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BREACH OF CONTRACT AND THE MEANING OF LOSS

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A number of recent contract cases in the appellate courts share the following common feature: they all concern a situation in which the defendant has admittedly breached the contract but the plaintiff has suffered no obvious financial loss or the loss which it has suffered is considerably less than the gain which the defendant has made from the breach of contract. The reasons for the plaintiff's inability to prove the existence of a loss are many: the plaintiff may have suffered 'non-pecuniary' loss, such as loss of amenity, the financial loss may have been suffered by a third party for whose benefit the contract was concluded, or the financial loss which the plaintiff initially suffered has subsequently been made good by his own actions or by the intervention of a third party. The courts have, on the whole, recoiled from the conclusion that nominal damages should be awarded because, to do so, would allow a contracting party to break a contract with impunity. But we must tread carefully here. A breach of contract is not a crime and it does not attract the sanction of punitive damages.[1] So the fact that the defendant has made a calculated decision to break the contract does not of itself entitle the plaintiff to a financial remedy beyond nominal damages. On the other hand, it does not necessarily follow that the plaintiff's only entitlement should be to nominal damages.

It is important at the outset of this paper to note that its focus

My thanks to Steve Smith and Roger Halson and to participants at staff seminars at the Universities of Edinburgh, Hull, and Nottingham for helpful comments on a draft of this paper. The usual caveat applies.

[1] *Cassell* v. *Broome* [1972] AC 1027.

is solely upon the plaintiff's entitlement to a financial remedy in respect of the loss which the plaintiff claims it has suffered as a result of the breach of contract or in respect of the gain which the defendant has made from its breach. Other potential remedies are not expressly considered. For example, the defendant's breach may entitle the plaintiff to terminate further performance of the contract on the ground that the defendant has repudiated the contract. While termination is an important remedy in practice, it is not the focus of this paper.[2] Equally, a plaintiff might wish to seek specific performance of the contract rather than a remedy in damages. The difficulty with specific performance is, of course, that it is not the primary remedy for a breach of contract in English law. Indeed, its precise status is presently the subject of some uncertainty because the more liberal approach to its use apparent in recent years may have been brought to an end by the decision of the House of Lords in *Co-operative Insurance Society Ltd.* v. *Argyll Stores (Holdings) Ltd.*[3] However, the availability of specific performance as a remedy is not the main focus of this paper. Having said that, the restricted role afforded to specific performance may have some explanatory force in relation to the issues considered in this paper because it provides evidence of the fact that English law has a rather limited perception of the performance interest of the plaintiff. In general, the plaintiff's interest is held to lie not in the actual enforcement of the primary obligations under the contract but in securing the financial equivalent to performance by the defendant.

The argument which I wish to advance has one central theme and four sub-themes. The central theme or argument is that English law presently adopts an unduly restricted notion of loss in that it has difficulty recognizing the existence of a loss to the plaintiff which is not financial in nature. Yet many people today enter into contracts for reasons other than to make money. What is required is a more expansive notion of loss which embraces and hence provides protection for the non-economic reasons which people have for entering into contracts (for example, to enhance their leisure or to obtain satisfaction from performance). At the

[2] The fact situation with which I am concerned is one where the plaintiff asserts that it has suffered some form of loss or that the defendant has made a gain from the breach and neither of these perceived injustices will be rectified simply by terminating the contract.

[3] [1998] AC 1.

same time, the law should recognize the existence of a loss to the plaintiff every time that something is supplied to him which is worth less to him than the performance for which he contracted and damages should be assessed by reference to the cost of providing him with that performance ('cost of cure' damages) whenever the plaintiff's interest lies in the actual performance of the contract and not the economic return which he would obtain from performance and the decision to seek cost of cure damages is not wholly unreasonable.[4]

The four sub-themes are as follows. First, the courts must always consider whether the loss is truly that of the plaintiff contracting party or whether it is in fact the loss of a third party which is in issue. The second is that in some of the cases the fact situation is that a number of parties have an interest in performance of the contract (usually because they are concurrent or successive owners of the work produced by the defendant) and one question which arises for consideration is whether or not the law should develop a special set of rules to reflect their different entitlements in relation to the work done. The third is that in a number of the cases the issue is not whether the plaintiff has suffered a loss (he undoubtedly has) but whether that loss has in fact been made good by the actions of the plaintiff or the intervention of a third party. The fourth sub-theme is that some of the cases are concerned, not with the loss to the plaintiff, but with the gain which the defendant has made from the breach and the source of the rules which seek to strip the defendant of his gain is to be found largely in the law of restitution. The plaintiff must decide whether he wishes to recover the loss which he has suffered or whether he wishes to strip the defendant of the gain which he has made from the breach. He cannot do both.[5] Having thus sketched out the essence of the argument, it is time to turn to my central theme.

[4] The latter qualification is a particularly contentious one and it is developed in more detail below, at 53–5.

[5] *Tang Man Sit* v. *Capacious Investments Ltd.* [1996] AC 514. The case has not escaped criticism: see P. Birks, 'Inconsistency between Compensation and Restitution' (1996) 112 *LQR* 375, and A. Burrows, 'Postscript to Solving the Problem of Concurrent Liability', in *Understanding the Law of Obligations* (Oxford, 1998), 41–4. Consideration of this issue is beyond the scope of this paper.

The Traditional Analysis

The traditional approach of English law to the assessment of damages for a breach of contract is well known. It is to be found in the judgment of Parke B in *Robinson* v. *Harman*[6] where 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.[7]

This is generally understood to be a reference to the *financial* situation of the plaintiff had the contract been performed, as can be demonstrated by reference to the following statement taken from the judgment of Lord Bingham MR (as he then was) in *White Arrow Express Ltd* v. *Lamey's Distribution Ltd*.[8] He stated that the *Robinson* v. *Harman* 'formulation assumes that the breach has injured [the plaintiff's] financial position; if he cannot show that it has, he will recover nominal damages only.'[9]

The question which I wish to pose at this point is whether or not that perception is correct. The point is an important one. The law of contract permeates into an ever-increasing range of transactions in our society and, in a not insignificant minority of them, pursuit of profit is not a primary aim of both parties. Take the case of a homeowner who enters into a contract for the construction of a swimming-pool in his garden, the son who enters into a contract to have central heating installed in his parents' home or

[6] (1848) 1 Ex. 850.

[7] Ibid. 855. The exact scope of the expectation interest has not been greatly explored in the periodical literature. One reason for this may be the impact of L. Fuller and W. Purdue's famous article 'The Reliance Interest in Contract Damages' (1936) 46 *Yale LJ* 52, which has led commentators to debate the justification for the protection of the expectation interest rather than the scope of the expectation interest. The scope of the expectation interest has been explored in some articles: see H. Lucke, 'Two Types of Expectation Interest in Contract Damages' (1989) 12 *UNSW Law Journal* 98; D. Barnes, 'The Meaning of Value in Contract Damages and Contract Theory' (1996) 46 *American University Law Review*; and B. Coote, 'Contract Damages, *Ruxley* and the Performance Interest' [1997] *CLJ* 537.

[8] (1996) Trading Law Reports 69.

[9] Ibid. 73. To similar effect see e.g. *Ford* v. *White* [1964] 1 WLR 885. The position would appear to be the same in Scotland: see *Houldsworth* v. *Brand's Trustees* (1876) 4 R 369, 375 *per* Lord Gifford.

the local authority which enters into a contract to provide services for residents who live within its boundaries. These three contracts are not entered into by the party whose obligation is to pay money with a view to making a profit. They are entered into with a view either to enhance leisure or to provide a service for the community or particular individuals in the community who do not pay for the service directly,[10] and whose need for the service is not based solely on the income or profit which the provision of that service will enable them to generate.[11]

The pursuit of leisure and the receipt of services which promote the quality of our lives but do not directly enhance our financial position are values which are esteemed or prized in our society. Yet they are values which our law of contract has experienced and continues to experience great difficulty in protecting and valuing. The reasons for this difficulty are not hard to find. The law was developed largely in the context of contracts entered into by the parties with a view to making a profit; often but not always commodity sales. The rules of law work tolerably well in that context but they do not translate so easily into the situation where the parties enter into a contract for reasons other than the pursuit of profit. But the development of a broader perspective may not be far away. In *Ruxley Electronics and Construction Ltd* v. *Forsyth*[12] Lord Mustill stated 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'.[13] This is a very important statement, the validity of which and the scope of which require careful consideration. In

[10] In the local authority case the residents of course will generally be required to pay for the service indirectly through the payment of the council tax. But in some cases the resident will be exempt from having to make payment. In the case of the son who enters into a contract to have central heating installed in his parents' home there is no payment by the parents, although it could be argued that their 'payment' was the support which they provided to the son in the early years of his life and this is the son repaying them for their earlier support. Even if there is an element of 'paying back' in this transaction, it would be a mistake to conceive of the transaction wholly or even largely in economic terms.

[11] Of course there are exceptions. In some cases the service provided by the local authority will enable a business indirectly to make a profit by providing a service which is a necessary cost of running the business: for example, the local authority which provides a refuse collection for a local factory. Removal of the rubbish is part of the cost of running the business and it is a cost which the business has to bear.

[12] [1996] AC 344.

[13] Ibid. 360.

seeking to evaluate it the best starting-point is the fact-situation in *Ruxley*, which neatly brings out the relevant issues.

Expectation of What?

In *Ruxley* the plaintiff builders agreed to construct a swimming-pool for the defendant. In breach of contract the plaintiff built the pool to a maximum depth of six feet when its maximum depth should have been seven foot six inches. But the difference in depth did not impair the defendant's use of the pool. It was perfectly safe for him to dive into the pool, even though he was a tall man.[14] The cost of rectifying the deficiency in the pool was assessed by the trial judge as £21,560, but the difference in value between the pool which was provided and the pool which should have been provided was found to be zero. So the defendant was not financially worse off as a result of the plaintiff's breach. Should the damages to which the defendant was entitled therefore have been assessed at zero? The instinctive answer is 'no'. The defendant did not enter into the contract to improve his financial position. He entered into the contract to enhance his leisure or, possibly, to improve his social standing with his friends and business acquaintances. To award the defendant damages assessed only by reference to the financial enhancement of his position which full performance would have secured him would have been to misrepresent the defendant's purpose in entering into the contract and it would also have given to builders the licence to provide the homeowner with a different service from that for which the homeowner had contracted and then turn to the homeowner and say 'what are you complaining about? I have provided you with a service which is of equal market value so that you are no worse off as a result of my breach.' The effect of acceptance of such an argument would have been to deprive many if not most homeowners who enter into contracts with builders of a remedy of any significance because, as Lord Mustill noted, 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

[14] It would have been otherwise if the defendant had intended to use a diving-board. In such a case the difference in depth would have been important because the pool could not then have been used for the purpose for which it was built.

market value of the house, and that comparatively minor deviations from specification or sound workmanship may have no direct financial effect at all.[15]

The diminution in value measure therefore fails to capture the homeowner's purpose in entering into the contract. So should the homeowner be entitled to recover the cost of cure measure? Cost of cure would capture his interest in the performance of the contract because it would enable him to pay for and thereby obtain the performance for which he contracted. But the House of Lords refused to take this step on the facts of *Ruxley* on the ground that it would have been unreasonable for the defendant to recover the cost of cure because the cost of carrying out the work was out of all proportion to the benefit which the defendant would have obtained from full performance. Two important factors operated in combination here to deny the defendant cost of cure damages. The first was the high cost of the repairs and the second was that the repair work would have resulted in little by way of benefit to the defendant. It was the combination of these factors which was conclusive; taken in isolation they may well not be decisive.[16] The correct answer on the facts of *Ruxley* was, according to the House of Lords, to award the defendant damages to compensate him for the disappointment which he had suffered as a result of not getting a swimming-pool built to the specifications for which he had contracted. He was awarded loss of amenity damages of £2500.[17] In awarding damages on this basis it can be argued that the House of Lords took one significant step forward but, arguably, it also took one step backwards.

[15] [1996] AC 344, 360.

[16] For example, the high cost of repair is unlikely to be of great significance where the work which has been done is of little or no benefit to the homeowner: see the speech of Lord Jauncey at 358. Much more difficult is the case where the benefit is small but the cost of cure is not as great as was the case in *Ruxley*. For example, what would have been the position if the cost of repairs had been £5000?

[17] The quantification of the loss of amenity damages was not in issue before the House of Lords as neither party had any interest in challenging the trial judge's assessment of damages under this head. Lord Lloyd did, however, indicate (at 374) that in his view the defendant was 'lucky to have obtained so large an award for his disappointed expectations', and his approval of the award of £250 on the facts of *G W Atkins Ltd* v. *Scott* (1980) 7 Const LJ 215 may indicate the level of award which he thought was more appropriate.

One Step Forward

The step forward taken by their Lordships was the award of damages to reflect the defendant's loss of amenity. This step is to be welcomed in so far as it recognizes that contracting parties may place a higher value on performance than its market value. However, the scope of the right so recognized remains the subject of some uncertainty. Lord Lloyd apparently took a narrower view of it than did Lord Mustill. Lord Mustill's approach was not confined expressly to any particular type of contract, although it is likely to find its principal expression in cases involving consumers. On the other hand, Lord Lloyd chose to emphasize the fact that the trial judge had found that the contract was one 'for the provision of a pleasurable amenity'[18] and he was hesitant[19] about recognizing the existence of a right of recovery where the contract was for the construction of something which was not a pleasurable amenity but the performance supplied gave rise to 'disappointed expectations' on the part of the customer. The source of this hesitation is understandable. Judges do not want to open the floodgates. As a matter of principle, however, the hesitation cannot be supported. Provided that the customer can prove that he or she attached a value to performance which exceeded the market value of performance, why should he or she be denied recovery, provided that the measure of recovery is kept within reasonable bounds? To recognize such a right is to do no more than recognize the values of our society. For example, many of us do not seek employment solely for the financial rewards which work brings; we seek to find that more elusive concept of 'job satisfaction' or, perhaps less worthily, we want to enjoy the status which a particular job carries with it. On the occurrence of a breach of contract which deprives the employee of these benefits, should the employee not be entitled to recover in respect of her loss of amenity or loss of job satisfaction which she can prove that she has suffered as a result of the breach? The law of contract is prepared to compensate an employee for the financial consequences which it can be proved follow from a breach of the oblig-

[18] And therefore analogous to cases such as *Jarvis* v. *Swans Tours Ltd.* [1973] QB 233 and *Jackson* v. *Horizon Holidays Ltd.* [1975] 1 WLR 1468.

[19] [1996] AC 344, 374.

ation of trust and confidence owed to an employee by an employer,[20] but it has not so far extended to recognizing a claim in respect of the non-financial losses caused by a breach of the contract of employment.[21] Yet to treat labour as a mere commodity is 'to ignore the extent to which so many of us define and value ourselves by our work'.[22] There is room for further development here. Once the step is taken of recognizing that the law must cater for those situations in which the value of a promise to a promisee can exceed the financial enhancement of his position which full performance will bring, there is no basis for restricting such a recognition to the facts of *Ruxley*. It must logically apply to all contracts where proof of such a loss can be established.

One Step Backwards?

Welcome as the recognition of loss of amenity damages is, it can be argued that the decision to award the defendant £2500 by way of loss of amenity damages amounts to a step backwards in that the court failed adequately to protect the expectation or performance[23] interest of the defendant. This is because the award did not enable him to have the pool for which he contracted. He had to put up

[20] *Mahmud* v. *Bank of Credit and Commerce International SA* [1998] AC 20. And, of course, the financial consequences of the breach are likely to be much more significant in monetary terms than any loss of amenity suffered by the employee.

[21] The problem here is the decision of the House of Lords in *Addis* v. *Gramophone Co. Ltd.* [1909] AC 488. But the proper interpretation of *Addis* may be that the loss in respect of which the employee sued was not caused by the breach in respect of which he brought his claim (see *Mahmud* v. *Bank of Credit and Commerce International SA* [1998] AC 20, 51, *per* Lord Steyn, citing with approval N. Enonchong, 'Contract Damages for Injury to Reputation' (1996) 59 *MLR* 592). Given that the House of Lords in *Mahmud* has now taken the vital step of recognizing the existence of an implied term of trust and confidence in employment contracts, a breach of such an implied term which causes the employee injury to her feelings or to suffer a loss of amenity should be compensated by an award of damages. This approach has its academic supporters (in particular see D. Brodie, 'A Fair Deal at Work' (1999) 19 *OJLS* 83), but the courts may be rather more reluctant to confine *Addis* in this way (see e.g. *Johnson* v. *Unisys Ltd* [1999] 1 All ER 854).

[22] H. Beale, 'Exceptional Measures of Damages in Contract', in P. Birks (ed.), *Wrongs and Remedies in the Twenty-First Century* (Oxford, 1996), 230. To similar effect see *Wallace* v. *United Grain Growers* (1998) 152 DLR (4th edn.) 1, 32–3.

[23] Performance is the phrase preferred by Professor D. Friedmann, 'The Performance Interest in Contract Damages' (1995) 111 *LQR* 628.

with something less and instead was given an award of damages to reflect the disappointment or loss of amenity which he suffered as a result of not getting the pool for which he had contracted. On this view, his full performance interest was not protected.[24] And this is the nub of the problem. Had the defendant entered into the contract for financial reasons, the law would have protected his interest because he would, subject to limiting factors such as the remoteness rules, have been able to recover the difference in value between the performance which he received and the performance for which he contracted. It is when the defendant enters into the contract to obtain performance itself, and not the financial or market equivalent of performance, that the law begins to experience serious difficulties. This difficulty is in substantial part attributable to the fact that the law has failed consistently to recognize the value of the right to performance itself rather than the consequences of performance or the economic end-result of performance.[25] Yet numerous examples can be given of contracting parties who enter into a contract to obtain a particular type of performance and who will not be content with a different type of performance even when it is of the same market value. Take the case of the decorator who puts the wrong wallpaper on the wall or the carpet-fitter who lays the wrong carpet. In such a case is the homeowner confined to a claim for the diminution in value plus loss of amenity damages or can he or she claim cost of cure damages? To the extent that *Ruxley* suggests that the answer is more likely to be diminution in value plus loss of amenity damages, the conception of the performance interest which *Ruxley* embodies may turn out to be a rather limited one.

How Can Performance Be Obtained?

After *Ruxley* how can a party who wants to receive a particular type or form of performance ensure that he actually obtains that performance? The question is an important one because the answer to it tells us a great deal about the protection which

[24] Cf. Friedmann, ibid. at 650, who maintains that *Ruxley* is a decision 'predicated on the approach that pacta sunt servanda and that the plaintiff's performance interest should be protected'.

[25] See generally B. Coote, 'Contract Damages, *Ruxley* and the Performance Interest' [1997] *CLJ* 537.

Ruxley actually affords to the performance interest. On closer examination of the facts of *Ruxley* it is arguable that the case is an extreme one, where cost of cure was not appropriate, and that therefore the case does not embody such a limited conception of the performance interest. It would appear that, after *Ruxley,* there are three possibilities open to a party who wishes to ensure that the promised performance is obtained.

Specific Performance

The first is to seek specific performance as the remedy in the event of a breach of contract. The difficulty of course is that specific performance is not widely available as a remedy in English law and, paradoxically, one effect of *Ruxley* is likely to be to diminish the availability of specific performance because the willingness of the courts to grant loss of amenity damages will make it harder for the innocent party to show that damages would be an inadequate remedy. And, if the court is not willing to order that performance be carried out, does this 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?[26] 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 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 wholehearted.

Withhold Performance

The second possibility is to refuse to pay for the work done and leave it to the party in breach to bring a claim for payment for the

[26] For this reason it would be interesting to consider whether *Ruxley* would be decided the same way in Scotland. Given the wider availability of specific implement in Scotland, does this suggest a deeper commitment to the performance interest which would be reflected in a greater willingness to award cost of cure damages?

work which has been done. This of course was what happened on the facts of *Ruxley*. It was the contractor who was the plaintiff seeking to recover payment for the work which had been done. One of the grounds on which the defendant resisted the claim for payment by the plaintiff was that the contract was entire but that defence was rejected on the grounds that the contract was not entire (payment being made in stages) and the plaintiff had also substantially performed his obligations under the contract. The latter finding might actually suggest that *Ruxley* was correct on its facts on the ground that the defendant had obtained substantially what he had bargained for so that it would have been wholly unreasonable to give him damages in order to enable him to undo what had been done when what had been done was substantially what he had contracted for. The result of the case might therefore have been otherwise if the defendant had not obtained substantially that for which he had contracted.

Return to the example of the decorator who puts on the wrong wallpaper or the carpet-fitter who lays the wrong carpet. If the decorator or carpet-fitter brought a claim for payment, would the claim succeed? According to the authorities, the answer depends on the extent of the non-conformity of the work and the cost in relation to the contract price of rectifying the deficiency.[27] These authorities are, of course, open to question. But that is not my immediate point here. Rather, it is that the law should not distinguish between the case where the homeowner has paid in advance for the work and the case where she has not paid in advance. If the homeowner would be entitled to resist payment of the price, she should also be entitled to recover damages which would enable her to obtain the performance of the contract for which she contracted. On this view *Ruxley* is confined to cases where there has been substantial performance of the contract and it does not place such a great barrier in the way of a party seeking to recover cost of cure damages. The difficulty with this argument is that, while it achieves a consistency of treatment, it does so at the expense of invoking a doctrine of dubious repute, namely the doctrine of substantial performance. Although the doctrine of substantial performance is relatively well-established in the

[27] See e.g. *Bolton* v. *Mahadeva* [1972] 1 WLR 1009.

cases,[28] it has been criticized on the ground that 'it is based on the error that *contracts*, as opposed to particular *obligations*, can be entire'.[29] If an obligation is entire it means by definition that it must be completely performed before the corresponding obligation of the other party can arise. If performance remains incomplete there can, for example, be no corresponding obligation to pay for that incomplete performance. Critics of the doctrine of substantial performance are themselves open to criticism on the ground that their view can produce extremely harsh results and it also requires us to be able to identify when an obligation is entire and when it is not. Professor Treitel suggests that the obligation to complete performance is entire but that, in the absence of a stipulation to the contrary in the contract, the obligation to do so in a workmanlike manner should not be regarded as entire.[30] Yet the distinguishing line between these two cases is not always clear cut. For example, has the decorator who puts the wrong wallpaper on the wall failed to complete the work or has he completed it but not in a workmanlike manner? It seems more realistic to conclude that his mistake relates to the quality of the workmanship rather than its completion but, where the homeowner has expressly stipulated that the decorator put a particular type of wallpaper on the wall, it is not difficult to make out an argument that putting the right paper on the wall was a condition precedent to payment. The precise point at which we draw the line will always be the subject-matter of debate, but the point which I wish to make here is that the doctrine of substantial performance has to be brought into account when seeking to resolve these issues. The existence of the doctrine does provide further evidence of the fact that the commitment of English contract law to the protection of the performance interest is not wholehearted and, to that extent, it can be used to support the outcome in *Ruxley*.

[28] See e.g. *H Dakin & Co. Ltd.* v. *Lee* [1916] 1 KB 566; *Bolton* v. *Mahadeva* [1972] 1 WLR 1009; *Williams* v. *Roffey Bros. & Nicholls (Contractors) Ltd.* [1991] 1 QB 1, 8–10, 17.

[29] G. Treitel, *The Law of Contract*, 9th edn. (London, 1995), 703 and, to similar effect, see Chitty, *On Contracts*, 27th edn. (London, 1994), paras. 21-025–6.

[30] G. Treitel, n. 29 above, 700–3.

The Role of Intention

The third possibility is to seek to offer to the court an undertaking that the work will be carried out if damages are awarded on a cost of cure basis or otherwise endeavour to lead evidence of the importance which is attached to performance. This line of argument would appear to be doomed to failure after the decision of the House of Lords in *Ruxley*. Their Lordships clearly stated that a party cannot 'create' a loss by the mere assertion of an intention to carry out the work. The overriding requirement is that it must be reasonable for him to carry out the repair work and, in deciding whether it is reasonable to carry out the work, the intention of the parties is not the decisive factor. So Mr Forsyth's undertaking to the Court of Appeal to use the damages award to construct a new pool did not act as a passport to obtaining cost of cure damages. This view is not without its merits. The courts are not generally concerned with the use which a party will make, plans to make or undertakes to make with the award of damages and any undertaking given might be difficult to police and to enforce. There is also the danger of a party, such as Mr Forsyth, holding the other party to ransom by offering to give such an undertaking to the court.

While the intention of the parties is not decisive, it does not follow that it is irrelevant. Their Lordships in *Ruxley* did not think intention irrelevant; rather, they thought it was relevant but not decisive. But what do we mean by intention in this context and how much weight is to be attributed to it? In *Ruxley* the trial judge found as a fact that Mr Forsyth had no intention of building a new pool,[31] although after the hearing before the trial judge Mr Forsyth did offer to give an undertaking to build a new pool if he recovered the cost of doing so as damages. So the vital issue is not whether the defendant would build a new pool if given the money to do so because an aggrieved defendant, such as Mr Forsyth, might state that such was his intention simply in order to punish the plaintiff, which the law of contract does not allow. Rather the issue is whether a pool of the required depth was an objective of the parties when they entered into the contract such that, if they

[31] [1996] AC 344, 362.

were told that the pool had been built to the wrong depth, the party for whom the work was done would immediately have declared his intention to seek to have the work re-done. Given that the pool in *Ruxley* was safe to dive into, and that safety was the dominant motive of the defendant in stipulating for a particular depth, it is unlikely that the defendant, on being told of the disparity, would have declared an immediate intention to have the pool rebuilt. This being so, he failed to demonstrate that it was, *and always had been*, his intention to have the pool rebuilt and he was therefore properly denied cost of cure damages.

But there may be many other cases where the innocent party would be able to demonstrate the existence of such an intention to carry out the work and, in such a case, *Ruxley* should not preclude the award of cost of cure damages. An instructive example is the case of the son who enters into a contract with a central heating engineer to have central heating installed in his parents' house. There is a temptation to dismiss this example as irrelevant on the ground that this is essentially a privity problem which arises because English law does not allow the parents to bring a contractual claim against the heating engineer.[32] This temptation must be resisted. While it is true that there is a privity aspect to it,[33] the example cannot be seen exclusively in these terms. After all, the son is undoubtedly a party to the contract and he is entitled to bring a claim in respect of any breach of that contract. What would be the response of the courts to such a claim? In *Linden Gardens Trust Ltd* v. *Lenesta Sludge Disposals Ltd*[34] Lord Griffiths gave a very similar example and dismissed as 'absurd'[35] the argument that the party in the position of the son had suffered no damage because he did not own the property upon which the work was carried out. In his view, the son had suffered a loss because he did not receive the bargain for which he had contracted and the measure of his damages was the cost of securing the performance of that bargain

[32] Note also that, where the system is merely defective, the parents will also not have a claim against the central heating engineer in tort as a result of the decisions of the House of Lords in *D & F Estates Ltd* v. *Church Commissioners for England and Wales* [1989] AC 177 and *Murphy* v. *Brentwood District Council* [1991] 1 AC 398.

[33] Thus Professor Treitel chooses to discuss Lord Griffiths's principle entirely in the context of his analysis of privity and its exceptions (see Treitel, n. 29 above, 545–6) and not in the section of his book dealing with damages generally.

[34] [1994] 1 AC 85.

[35] Ibid. 96.

by having the work completed properly by a second contractor.[36] However, the status of Lord Griffiths's dicta, as a matter of authority, is not entirely clear. While it was received sympathetically in *Linden Gardens*, their Lordships expressly refrained from giving it their seal of approval,[37] although it has since been cited with approval by Steyn LJ (as he then was) in *Darlington Borough Council* v. *Wiltshier Northern Ltd.*[38] and by the Court of Appeal in *Alfred McAlpine Construction Ltd* v. *Panatown Ltd.*[39] It is respectfully suggested that Lord Griffiths was essentially correct in his analysis.[40] When seeking to evaluate the merits of his approach, it is of crucial importance to notice that Lord Griffiths was making the point that it was the son who has suffered the loss. It was not that the parents had suffered a loss.[41] This being the case, damages should be payable to the son and not to the parents. They are payable to the son either because he has paid for a performance which he has not received (in that defective performance is worth less than the contracted-for performance) or because he will have to employ a second heating engineer to complete the work satisfactorily. Were the son to seek cost of cure damages, it would not be

[36] [1994] 1 AC 96–7.

[37] Lord Keith (95) had 'much sympathy' with the view of Lord Griffiths but did not express a concluded view because the 'matter was not fully explored in argument' and 'the possible effects upon other forms of commercial contract remain uncertain'. Lord Bridge (96) was 'much attracted' by the broad principle but also found it unnecessary to resolve the matter, while Lord Browne-Wilkinson (112) thought that such a principle, which could have 'profound effects on commercial contracts which effects were not fully explored in argument', merited 'exposure to academic consideration' before it was finally decided by the House of Lords.

[38] [1995] 1 WLR 68, 80, although he was of the view that the approach of Lord Griffiths was too narrow rather than too wide. Dillon LJ, sharing the caution of their Lordships in *Linden Gardens*, expressed no concluded view (75).

[39] (1998) 88 Build LR 67, 85–6. Lord Griffiths's speech was relied upon at first instance in Scotland in *Steel Aviation Services Ltd* v. *H Allan & Co Ltd* but on appeal to the Inner House of the Court of Session the court found that it was not necessary to decide whether or not the sheriff had been right so to rely upon Lord Griffiths's approach (1996 SC 427, 429).

[40] His later proposition that who actually pays for the work necessary as a result of the defendant's breach is irrelevant because it is *res inter alios acta* as far as the defendant is concerned does, however, require qualification. See below, 64.

[41] On this view there can be no room for the conclusion that the son holds the money on trust for his parents or is otherwise accountable to his parents for the money. The trust analysis might have some persuasive force if the loss was the loss of the parents. But, given that the premiss is that the loss is that of the son, there is no basis for the conclusion that the money should be paid to the parents.

difficult for him to demonstrate that it was his intention to provide his parents with a heating system which worked and that he therefore intended to have the repair work carried out. If asked to do so, he would surely give to the court an undertaking to use the damages for the purpose of repairing the heating system.[42] The undertaking would be no mere formality designed to obtain cost of cure damages; it would reflect the intention which the son had always had.

How much weight should be given to the intention of the innocent party? In the central heating example, intention plays a critical role. If the son does not intend to carry out the work, cost of repairs are unlikely to be awarded; but if he does intend to carry out the work, then cost of cure damages would almost certainly follow. This example is, however, relatively straightforward because the central heating system is defective in that it does not work. Much more difficult is the case where the goods supplied do not correspond with description but otherwise perform the intended function.[43] In such a case the role of intention may not be quite so crucial because a court may conclude that, irrespective of the intention of the parties, the non-compliance can adequately be compensated by the award of loss of amenity damages. The justification for this approach is that the value of the promise to provide goods of a particular description lies in the aesthetic quality of the goods so that the loss is best reflected by an award of damages for loss of amenity. That said, there may be cases where loss of amenity damages would be inappropriate because precise compliance with the contractual specifications was in fact the contractual objective of the parties. Take the example which was used in *Ruxley* of the man who enters into a contract for the construction of a house and stipulates that one of the lower courses of brick should be blue. Suppose that the builder uses red brick instead.[44] Lord Jauncey was of the view that 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,

[42] Such an undertaking would be owed to the court or, possibly, to the defendant heating engineer. It would not be owed to his parents and so would not give them a cause of action.

[43] A case in this category is *Jacob & Youngs* v. *Kent* 129 NE 889 (1921).

[44] In the example which was given by Lord Jauncey the brick used was yellow but, as will become apparent, red suits my example rather better.

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.'[45] But suppose that the man was an Everton supporter and that this was known to the builder.[46] In such a case a course of blue bricks would have been an integral part of the design of the house and the use of red[47] bricks instead would, in all probability, render the house uninhabitable by a true Evertonian. In such a case should cost of cure damages be awarded notwithstanding the disproportionate cost of reconstruction? This is an issue on which reasonable minds will differ because it depends on a balancing of the right to performance against the extremely high cost of providing that performance. If primary emphasis is given to the right to literal performance then the homeowner should be entitled to the cost of providing him with what he was promised. The contract-breaker has only himself to blame for his misfortune. On the other hand, we know that English law presently does not give primary emphasis to the right to obtain literal performance. This can be demonstrated by the fact that specific performance is not the primary remedy for breach of contract, the substantial performance exception to the entire contracts rule, and the 'legitimate interest' in performance requirement in the *White & Carter (Councils) Ltd* v. *McGregor*[48] line of cases. While the argument of this paper has been that English law should place greater value on the right to performance rather than on the economic end-result of performance, there comes a point where the protection of the right to performance is outweighed by the excessive cost to the defendant and to society of providing that protection. In such exceptional circumstances the court should be entitled to deny to the

[45] [1996] AC 344, 358.

[46] Knowledge of the builder would appear to be an essential prerequisite. Where the builder does not have the requisite knowledge then cost of cure is much more difficult to justify because it appears such a remote consequence of the breach. But, where the objective was in the contemplation of both parties at the time of entry into the contract, then the award of cost of cure damages is more readily justifiable. But even then, for reasons given in the text, the courts may stop short of awarding cost of cure damages.

[47] Red being the colour of Liverpool Football Club, Everton's great rivals.

[48] [1962] AC 413. The 'legitimate interest' requirement has since been exploited in cases such as *Attica Sea Carriers Corp* v. *Ferrostaal Poseidon Bulk Reederei GmbH* [1976] 1 Lloyd's Rep 250, *The Odenfield* [1978] 2 Lloyd's Rep 357 and *Clea Shipping Corp* v. *Bulk Oil International Ltd* [1984] 1 All ER 129 to limit the impact of *White & Carter*.

plaintiff cost of cure damages and relegate him to a claim for diminution in value and loss of amenity damages (and the latter should not be insubstantial where it is known to the parties that one contracting party places particular value on precise compliance with a particular stipulation[49]).

The Sub-themes

A more expansive conception of loss will not, however, bring an end to our problems. *Ruxley* itself illustrates this point because it is no easy task to work out whether or not the defendant should have been entitled to cost of cure damages; it may be that it was a case in which cost of cure was rightly refused on the ground that the defendant could not show that his interest was in literal performance because he was unable to prove that it was always his intention to ensure that the pool was built to the stipulated depth. So the identification and quantification of the loss which a party has suffered is a complex matter both in theoretical and in practical terms. That complexity is compounded by the fact that the issue of the identification and quantification of the loss has become intertwined with other issues, which should in fact be kept separate and distinct. The intermingling of issues which should have been kept separate has been a major contributory cause of the confused state of the case law. There are four issues which require separate identification and resolution.

Who has Suffered the Loss?

The first relates to the identification of the loss. Take the case of the son who engages central heating engineers to install central heating in his parents' house. Who has suffered the loss in this case? There are three possible answers to this question.[50] The first is that the loss is that of the son and this is Lord Griffiths's position in *Linden Gardens*. The second is that the loss is that of the

[49] *Ruxley* can be distinguished on the ground that the defendant did not place a particular value on the depth of the pool, so that statements to the effect that the award of loss of amenity damages should be 'modest' must be seen in that context.

[50] It may be that the first two views can be held together so that both the son and the parents can recover damages provided that the engineer is not required to pay twice for the same loss.

parents and that the parents should have a direct right of action to recover that loss. The third is an intermediate position, namely that the loss is that of the parents but that it is the son who is entitled to sue and recover damages on their behalf. Rather surprisingly, this question has not been clearly answered in the cases. The failure to articulate and resolve this elementary issue is, one suspects, attributable to the fact that in some of the cases the loss which the court believes it is actually compensating is the loss of the third party but that this cannot be done openly because of formal adherence to the doctrine of privity of contract.

Will the picture change when privity is abolished and a third party right of action is created? The answer to this question is that the likely enactment of the Contract (Rights of Third Parties) Bill 1999 may not be as significant in this respect as one might initially think. In many cases the contract between the two contracting parties will contain terms which will negative the existence of any right of action in the third party. For example, in *Linden Gardens* the presence of the clause prohibiting assignment without the defendant's consent would have operated to deny to the third party a right of action when no attempt had been made to obtain the consent of the defendant to the assignment. At first sight *Darlington Borough Council* v. *Wiltshier Northern Ltd*[51] looks a more promising candidate for a direct right of action on the part of the local authority third party. But first appearances can be deceptive.

In *Darlington* Morgan Grenfell entered into a contract with the defendant construction company under which the defendants agreed to build a recreational centre for Darlington Borough Council. It was alleged that the construction work was done defectively and the cost of repairs was estimated at £2 million. Should Darlington have had a direct right of action to recover its loss? There is a case for saying that it should. In the first place the only interest which Morgan Grenfell had in the performance of the contract was a financial one. They were not interested in performance of the work to a proper standard provided that they got their money back.[52] Secondly, Steyn LJ devoted a substantial

[51] [1995] 1 WLR 68. On which see J. Cartwright, 'Damages, Third Parties and Common Sense' (1996) 10 *JCL* 244.

[52] A fact evidenced by their exclusion of any responsibility to Darlington for any defects in the work.

part of his judgment to a critical analysis of the doctrine of privity and expressed the hope that the courts would one day get rid of this doctrine which he stated was commercially inconvenient and capable of giving rise to injustice. His focus on the doctrine of privity can be explained only on the ground that he believed that the third party, Darlington, should have had a direct right of action in contract. But, on closer analysis it is not at all obvious that it should have had such a claim. There are two obstacles which make it difficult to assert that Darlington should have had such a direct contractual claim. First, Darlington did have a direct right of action against the defendants for liquidated damages for delay in the performance of the contract. Secondly, Morgan Grenfell assigned its interest under the contract with the defendants to Darlington and it was in its capacity as assignee that Darlington brought its claim for damages.[53] Does it not therefore follow that the parties' intention was to give Darlington a direct right of action only for liquidated damages but that otherwise its rights were only those which it acquired by virtue of the assignment? Of course, it can be argued that, once a direct right of action is created, there will be no need for the inclusion of such comprehensive assignment clauses in contracts. But the parties might prefer the certainty of a comprehensive assignment clause to the uncertainty of a direct right of action of doubtful scope. And, if they do include such an assignment clause in their contract, does this operate to exclude any direct third party right of action? The answer, ultimately, turns on the intention of the parties. But, in my view, there is a strong case for saying that the effect of the assignment will be to negative the intention to create a direct right of action in the third party, thereby confining the third party to his rights as an assignee of one of the contracting parties. Whatever the precise answer to this question, enough has been said to dispel the notion that the introduction of a third party direct right of action will bring an end to the problems associated with the *Linden Gardens* line of authority.

One final issue which merits some consideration in this context is the intermediate position, namely the possibility that the plain-

[53] It was common ground between the parties that Darlington as assignee could not recover damages beyond those which Morgan Grenfell could have recovered from the defendants.

tiff contracting party can sue and recover damages on behalf of the third party. The orthodox answer is that a plaintiff cannot do this.[54] He can only recover in respect of his own loss. This rule is not absolute[55] but it seems clear from the decision of the House of Lords in *Woodar Investment Development Ltd.* v. *Wimpey Construction Co Ltd.*[56] that the exceptions operate within relatively narrow compass. Yet in *Alfred McAlpine Construction Ltd* v. *Panatown Ltd*[57] the Court of Appeal held that the ability of a plaintiff to recover damages in respect of a loss suffered by a third party was in fact dependent upon the intention of the parties at the time of entry into the contract. If it was their intention that the plaintiff recover substantial damages on behalf of the third party, then effect should be given to that intention and the plaintiff should be accountable to the third party for the damages which he receives.

There are two possible objections to this analysis. The first is that, in so far as it is based on the speech of Lord Griffiths in *Linden Gardens,* it misinterprets his speech because, as we have seen,[58] he was of the view that the loss was truly that of the contracting party and not the third party. The second is that the rule that a contracting party can only recover in respect of his own loss and not the loss of a third party appears to be a rule of law and not one based on the intention of the parties. It is probably a direct offshoot both of the principle that damages are awarded to compensate a plaintiff for the loss which he has suffered and of the privity rule in that it prevents the third party obtaining indirectly what he cannot obtain directly. That said, is the rule mandatory or can the parties contract out of it? If A and B enter into a contract and they agree that any breach by A will have a detrimental effect on C and that B should be entitled to sue and

[54] See *Woodar Investment Development Ltd.* v. *Wimpey Construction Co Ltd.* [1980] 1 WLR 277.

[55] e.g. an agent may sue to recover the loss suffered by his principal and a trustee may sue to recover a loss which has been suffered by the beneficiary. See *Jackson* v. *Horizon Holidays Ltd.* [1975] 1 WLR 1468, as interpreted by the House of Lords in *Woodar Investment Development Ltd.* v. *Wimpey Construction Co Ltd.* [1980] 1 WLR 277.

[56] [1980] 1 WLR 277.

[57] (1998) 88 Build LR 67. The case is discussed in more detail by G. Treitel, 'Damages in Respect of a Third Party's Loss' (1998) 114 *LQR* 527, and N. Palmer and G. Tolhurst, 'Compensatory and Extra-Compensatory Damages: *Linden Gardens* and the "Lord Griffiths' " Principle' (1998) 13 *JCL* 143.

[58] See 57, above.

recover damages on behalf of C, why should the law refuse to give effect to that agreement? When privity was operated strictly by the courts they may well have been reluctant to accede to an argument which effectively outflanked privity and the House of Lords in *Woodar* appeared to be of the view that the rule could not be contracted out of in this way. But now that privity is generally seen to be a doctrine which is both commercially inconvenient and unjust, there seems no reason not to give effect to the agreement which A and B have voluntarily concluded. If A has agreed to pay damages to B on behalf of C, effect should be given to the agreement. It may be that this is the true explanation of cases such as *Dunlop* v. *Lambert*[59] which have, hitherto, been difficult to classify.[60]

If it is the case that the parties can contract out of the rule that a contracting party cannot sue and recover damages on behalf of a third party, how likely is it that the contracting parties will have such an intention and, further, be able to persuade a court that such was their intention? Where the parties are commercial parties who have been legally advised such an intention may be discernible. But even in commercial contracts the creation of a direct contractual relationship between the third party and one of the contracting parties[61] or a clause assigning to the third party the rights of one of the contracting parties is likely to make it difficult to persuade a court that the intention of the parties was that one contracting party should be entitled to sue and recover damages on behalf of the third party.[62] Outside the commercial context, the likelihood

[59] (1839) 2 Cl & F 626. It may well not extend to *Linden Gardens* because, as Lord Goff pointed out in *White* v. *Jones* [1995] 2 AC 207, 268B-C, the remedy there was made available to the third party as a matter of law and not as a consequence of the intention of the parties.

[60] This might also explain why the plaintiff cannot recover damages where the third party has a direct right of action against the defendant. The existence of such a direct right of action suggests that an indirect right of action by the plaintiff for the benefit of the third party is not likely to have been in the contemplation of the contracting parties.

[61] A difficulty which arose on the facts of *Alfred McAlpine Construction Ltd* v. *Panatown Ltd* (1998) 88 Build LR 67, where there was a duty of care deed which created a contractual relationship between the third party and the defendant, but, as a matter of construction, this was held not to prevent the plaintiff from recovering damages on behalf of the third party.

[62] On the basis that the entitlement of the third party to sue directly or as an assignee constitutes the sum total of the third party's rights.

that contracting parties will have an intention that one of them should be entitled to sue and recover damages on behalf of a third party appears remote. An example will illustrate the point. Assume that a husband takes his wife out for a meal on her birthday. She suffers food-poisoning as a result of eating food which was inadequately prepared by the restaurant.[63] The husband pays the bill for the meal and decides that he wishes to sue the restaurant.[64] Can he sue and recover damages on behalf of his wife? According to the Court of Appeal in *Panatown*, that depends on their intention when entering into the contract. The difficulty is that it seems inherently unlikely that they would have addressed their minds to this question prior to entry into the contract. Even if they had thought about it, they would have had to have read a few law books before coming to the conclusion that what should happen is that the husband should sue the restaurant on behalf of his wife and that his wife should then claim from him the sum which he recovered from the restaurant. To find in such a case that the parties intended to mediate the award of damages through the hands of one of the contracting parties would be nothing more than a fiction. Much more likely is the conclusion that their intention was that the wife should be entitled to sue the restaurant owner directly. While it may be workable to introduce a rule which allows a direct right of action by the third party where that is consistent with the intention of the parties,[65] a half way house under which the contracting parties intend that one of them should be entitled to sue and recover on behalf of a third party is likely to be a relatively rare event. But where it is demonstrated that this was the intention of the parties it is submitted that there is no good reason not to give effect to that intention.

[63] For this purpose I am ignoring any right of action which the wife may have in tort or under any applicable statute.

[64] Of course, he may be better advised not to sue himself and leave it to his wife to bring a claim in contract in the light of *Lockett* v. *A & M Charles Ltd* [1938] 4 All ER 170. But let us suppose that he feels very badly about what has happened and wishes to seek redress himself rather than inflict further suffering on his wife by making her party to legal proceedings.

[65] As proposed by the Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com No. 242 (HMSO, 1996) and presently before Parliament in a slightly modified form in the Contract (Rights of Third Parties) Bill.