *Hong Kong* approach to deny the charterer the right to withdraw.[45] How, then, should such a case be treated?

One view is that all cases of unintentional breach (without more) should be treated the same. In other words, there should be no distinction between negligent and non-negligent breach. At the root of this view is the point already made that parties contract for performance, not for compensation in lieu of performance. Put this way, it makes no difference whether the non-performance arises from a negligent or non-negligent breach. An alternative view is that the two cases of unintentional breach should be treated differently, at least in relation to

43 That is, something along the lines provided for in cl 11 of the distributorship agreement in *Schuler v Wickman*.

44 (1863) 3 B & S 751; 122 ER 281.

45 (1862) 1 B & S 877; 121 ER 939.

the availability of the right to withdraw. For negligent breach, a warning — maybe even withdrawal for feared repetition — is appropriate. For non-negligent breach, warnings and withdrawals on the ground of feared repetition are inappropriate. Instead, the innocent party must make some allowance for the contract-breaker's misfortune and, in the absence of aggravating factors, must expect to enjoy the option of withdrawal only exceptionally, in short, only where the breach renders performance under the contract radically different.

If, for the sake of argument, this alternative view is followed, it remains to determine just what degree of allowance is to be made. Traditionally, the standard for release is set high. For example, in *Flight v Booth*,[46] Tindal CJ proposed the following test for rescission where a seller unintentionally misstated the character of the property:[47]

> [W]here the misdescription, although not proceeding from fraud, is in a material and substantial point, so far affecting the subject-matter of the contract that it may reasonably be supposed, that, but for such misdescription, the purchaser might never have entered into the contract at all, in such case the contract is avoided altogether, and the purchaser is not bound to resort to the clause of compensation.

In the regime outlined here, a 'radical difference' test has been adopted. This seems broad enough to encompass situations like that in *Flight v Booth*, as well as the case of the proverbial innocent party who, having contracted for peas, is delivered a cargo of beans. It would also cover a situation such as that in the *Federal Commerce and Navigation*[48] case where the owners' breach, although based on legal advice, was liable to cause grave damage to the charterers' reputation and ability to trade in grain. On the other hand, it seems fairly clear that the charterer in *Behn v Burness*, although understandably concerned that the vessel should be available as anticipated, did not face a radically different situation as a result of the owners' breach.[49]

If a 'radically different' test is adopted, it may be noted that there is then a certain alignment between the ruling *Davis v Fareham*[50] test for frustration and the test for withdrawal for breach, thus achieving something of the symmetry sought by Diplock LJ in the *Hong Kong Fir Shipping* case.[51] However, this alignment is on a very narrow front. It is not a general equation of the tests for withdrawal for breach and frustration: it is simply an equation where *the breach is unintentional and non-negligent.* To be precise the equation is between the test for that category of excused non-performance which discharges the parties (frustration) and that for a right to withdraw in respect of a non-excused non-performance (breach) which is unintentional and non-negligent.[52]

46 (1834) 1 Bing NC 370; 131 ER 1160.
47 (1834) 1 Bing NC 370 at 377; 131 ER 1162–3.
48 *Federal Commerce and Navigation Co Ltd v Molena Gamma Inc* [1979] AC 757.
49 But, of course, if it is established by precedent that descriptive statements of this kind are to be treated as conditions in the strict sense, then the charterer has the right to withdraw irrespective of whether the breach produced a radically different situation.
50 *Davis Contractors Ltd v Fareham UDC* [1956] AC 696 (see Lord Radcliffe, esp at 729).
51 [1962] 2 QB 26 at 65–6.
52 There is a tendency to draw a simple contrast between 'breach' and 'frustration'. It would be clearer, however, if the contrast were between 'breach' and 'excused non-performance'. Within such a scheme, 'breach' would divide into 'breach of warranty' and 'breach of condition' while 'excused non-performance' would divide into 'excused non-frustrating non-performance' and 'excused frustrating non-performance' (ie frustration). Roughly speaking, 'breach of warranty' and 'excused non-frustrating non-performance' would be correlates, as would 'breach of condition' and 'excused frustrating non-performance'. Collateral economic reasons fit into this scheme in two ways: first, where a party fails to perform for such reasons, there can be no defence of 'excused non-performance'; and, secondly, where an innocent party seeks to withdraw, ostensibly for breach of condition, but truly for collateral economic reasons, withdrawal will be disallowed.

4 Proving (or Quantifying) Losses Flowing from the Breach Gives Rise to Difficulties which Put the Innocent Party at Risk

In *Bunge v Tradax*,[53] Lord Wilberforce made the point that, if the term was not to be construed as a condition in the strict sense, then the sellers would be confined to a remedy in damages 'which might be extremely difficult to quantify'.[54] This, his Lordship conceded, was a serious objection 'in practice'.[55] Now, although it seems to be generally accepted that the difficulty of quantifying damages is a factor weighing in favour of the innocent party having the right to withdraw, it is not immediately obvious why this should be so. After all, the quantification difficulty applies irrespective of whether the innocent party has the right to withdraw.

To appreciate the force of this particular reason, it might be helpful to distinguish between two heads of damages each of which may give rise to difficulties of proof or quantification. First, there are those damages (D1) which relate to the instant breach (B1), the breach in respect of which the innocent party is arguing for a right to withdraw. Secondly, there are those damages (D2) which relate to a feared future breach (B2) should the innocent party be denied the right to withdraw for the instant breach (B1). Where the innocent party's argument in favour of having a right to withdraw hinges upon the difficulty of proving or quantifying future damages (D2), then it is clear how the availability of such a right (at least, if the option of withdrawal is exercised) would overcome the problem (viz, by preventing the occurrence of the breach, B2, which would generate the difficulty). However, it remains unclear why the difficulty of quantifying instant breach damages (D1) should operate as a good reason in favour of having the right to withdraw. In support of the innocent party's claim, it might be argued that, given the quantification problems, the innocent party might not pursue its claim for damages

53 *Bunge Corp v Tradax SA* [1981] 2 All ER 513.
54 [1981] 2 All ER 513 at 541. Similarly, although in different contractual contexts (respectively, a suretyship contract and a distributorship agreement), in *Ankar Proprietary Ltd v National Westminster Finance (Australia) Ltd* (1987) 162 CLR 549 at 557, the High Court of Australia accepted that the difficulty of proving damages was a factor which favoured reading the relevant terms as conditions in the strict sense; and, in *Schuler v Wickman* [1974] AC 235, Lord Wilberforce pointed to the difficulties of the manufacturers proving lost sales as a result of the agents' breach of the visiting obligation.
55 [1981] 2 All ER 513 at 541. See also *Flight v Booth* (1834) 1 Bing NC 370 at 378–9.

(D1) relating to the instant breach (B1), so that, if the right to withdraw were denied, the breach (B1) would go unremedied. Alternatively, it might be argued that, if the innocent party were able to withdraw from the contract, this would free it to pursue its claim for damages without fear of prejudicing the contractual relationship.

Two other points should be made here. First, if damages are difficult to prove, and if this is known to a potential contract-breaker, then the remedial security against breach (B1) is weakened. To protect the party at risk, the right to withdraw may be needed as additional remedial security. If the parties have not provided for this right, this might be an appropriate case for protective intervention by way of preclassification of terms (that is, ex ante provision to compensate for a weakness in the ex post reason-centred regime).[56] Secondly, where damages are known at the outset to be difficult to quantify, this is, of course, just the kind of situation in which liquidated damages clauses are to be encouraged. If the parties have agreed upon a liquidated damages provision, then, irrespective of whether the quantification problem concerns instant breach damages (D1) or anticipated future breach damages (D2), this presumably undercuts the argument in favour of a right to withdraw.

5 The Breach Gives Rise to Concern about the Contract-breaker's Ability to Meet Future Claims

On occasion, a breach may give the innocent party reason to doubt the contract-breaker's ability to satisfy claims for damages in future (for example, where the instant breach gives rise to a particularly big claim, or where a negligent breach implies a more general lack of competence). In such a case, therefore, the justifying reason for having a right to withdraw is that the right, if exercised, will protect the innocent party against the risk of under-compensation in the future. This seems plausible enough.[57] However, it should be emphasised that this is not a licence for withdrawal for late payment. Accordingly, in a case like *Decro-Wall International SA v Practitioners in Marketing*,[58] where the defendants were persistently late in paying for goods received, the right to withdraw would not arise *on this ground* because there was no suggestion that the contract-breakers would fail to meet their financial obligations. Nor, of course, would this head operate as a reason licensing withdrawal for late payment where the motivation was of a collateral economic kind.[59] For, it must be remembered that the innocent party will only have the right of withdrawal where the claim is made in good faith.

56 See further section IV of the text, esp pp 103-4 below.
57 Though, perhaps an assurance might be the first line of security for the innocent party, cf s 2-609 of the Uniform Commercial Code.
58 [1971] 2 All ER 216.
59 Cf *The Laconia* [1977] AC 850, and *The Chikuma* [1981] 1 All ER 652.

6 The Breach Gives Rise to Concern about the Innocent Party's Own Ability to Perform Either the Contract in Question or Another Associated Contract

Some contracts may be structured in such a way that, not only is there a clear order for performance, but also particular obligations may not arise unless and until some item in the scheduled performance has been fulfilled.[60] In other words, within the contractual structure, performance of one or more of the terms by one of the parties may be a condition precedent to the other party's obligation to perform a particular term. Analysis of such contracts is relatively unproblematic. However, there may be cases where the contractual provisions, although less formally ordered, are nonetheless linked in such a way that if one side fails to perform as contemplated this will prejudice the other party's ability to perform. For example, in *Bunge v Tradax*, Megaw LJ pointed to such interlocking provisions:[61]

> [J]ust as the contractual time for delivery of the goods is a condition binding on the sellers, so the contractual time by which the notice has to be given for the purpose of enabling the sellers to perform that condition should be regarded as a condition binding on the buyers.

Given that there are other devices by which the law might protect the innocent party (for example, implying appropriate terms for the benefit of that party), it might be only exceptionally that this will generate questions about the right to withdraw. Nevertheless, if the point does arise, it does not seem unreasonable to give the innocent party a right to withdraw in such a case.

Even if the contractual provisions are not linked for ordered performance, in many commercial contracts the contract itself will be linked to *other contracts*. Thus, performance of contract A, if not a condition precedent for the obligations under contract B to arise, at least bears significantly on a party's ability to perform contract B. In *The Naxos*,[62] one of the factors which persuaded the majority of their Lordships to rule that the buyers had a right to withdraw was that the dispute arose in the context of a string of contracts, the buyers having onward commitments to fulfil. Yet, why would damages be an inadequate remedy in a case of this type? In some situations (for example, where the sub-sale is for specific goods), the right to withdraw will not assist the buyer;[63] and, in other cases, it may be possible for the original contract-breaker to cover the innocent party's own onward liabilities by paying damages. However, if the right to withdraw would enable the innocent

60 See Hugh Beale, *Remedies for Breach of Contract*, Sweet and Maxwell, 1980, chs 2–3, esp pp 28–34.
61 [1981] 2 All ER 513 at 532.
62 [1990] 3 All ER 641.
63 In *Re Moore and Landauer* [1921] 2 KB 519, the sellers argued that the buyers should be restricted to a remedy in damages. However, the court treated the possibility that the buyers might have sub-contracted on the basis of cases of 30 tins as telling against the sellers. Whilst, the possibility of such sub-contract commitments might be relevant to the specification of 30-tin cases as part of the contractual description, it is not clear how the right to withdraw would assist the buyers to meet their sub-contract commitments.

party to perform its onward obligations, then there is perhaps force in the argument that it should enjoy this right in order to maintain its commercial reputation (that is, as a party which meets its obligations). Given that the strength of the innocent party's claim might vary from one situation to another, it may be advisable for the right to withdraw to be expressly reserved in the contract.

Before moving on, in the next section, to the question of prior classification of terms, it is as well to make two general points which perhaps serve to put the heads of good reasons into better perspective. First, to avoid any misunderstanding, it is worth labouring the point that the so-called 'reason-centred' regime permits the innocent party to argue for a right to withdraw under any one of three general headings: namely, by virtue of prior classification of stock terms by statute or precedent, by virtue of prior classification of a particular provision (or, prior reservation of the right to withdraw) by express agreement, or by virtue of having a 'good reason' as outlined in this section. The arguable good reasons sketched above, therefore, represent only one dimension of the regime. Secondly, the category of good reasons may be regarded as being of a residual nature. The point is that if the innocent party lacks the information to discharge the burden of proof in relation to a particular good reason, it may be advisable to argue for the right to withdraw on the basis of prior classification. Moreover, given possible evidential difficulties facing the innocent party (who may not know, for example, whether the breach was intentional or unintentional, negligent or non-negligent), it may turn out, in practice, that innocent parties who have to rely on the residual good reasons tend to favour reason 3 (rather than 1 or 2) or 4–6 where appropriate.[64] If so, this would not be so very different perhaps from the existing position.

IV

In the previous section, we concentrated on the kind of reasons which, in the absence of stipulation by statute, precedent, or agreement, might justify withdrawal for breach. In this section, we must consider the policy of the law in relation to preclassification of terms, paying particular attention to the possibility of having terms pre-classified so that they attract either a peremptory or a presumptive right of withdrawal.

1 Express Agreement

We can deal, first, with cases of express agreement. In the wake of the decision in *Schuler v Wickman*,[65] debate focused on whether it was adequate to stipulate that a particular term was a 'condition', or whether it was necessary to spell out that if a particular term was broken then the innocent party should have the right to withdraw, or even to provide that the right to withdraw applied irrespective of the actual consequences of

64 It must also be remembered that, no matter how a reason-centred regime were implemented (ie whether by statute or by judicial innovation) it would take some time for the jurisprudence of the reasons to develop.

65 [1974] AC 235. See R Brownsword (1974) 37 *MLR* 204.

the breach, and so on. Now, it would be possible, in principle, to develop quite complex conventions about particular forms of words in contracts, with precedents available for each required nuance of meaning. However, for our purposes, the critical questions are: (1) whether as a matter of policy it should be possible to agree to a peremptory right of withdrawal; and (2) whether, if so, any of the standard locutions should be recognised as adequate to confer such a peremptory right. The first of these questions is a matter of principle; the second is a practical matter.

Why should it not be open to the parties, if they so wish, to agree to a peremptory right of withdrawal in respect of a particular provision? Two lines of argument suggest themselves, one contending that such a right would be incompatible with the very concept of contract as an affair of obligation, the other that such a right would be capable of producing injustice.

The conceptual argument starts by underlining the point that the essence of contractual commitment is that the parties place themselves under an obligation to one another. If they agree that it is open to withdraw for collateral economic reasons this surely reduces the transaction to a declaration of convenience (or, as it was commonly said in the context of swingeing exclusion clauses, a mere declaration of intent).[66] However, this objection slides over a crucial qualification. A peremptory right to withdraw for breach is not identical to a right to withdraw (or terminate) at convenience; unlike the latter, the former is necessarily conditioned upon there being a breach of the relevant provision. Accordingly, if both sides treat their transaction as obligatory, and perform to the letter, no right to withdraw for breach — peremptory or otherwise — can arise.[67]

The argument based on fairness fixes on the undeniable fact that, if the parties are permitted to agree to a peremptory right of withdrawal for breach, this could license some pretty harsh outcomes. Recall, for example, the 19th century American cases, *Norrington v Wright*[68] and *Filley v Pope*,[69] in both of which the American buyers argued that a minor deviation from the contract released them to buy used rails on a falling market. In *Filley*, for example, the sellers shipped the rails from the east coast of Scotland rather than from Glasgow (the contract port of shipment) where no vessels were available. The sellers' initiative thus procured speedier delivery than if there had been strict compliance with

66 Classically, see *Suisse Atlantique Société d'Armement Maritime SA v NV Rotterdamsche Kolen Centrale* [1967] 1 AC 361 at 432 (Lord Wilberforce).

67 In fact, the conceptual point merits greater analysis than space permits. The essence of a contract is that the parties put themselves under an obligation to one another. A derivative idea is that a breach should not be cited as a pretext for withdrawal (ie that collateral economic reasoning should be eschewed by the parties). The argument presupposed by the text is that it is possible for the parties to waive their derivative rights without this undermining the very idea of a contract. However, if the parties were to agree that there should be a right to terminate at will, this might be argued to be incompatible with the idea of a contract — although this is not to suggest, of course, that parties should not be free to agree to such an arrangement.

68 115 US 188 (1885).

69 115 US 213 (1885).

the contract. Nevertheless, the court in *Filley*, as in *Norrington*, ruled in favour of the buyers. Even such a robust liberal as Charles Fried is critical of these decisions:[70]

> The courts in *Norrington* and *Filley* reached absurd results by assuming that the schedule and departure terms respectively were conditions. They assumed this because they assumed that *every* term was a condition. They assumed that every term was a condition on the fallacious reasoning that since it was their duty to respect the autonomy of the parties and not to impose obligations upon them that they had not assumed, therefore they must condition *all* of the buyers' duties to the sellers on strict compliance by the sellers with *all* of the buyers' terms. But this begs the question. If the buyers and sellers did not intend to treat minor, nonmaterial deviations from the terms of the contract as conditions, it frustrates rather than realises the will of the parties for the courts to treat them as conditions.

It will be appreciated, though, that the underlying principle in Fried's critique is that party autonomy should be respected and that the parties' intentions should be realised. Accordingly, *if* the parties in *Norrington* and *Filley* had intended that the buyers should have a right to withdraw for minor deviations, then it would not be unfair to allow such a right to operate. This line of reasoning applies a fortiori if we are considering the possibility of a peremptory right to withdraw for breach. In other words, if in cases of this type, the parties have expressly agreed that the buyer should have a peremptory right to withdraw for breach of the schedule or departure terms, then the seller must have been on notice of the risk and there would be no injustice in enforcing the agreement.[71] Of course, it might be said that no seller could possibly agree to such terms unless it found itself in a desperate bargaining position; and there may be some truth in this. Nevertheless, this is a problem to be addressed directly by a doctrine of economic duress, or inequality of bargaining strength, not indirectly by a restriction on a peremptory right to withdraw (nor by manipulating a doctrine of presumed contractual intention).[72]

This leaves the practical question of how the parties might signal their intention to confer a peremptory right to withdraw for breach. We can deal with this quite summarily. It certainly would not be sufficient, given present conventions, to label the term as a condition, nor, of course, would it do to say that the right obtained irrespective of the gravity of the consequences of the breach. For at least two reasons, it would be essential to spell out the peremptory right quite explicitly, emphasising that, if the particular term were breached, then the innocent party would be entitled to withdraw for any reason (*including for collateral economic reasons*). On the one hand, this would begin to familiarise the English legal community with the concept of a peremptory right (this idea not yet having been properly disentangled from the concept of a condition in the

70 Charles Fried, *Contract as Promise*, Harvard University Press, 1981, p 122.

71 For the moral underpinnings of this kind of view, see R Brownsword, 'Liberalism and the Law of Contract', in *Liberalism and Recent Legal and Social Philosophy*, ed Richard Bellamy, Franz Steiner, 1989, p 86.

72 Cf R Brownsword, 'Remedy-Stipulation in the English Law of Contract – Freedom or Paternalism?' (1977) 9 *Ottawa Law Review* 95.

strict sense as that concept is presently understood);[73] on the other hand, it would serve to ensure that the parties had fully understood the nature of their agreement.

2 Pre-classification by Law

The regime of good reasons, if sound, ensures that the innocent party has proper redress when the question of withdrawal for breach is addressed in an ex post fashion. Moreover, by leaving the parties free to vary this regime by express agreement, there is always the possibility of their contracting out of any unwanted features. One might wonder, therefore, whether it is necessary to regulate the situation any further. In particular, why should there be any need to preclassify certain terms by statute or precedent?

As explained already, prior classification of terms as conditions in the strict sense (as we now understand it) can lead to 'unreasonable' withdrawals, in particular, withdrawal for collateral economic reasons. Clearly, this is a path to be avoided. One qualification, therefore, must be that preclassification does not become a shield for withdrawal based on collateral reasons. To neutralise this possibility, it simply has to be provided that where a particular term is pre-classified as a condition in the strict sense this does *not* confer upon the innocent party a peremptory right of withdrawal for breach. Rather, it confers, so to speak, *a presumptive right*, in the sense that the innocent party is relieved of the requirement of making out a prima facie case of good reason for having the right to withdraw. What this would entail would be that the innocent party, once having established a breach of the relevant preclassified term, would then be free to withdraw unless the contract-breaker could counter by showing collateral economic reasons. Although this avoids one problem with preclassification, it fails to respond to the initial question of why such an ex ante strategy is needed at all. In other words, even though we are granting only a presumptive (not a peremptory) right of withdrawal, why give the innocent party this advantage?

Three considerations might be advanced in response to this question. First, as it is commonly said in favour of the extant classification approach, preclassification might render the legal position more certain, more calculable for both the parties and their advisers. Preclassification assists, therefore, with ex post dispute resolution. This line of reasoning is perhaps most persuasive in relation to unintentional non-negligent breaches where the proposed test, the radical difference test, is imprecise. Inevitably, with such questions of degree, there will be clear cases and marginal cases. If, by pre-classification, the number of marginal cases can be reduced, this must be to the good.

A second line of argument views preclassification as a device, not merely to clarify the application of the reasons regime, but equally to

73 However, it should be noted that clauses allowing for termination at will, or termination for convenience, are by no means unknown (although termination here is not necessarily conditional upon there being a breach). See eg Beale, n 60 above, pp 23–6; and J W Carter, 'Termination Clauses', (1990) 3 *JCL* 90 at 94.

protect innocent parties who might lack the resources, whether economic or informational, to make out a case in support of a claimed right to withdraw. In other words, preclassification is seen as a means of delivering the right to withdraw as a practical remedy to classes of contractors (typically consumers rather than commercial contractors) who otherwise might have difficulty in exercising their paper remedies.[74]

Thirdly, preclassification might be favoured as a device to secure performance, thereby improving the prospect of the parties treating their contracts as obligatory in both theory and practice. In other words, the *settled* availability of a presumptive right of withdrawal might act as a deterrent against non-performance. And, to pick up an earlier point, this might offer significant remedial security where damages would be difficult to prove. Of course, the threat of withdrawal can be translated into monetary terms, to be put into a cost/benefit calculation alongside anticipated damages for breach. However, what sharpens the deterrent effect with a preclassified term (bearing a presumptive right of withdrawal for breach) is that the burden of rebuttal lies with the contract-breaker and can be argued only on very narrow grounds. Other things being equal, therefore, the putative contract-breaker must judge that there is little reason why the innocent party should be inhibited from withdrawing.

If pre-classification appeals as a deterrent against breach, one might be tempted to pursue a deterrent strategy independently of the ex post regime. For example, one might preclassify as conditions (that is, conferring a presumptive right of withdrawal) terms the breach of which do not go to the root of contract. Quite clearly, though, this would be a significant step, for it would enable innocent parties to withdraw in circumstances where they might not otherwise have good reasons for withdrawal. If we suppose that the point of prior classification (with the concomitant presumptive right to withdraw for breach) is either to resolve problematic borderline cases of good reasons or to relieve the innocent party of the burden of eliciting good reasons which it is plausibly assumed to have, then preclassification cannot be allowed to open the way for withdrawal where it is known that there are not good reasons. On the other hand, it may be argued that such an extension of the right to withdraw can be justified in order to discourage economic opportunism and thereby to advance the principle that contracts should be treated as affairs of obligation. Plainly, there is a tension here which needs to be teased out and resolved.

In fact, the tension is quite complex. Two very general principles have exerted a gravitational force in pulling this paper towards the idea of a reason-centred regime and the notion that the right to withdraw should be available, prior classification (or reservation) apart, only where the innocent party has good reason. First, there is the principle that, prior classification apart, the right to withdraw for breach should be available only where damages would not be an adequate remedy. This leads directly to the idea that the adequacy of damages is to be judged

74 Cf Chris Willett, (1991) 54 *MLR* 552.

according to whether, in the light of the breach, the innocent party has good reasons for seeking the right to withdraw. Secondly, there is the principle that contracts, being a matter of obligation, are to be performed. This yields the principle that contracting parties have a duty to eschew economic opportunism, which, in post-breach situations, generates the idea that, prior classification apart, the innocent party should have good reasons for withdrawal. If we act on the *first* principle (viz that, prior classification apart, the right to withdraw should be available only where damages would not be an adequate remedy), we need to decide whether prior classification should be regulated, too, by the regime of good reasons. If we think that it should, then there are severe limits on the extent to which prior classification can be used as a deterrent against non-performance. If, however, we think that it should not, then there is no apparent objection to employing prior classification as a deterrent strategy. Turning to the *second* principle, the fundamental idea is that the law of contract should act against economic opportunism. To this end, prior classification is the law's ex ante strategy, while the requirement of good reasons is its ex post strategy. On the face of things, this conception of contract must favour performance as against compensation, so that, in the event of any tension, the ex ante strategy must have priority. Accordingly, on this interpretation, it would not be inconsistent to employ the right to withdraw extensively as a deterrent strategy. Of course, since we can probably afford to be fairly sceptical about anything more than very general claims concerning the deterrent or incentive effect of a known right to withdraw, the various tensions involved in these principles do not have to be resolved as a matter of urgency. Nevertheless, it has to be conceded that there is considerable unfinished business here.

V

Given that no more than a sketch has been offered of what a reason-centred legal regime for withdrawal for breach might look like, there is no warrant for claiming that such a regime would be more rational than the existing law. Nevertheless, in favour of such a regime, it can at least be said that it promises to avoid one form of irrationality, namely, a lack of congruence between the law as declared and the law as administered which has been particularly prevalent in the English law of contract this century.

Rationality, as applied to legal doctrine, is a complex concept, involving a number of dimensions.[75] To be fully rational, legal doctrine must be *formally* rational (for example, it must not violate the law of non-contradiction);[76] it must be *instrumentally* rational at both a general

75 Cf Beyleveld and Brownsword, 'Privity, Transitivity, and Rationality', (1991) 54 *MLR* 48, and 'Impossibility, Irrationality, and Strict Product Liability', (1991) 21 *Anglo-American LR* 257.

76 Two caveats need to be noted here. First, contradictions in legal doctrine cannot be avoided simply by drawing arbitrary distinctions or by refusing to consider doctrines drawn from different divisions of the law (eg contract and tort). Secondly, contradictions cannot be established simply by pointing to a tension between principles, see Beyleveld and Brownsword, (1991) 54 *MLR* 48 at 55–6.

level (that is, it must be capable in general of guiding action) and a specific level (that is, it must be an appropriate means towards a particular end); and it must be *substantively* rational (that is, its content must be acceptable relative to some criterion of 'rightness').

One significant form of *instrumental* irrationality (at a general level) arises where legal doctrines proclaim one thing but legal officials, while purporting to apply these doctrines, actually act on different, unstated, considerations. Where this happens, there is what Lon Fuller called a lack of congruence between the law in the books and the law in action.[77] In contract, we have seen such covert judicial activity in a number of fields, for example, in relation to the protection of consumers against one-sided standard form contracts and sweeping exclusion clauses,[78] and in commercial contexts where the privity doctrine obstructs commercially sensible outcomes.[79] Now, as these examples make clear, the covert considerations relied upon are not necessarily in any sense illegitimate. On the contrary, the judges' real reasons, although not in line with legal doctrine, were perfectly good reasons. The irrationality, then, does not reside at all in judges acting on bad reasons, but in their having to conceal perfectly good reasons behind doctrine which does not yet track such reasons. When we reflect upon this question of congruence in relation to the right to withdraw for breach, it is arguable that legal doctrine no longer tracks the real reasons acted upon by judges. Granted, the disjunction between official doctrine and actual practice may not be quite as marked here as in some other areas of contract, but there is surely evidence enough that the problem exists. Quite apart from conspicuous examples such as *The Hansa Nord*, and the various attempts to protect charterers against opportunistic withdrawals by vessel owners,[80] it is arguable that the rationale of the *Hong Kong* approach is to counter withdrawals based on collateral economic reasons. After all, as Tony Weir has pointed out, in any case where the consequences of the breach are such as to deprive the innocent party of substantially the whole

77 Lon Fuller, *The Morality of Law*, Yale University Press, 1969, pp 81–91. Moreover, it is in the principle of congruence, coupled with the principle of generality, that Fuller identifies the essence of the Rule of Law, see pp 209–10.

78 See eg R Brownsword, (1972) 35 *MLR* 179; n 72 above; and J Adams and R Brownsword, *Understanding Contract Law*, Fontana, 1987, pp 121–2.

79 See eg J Adams and R Brownsword, 'Privity and the Concept of a Network Contract', (1990) 10 *Legal Studies* 12.

80 Although *The Chikuma* effectively settled that, where the charterer is in breach of the punctual payment clause of the NYPE form of time charter, the owner can withdraw for collateral economic reasons (see n 36 above), later decisions have hinted at a residual protective concern for charterers. For example, in *Afavos Shipping Co SA v Romano Pagnan and Pietro Pagnan: The Afavos* [1983] 1 WLR 195, the House construed a 'non-technicality' payment clause in such a way that the owners' notice of intention to withdraw was invalid. Similarly, in *Antaios Compania Naviera SA v Salen Rederierna AB* [1985] AC 191 (which Lord Diplock, at 200, said 'was a typical case of a shipowner seeking to find an excuse to bring a long-term charter to a premature end in a rising freight market'), the House upheld the arbitrators' ruling that the punctual payment clause could not be read as meaning that any breach of the charterparty, however trivial, gave the owners the option of withdrawal.

benefit of the bargain, it is a fair bet that the withdrawal is not motivated by economic opportunism.[81] Accordingly, if legal doctrine is to be brought into line with the real considerations guiding judicial determination of the question of withdrawal for breach, the reasons relied upon by the innocent party who seeks withdrawal must be addressed explicitly and incorporated coherently within legal doctrine.

Rationality, to repeat, is a complex concept with a number of facets. It does not follow, therefore, that the elimination of the particular irrationality of a lack of congruence will complete the rationality of the law in relation to the right to withdraw for breach of contract. For instance, it might be objected that the reason-centred regime, having overcome one form of instrumental irrationality unwittingly replaces it with another. Most obviously, this line of objection will appeal to those who feel that the proposed regime is simply too uncertain to act as a guide to commercial contractors and their advisers. Less obviously, it might also appeal to those who sense that, if collateral economic opportunism is the mischief, then the appropriate cure is simply to introduce a requirement of good faith,[82] or, less ambitiously, a good faith — or 'abuse of right' — proviso in relation to the *exercise* of the right of withdrawal.[83] Alternatively, it might be argued that the reason-centred regime is *substantively* irrational because it relies too much on the principle that the right to withdraw for breach should be available only where damages would not be an adequate remedy. In line with this contention, it might be submitted that, provided the innocent party seeks in good faith to withdraw *'for* breach', then the right to withdraw should hold without restriction (that is, for any breach of any term).[84] Whilst these points are certainly not to be lightly dismissed, it is suggested that a reason-centred regime of the kind proposed at least deserves a second look.

81 See A Weir, (1976) 35 *CLJ* 33.

82 Cf para 1–203 of the Uniform Commercial Code which provides for good faith in the performance and enforcement of contracts. See further, E Allan Farnsworth, 'Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code', (1962–3) 30 *University of Chicago Law Review* 666.

83 If the good faith provision merely determined whether the exercise of the option to withdraw was valid, the law determining whether the option was available in the first place could be left unchanged (NB the distinction drawn in n 1 above).

84 But, does it make sense to provide for an unrestricted right to withdraw, eg even where there is an unintentional, non-negligent breach which does not render the performance radically different? If not, must we presuppose a duty to support the contractual project, or a duty to co-operate, or something of that kind? Generally, cf Hugh Collins, *The Law of Contract*, Weidenfeld and Nicolson, 1986.