Part IV

Performance, Discharge and Remedies for Breach of Contract

18 Performance and Discharge of the Contract

18.1 Performance

Contracts are made to be performed. When parties enter into a contract, they generally do so in the expectation that it will be performed according to its terms. Indeed, a contract consists of a number of terms which determine the scope of the performance obligations which the parties have accepted. A failure to perform in accordance with these terms is a breach of contract, which will entitle the other party to the contract to an appropriate remedy (*Photo Production Ltd* v. *Securicor Transport Ltd* [1980] AC 827, see further 19.3).

However, in many cases the formation of the contract and the performance of the contract are practically simultaneous. For example, I purchase a newspaper at a nearby shop. Here my offer to buy the paper and the shopkeeper's acceptance of my offer occur at virtually the same time as the performance of the contract in the handing over, and the payment for, the newspaper. Atiyah asks (1986b): 'Is it really sensible to characterise these transactions as agreements or exchanges of promises?' He argues that obligations are really created by what we do, not what we promise or what we intend: in other words, it is the payment of the money and the handing over of the newspaper which form the basis of the obligations created, not the *promise* to pay or the *promise* to hand over the newspaper.

It must be conceded that in many cases formation and performance are practically simultaneous. This fact is often obscured by contract textbooks because formation appears at the beginning of the book and performance towards the end. But in the real world the two often occur at virtually the same time. On the other hand, there may be a considerable time lapse between formation and performance. For example, I may order a special anniversary issue of a newspaper which is not due for publication for another three weeks. In such a case I want to know at the moment that I reach agreement with the shopkeeper that he will order and deliver to me a copy of the newspaper. Here there appears to be no doubt that the agreement is the basis of our obligations, not any action in reliance upon the agreement. It is submitted that the same is true when formation and

performance are virtually simultaneous. In my example of the purchase of a newspaper, the source of the obligations created remains my promise to buy the paper and the promise of the shopkeeper to sell the newspaper; our actions are simply evidence of the fact that we have reached agreement (see 1.4).

18.2 Discharge of the Contract

Contracts may be discharged or brought to an end in four principal ways. We shall deal with three forms of discharge in this chapter. They are discharge by performance (18.3), by agreement (18.4) and by operation of law (18.5). Contracts can also be discharged by breach, but breach is a sufficiently important topic to deserve a chapter in its own right (see Chapter 19).

18.3 Discharge by Performance

A contract is discharged by performance where the performance by both parties complies fully with the terms of the contract. The vast majority of contracts are discharged by performance. We do not read about such contracts in textbooks because, when the contract is discharged by performance, no legal problems arise. Indeed, the discussion of 'performance' in most contract textbooks is, in fact, a discussion of breach of contract because the point which is being made is that performance which fails to comply fully with the terms of the contract is a breach of contract. We shall deal with such issues in the chapter on breach of contract (see Chapter 19).

It is, however, extremely important to realise that, in the real world, most contracts are discharged by performance. Students who read contract textbooks tend to get a distorted view of reality because they believe that all contracts go wrong for one reason or another. In fact, most contracts are performed according to their terms and the role of the lawyer is confined to giving advice on the formation or the drafting of the contract. It is only in the minority of cases that contracts go wrong and a dispute breaks out between the parties and, even when such a dispute does occur, empirical studies show us that the rules of contract law are often but one factor among many to be taken into account in the resolution of the dispute (see 1.5).

18.4 Discharge by Agreement

The parties can agree to abandon or to discharge the contract. The limiting factor here is that an agreement to discharge a contract must be supported by consideration (5.20). Where performance has not been completed by either party to the contract, there is generally no difficulty in finding consideration because, in giving up their rights to compel each other to perform, each party is giving something to the bargain and so consideration is given. But where the contract is wholly executed on one side, an agreement to abandon the contract (unless the agreement to abandon the contract is itself supported by fresh consideration) will not be supported by consideration and will be unenforceable unless (i) the agreement is in the form of a deed, (ii) the party who has fully performed his obligations under the contract is estopped from going back upon his representation that he will not enforce the original contract or (iii) he is held to have waived his rights under that contract (see 5.24 and 5.25).

Finally, a contract may be discharged by the operation of a condition subsequent which has been incorporated into the contract. A condition subsequent states that a previously binding contract shall come to an end on the occurrence of a stipulated event (see 10.2). The effect of the occurrence of the stipulated event is to discharge the contract, without either party being in breach of contract.

18.5 Discharge by Operation of Law

A contract may be discharged by operation of law. The principal example of a contract which is brought to an end by the operation of a rule of law is a contract which is frustrated. Frustration, it will be remembered, automatically brings a contract to an end by the operation of a rule of law, irrespective of the wishes of the parties (14.8). Other examples of the discharge of a contract by operation of law are discussed by Anson (1998, pp.552–5).

Summary

1 Contracts are made to be performed. The vast majority of contracts are discharged by performance.
2 Contracts may be discharged by performance, agreement, operation of law or breach.

3 A contract is discharged by performance where the performance by both parties has complied fully with the terms of the contract.
4 An agreement to discharge a contract must be supported by consideration, unless one party is held to have waived his rights under the contract or is estopped from asserting them.
5 A contract may be discharged by operation of law, for example, by the occurrence of a frustrating event.

Exercises

1 List the different ways in which a contract can be discharged.
2 When will performance be sufficient to discharge the contract?
3 Jenny agrees to buy Sarah's car for £2500. Sarah gives Jenny the car but Jenny does not pay the £2500. Jenny and Sarah then agree to abandon the contract and Sarah tells Jenny to keep the car and that she 'does not need the money anyway'. Jenny then uses the £2500 to pay for the installation of double glazing in her house. Sarah has now decided that she wants her car back and she alleges that the agreement to discharge the contract is not an enforceable agreement. Advise Jenny.

19 Breach of Contract

19.1 Introduction: Breach Defined

Professor Treitel (1999) has defined a breach of contract in the following terms: 'a breach of contract is committed when a party without lawful excuse fails or refuses to perform what is due from him under the contract, or performs defectively or incapacitates himself from performing'. It should be noted that in all cases the failure to provide the promised performance must be 'without lawful excuse'. Thus where the contract has been frustrated there is no liability for breach of contract because both parties have been provided with a 'lawful excuse' for their non-performance. Similarly, where one party has breached the contract and the breach has given to the other party the right to terminate performance of the contract, that party is not in breach of contract in refusing to continue with performance because he is given a 'lawful excuse' for his non-performance.

Although the breach can take the form of words (such as an express refusal to perform the terms of the contract), it need not do so and can be evidenced by the conduct of one party in disabling himself from performing his obligations under the contract or by performing defectively. Where it is alleged that one party has incapacitated himself from performing his obligations under the contract, his inability to perform must be established on a balance of probabilities. This is relatively easy to do where the party alleged to be in breach has sold the subject-matter of the contract to a third party, but greater difficulty arises where he enters into alternative obligations which it is alleged are inconsistent with his existing contractual obligations. The fact that a party has entered into inconsistent obligations 'does not in itself necessarily establish [an inability to perform], unless these obligations are of such a nature or have such an effect that it can truly be said that the party in question has put it out of his power to perform his obligations' (*Alfred C Toepfer International GmbH* v. *Itex Hagrani Export SA* [1993] 1 Lloyd's Rep 360, 362).

19.2 When Does Breach Occur?

The question whether or not a particular contract has been breached depends upon the precise construction of the terms of the contract. No universal legal principle can be established which displaces the need for a careful analysis of the terms of each individual contract. It is for the party alleging the existence of the breach of contract to prove that a breach has occurred. It is not generally necessary to prove that a party has been at fault before breach can be established. Many obligations created by a contract are strict; that is to say, liability does not depend upon proof of fault. A good example of a strict contractual obligation is provided by s.14(2) of the Sale of Goods Act 1979 which states that, where a seller sells goods in the course of a business, there is an implied condition that the goods supplied under the contract are of satisfactory quality, except in relation to defects drawn to the buyer's attention before the contract was concluded or, in the case where the buyer examines the goods, as regards defects which that examination ought to have revealed. The purchaser is not required to prove that the seller was at fault in selling goods which were not of satisfactory quality; the seller may have taken all reasonable steps to ensure that the goods were of satisfactory quality but he will still be in breach of contract if they are not of such quality. The strict nature of liability for breach of contract is also illustrated by the fact that it is generally no defence to a claim for breach of contract to show that the breach was committed in all good faith: the innocent party need only show that there has been a breach. But the courts have in some cases been reluctant to conclude that a party who has acted in good faith but was mistaken has thereby repudiated the contract. The position would appear to be that it is not a repudiation for one party to put forward his genuine but bona fide interpretation of what the contract requires of him (*Woodar Investment Development Ltd* v. *Wimpey Construction UK Ltd* [1980] 1 WLR 277 and *Vaswani* v. *Italian Motors (Sales) Ltd* [1996] 1 WLR 270) but that where that party performs in a manner which is not consistent with the terms of the contract, it is no defence for that party to show that he acted in good faith (*Federal Commerce & Navigation Co Ltd* v. *Molena Alpha Inc* [1979] AC 757, see further Peel, 1996).

On the other hand, a contractual term may impose a duty to take reasonable care, in which case a breach can only be established where it is proved that the party alleged to be in breach has failed to exercise reasonable care. An example in this category is provided by s.13 of the Supply of Goods and Services Act 1982 which provides that a person who supplies a service in the course of a business impliedly undertakes to 'carry out the service with reasonable care and skill'.

19.3 The Consequences of Breach

A breach of contract does not automatically bring a contract to an end (*Decro-Wall International SA* v. *Practitioners in Marketing Ltd* [1971] 1 WLR 361). Rather, a breach of contract gives various options to the party who is not in breach ('the innocent party'). The extent of these options depends upon the seriousness of the breach. Even the most serious breach, such as a fundamental breach (see 11.7), does not, of itself, terminate or discharge the contract (*Photo Production Ltd* v. *Securicor Transport Ltd* [1980] AC 827).

The consequences of a breach of contract depend upon the facts of each individual case, but three principal consequences of a breach of contract can be identified. The first is that the innocent party is entitled to recover damages in respect of the loss which he has suffered as a result of the breach. The second is that the party in breach may be unable to sue to enforce the innocent party's obligations under the contract. The third consequence is that the breach may entitle the innocent party to terminate the performance of the contract. We shall now deal with these consequences individually.

19.4 Damages

Every breach of a valid and enforceable contract gives to the innocent party a right to recover damages in respect of the loss suffered as a result of the breach, unless the liability for breach has been effectively excluded by an appropriately drafted exclusion clause. An action for damages lies whether the term which is broken is a condition, a warranty or an innominate term (see further Chapter 10). The basis upon which the courts assess the damages payable will be discussed in Chapter 20.

19.5 Enforcement by the Party in Breach

The second consequence of a breach of contract is that the party who is in breach may be unable to enforce the contract against the innocent party. Where the obligations of the parties are independent, that is to say, the obligation of one party to perform is not dependent upon performance by the other party, then breach by one party does not entitle the innocent party to abandon performance of his obligations under the contract. For example, a landlord's covenant to repair the premises and a tenant's covenant to pay rent are independent obligations so that a land-

lord is not entitled to refuse to repair the premises because the tenant has failed to pay his rent (*Taylor* v. *Webb* [1937] 2 KB 370). But, where the obligations of the parties are dependent, then a contracting party must generally be ready and willing to perform his obligations under the contract before he can maintain an action against the other party for breach of contract. Obligations created by a contract are generally interpreted as dependent obligations (see, for example, s.28 of the Sale of Goods Act 1979 which provides that, unless otherwise agreed, delivery of the goods and payment of the price are concurrent conditions, so that a seller must be ready and willing to give possession of the goods to the buyer in exchange for the price and the buyer must be ready and willing to pay the price in exchange for possession of the goods).

19.6 The Right to Terminate Performance of the Contract

A breach of contract may entitle the innocent party to take the further step of terminating performance of the contract. Here it is necessary to recount a little of the material which we discussed in Chapter 10. It will be remembered that contractual terms can be classified as conditions, warranties or innominate terms. Breach of a warranty does not give the innocent party a right to terminate performance of the contract; it only enables him to claim damages. But breach of a condition does give the innocent party the additional right to terminate performance of the contract, as does the breach of an innominate term, where the consequences of the breach are sufficiently serious (see 10.5). It should be noted that I have used the rather clumsy expression 'right to terminate performance of the contract'. Contract scholars and judges have disagreed as to the correct 'title' to be given to this right of the innocent party. Professor Treitel (1999) calls this right a 'right to rescind'. This terminology is acceptable, if dangerous. The danger lies in the fact that it tends to create confusion between 'rescission for breach' and rescission for misrepresentation'. Where a contract is rescinded for misrepresentation, it is set aside for all purposes. The contract is set aside both retrospectively and prospectively and the aim is to restore the parties, as far as possible, to the position which they were in before they entered into the contract (see 13.8). But a contract which is 'rescinded' for breach is set aside prospectively, but not retrospectively (*Johnson* v. *Agnew* [1980] AC 367 and *Photo Production Ltd* v. *Securicor Transport Ltd* [1980] AC 827). Provided this fundamental distinction is grasped, no objection can be raised to the use of the term 'right to rescind for breach'. We must now turn to give further

consideration to the consequences of the rule that breach operates prospectively but not retrospectively.

19.7 The Prospective Nature of Breach

The point that breach operates prospectively but not retrospectively is an important one. It is for this reason that I have termed the right of the innocent party a right to 'terminate performance of the contract' and not a right to terminate the contract. It is the obligations of the parties to perform their future primary contractual duties which are terminated (see Carter, 1991, p.66). The contract is not set aside *ab initio* and so a contract term which is intended to regulate the consequences of breach or the termination must be taken into consideration by the court (*Heyman* v. *Darwins Ltd* [1942] AC 356). The prospective nature of a breach of contract becomes clearer if we adopt the language of primary and secondary obligations. A primary obligation is an obligation to perform contained in the contract itself, whereas a secondary obligation is one which is triggered by a breach of a primary obligation.

The modern source of this distinction between primary and secondary obligations is the judgment of Lord Diplock in *Photo Production Ltd* v. *Securicor Transport Ltd* (above). Lord Diplock stated that 'breaches of primary obligations give rise to substituted secondary obligations'. There are two principal types of secondary obligation. The first is a 'general secondary obligation'. In such a case the primary obligations of both parties, in so far as they have not yet been fully performed, remain unchanged, but the breach gives rise to a secondary obligation, imposed upon the party in breach, 'to pay monetary compensation to the [innocent] party for the loss sustained by him in consequence of the breach'. Such a general secondary obligation arises on the breach of a warranty; the primary obligations of the parties in so far as they have not been fully performed remain unchanged and a secondary obligation to pay damages for the loss suffered as a result of the breach is created.

But, where the breach of a primary obligation entitles the innocent party to elect to terminate performance of the contract, and he does so elect, all primary obligations of both parties remaining unperformed are put to an end and

> 'there is substituted by implication of law for the primary obligations of the party in default which remain unperformed a secondary obligation to pay monetary compensation to the other party for the loss sustained by him in consequence of their non-performance.'

This obligation Lord Diplock called an 'anticipatory secondary obligation'. The crucial feature of an 'anticipatory' secondary obligation is that it enables damages to be assessed by reference to those obligations which would have fallen due for performance at some time in the future (see further 21.3). Although the judgment of Lord Diplock is not entirely clear on this point, it is suggested that he intended that an anticipatory secondary obligation should arise in every case of termination following upon a breach of a condition (an interpretation which is supported by the approach of the Court of Appeal in *Lombard North Central plc* v. *Butterworth* [1987] QB 527, discussed at 10.3 and 21.3). English law does not generally distinguish between a condition which is created by the general law and a condition which has been expressly agreed by the parties (that is to say, it would not otherwise have constituted a condition). The reason why parties choose to elevate a term to the status of a condition is to emphasise the importance of the term and to give to the innocent party, not only the right to terminate performance in the event of breach, but also the right to claim loss of bargain damages (see Opeskin, 1990).

The distinction between primary and secondary obligations is a useful one in that it helps us to see why there is no inconsistency between electing to terminate performance of the contract and, at the same time, claiming damages for the breach which gave rise to the right to terminate performance. Rather, the exercise of the right to terminate performance of the contract simply discharges the primary obligations of both parties *for the future* and imposes on the party in breach, by way of substitution, an anticipatory secondary obligation to pay damages to the innocent party.

19.8 The Right of Election

An innocent party is not obliged to exercise his right to terminate performance of the contract. As we have already noted, a breach which gives to the innocent party a right to terminate performance of the contract (often termed a 'repudiatory breach') in fact gives him an option. He can either terminate performance of the contract and claim damages ('accept the repudiation') or he can affirm the contract and claim damages. Although this right of election between termination and affirmation is notionally free, in practice it may be restricted by the rule that the innocent party must take reasonable steps to mitigate his loss (see further 20.5). For example, a seller, faced with a buyer who has breached a contract in such a way as to give to the seller a right to terminate performance of the contract, may elect not to affirm the contract but to sell the

goods elsewhere, thereby disabling himself from performing his obligations under the contract. A seller may take such a course of action because, if he fails to take reasonable steps to sell the goods elsewhere, a court may conclude that he has failed to mitigate his loss and he will be unable to recover the loss caused by his failure to mitigate.

Where the innocent party wishes to accept the breach and terminate performance of the contract he must generally communicate his decision to the party in breach. The requirements for an effective acceptance of a repudiatory breach were re-stated by Lord Steyn in *Vitol SA* v. *Norelf Ltd* [1996] AC 800 in the following form:

> 'An act of acceptance of a repudiation requires no particular form: a communication does not have to be couched in the language of acceptance. It is sufficient that the communication or conduct clearly and unequivocally conveys to the repudiating party that that aggrieved party is treating the contract as at an end. . . . the aggrieved party need not personally, or by an agent, notify the repudiating party of his election to treat the contract as at an end. It is sufficient that the fact of the election comes to the repudiating party's attention.'

While the House of Lords was at pains to emphasise that there is no rule that a mere failure to perform cannot constitute an acceptance, it does not follow that the courts will conclude that a failure to perform will always be sufficiently unequivocal to constitute an acceptance. Lord Steyn said (at p.811) that it all depended on 'the particular contractual relationship and the particular circumstances of the case' whether a mere failure to perform sufficed. An example which he gave of a failure to perform which would suffice to constitute an acceptance was given in the following terms:

> 'Postulate the case where an employer at the end of the day tells a contractor that he, the employer, is repudiating the contract and that the contractor need not return the next day. The contractor does not return the next day or at all. It seems to me that the contractor's failure to return may, in the absence of any other explanation, convey a decision to treat the contract as at an end.'

But a contractor who wishes to make sure that he has accepted a repudiation would be well advised to draw that acceptance expressly to the attention of the repudiating party. As we noted in Chapter 10, the party electing to terminate need not put forward the 'real reason' for his decision; as long as the terms of the contract entitle him to terminate he is

justified in doing so, irrespective of his motive (*Arcos Ltd* v. *E A Ronaasen & Son* [1933] AC 470, see further 10.3). Indeed, the law goes so far as to allow the innocent party to put forward no reason or even an invalid reason for deciding to terminate but, provided that the innocent party can subsequently point to a good reason which, unknown to him, existed at the moment of breach, he will still be entitled to terminate (*The Mihalis Angelos* [1971] 1 QB 164, 200, 204).

If, on the other hand, the innocent party elects to affirm the contract, the contract remains in force, so that both parties remain bound to continue with the performance of their respective contractual obligations. An innocent party who accepts further performance of the contract after the breach may be held thereby to have affirmed the contract (*Davenport* v. *R* (1877) 3 App Cas 115). Affirmation does not prevent the innocent party from claiming damages for any loss which he has suffered as a result of the breach, unless the innocent party waives not only the right to terminate performance of the contract but also the right to claim damages for the breach (sometimes known as 'total waiver', see below).

Once the innocent party has exercised his right of election and chosen either to terminate or to affirm, that decision cannot be revoked. Thus, an innocent party who has exercised his right to terminate performance of the contract cannot subsequently affirm the contract because the effect of the termination of performance is to release *both* parties from their obligations to perform in the future and, once released from these obligations, they cannot subsequently be resurrected (*Johnson* v. *Agnew* (above)).

Confusion is sometimes caused by referring to this right of election as a species of 'waiver'. This terminology is confusing but is now probably too well established to be abandoned. 'Waiver', in the sense of election, must be distinguished from 'waiver by estoppel'. These two types of waiver were clearly distinguished by Lord Goff in his judgment in *The Kanchenjunga* [1990] 1 Lloyd's Rep 391, 397–9. A contracting party who is faced by a repudiatory breach has a choice: he can either terminate or he can affirm, but he cannot do both. When the innocent party makes his choice ('makes an election'), for example by choosing to affirm, he thereby *abandons* his inconsistent right, in this case to terminate. The exercise of this right of election may be called 'waiver by election', although it is suggested that less confusion would arise if this right was simply known as 'election' and the word 'waiver' was dropped from the title. But there is another sense in which the word 'waiver' may be used. In this sense waiver does not mean the abandonment of a right but rather it refers to the forbearance from exercising a right. This species of waiver is closely linked to, if not identical with, the line of authority

exemplified by *Hughes* v. *Metropolitan Railway Co* (1877) 2 App Cas 439 (discussed in more detail at 5.25). This type of waiver may be called 'waiver by estoppel' and it arises when the innocent party represents clearly and unequivocally to the party in default that he will not exercise his right to treat the contract as terminated or so conducts himself as to lead the party in default to believe that he will not exercise that right.

Both waiver by estoppel and waiver by election share some common elements. The principal similarity is that both appear to require that the party seeking to rely on it (that is, the party in default) must show a clear and unequivocal representation, by words or conduct, by the other party that he will not exercise his strict legal right to treat the contract as repudiated. But there are also important differences between the two types of waiver (see generally *The Kanchenjunga* (above) at p.399). In the case of waiver by election, the party who has to make the choice must either know or have obvious means of knowledge of the facts giving rise to the right, and possibly of the existence of the right. But in the case of waiver by estoppel neither knowledge of the circumstances nor of the right is required on the part of the person estopped; the other party is entitled to rely on the apparent election conveyed by the representation. Waiver by election is final and so has permanent effect, whereas the effect of estoppel may be suspensory only (although in the context of waiver of breach, the waiver may have permanent effect because, where the party in breach has relied to his detriment on the waiver – for example, by not attempting to remedy the situation when there was time to do so – the innocent party may, as a result of the waiver, lose for ever the right to terminate on account of that particular breach). Finally, waiver by estoppel requires that the party to whom the representation is made rely on that representation so as to make it inequitable for the representor to go back upon his representation. There is, however, no such requirement in the case of waiver by election; once the election has been made it is final whether or not the other party has acted in reliance upon the election having been made.

One final distinction must be drawn. It is between the case in which a party waives his right to treat the contract as repudiated but does not abandon his right to claim damages for the loss suffered as a result of the breach, and the case where the innocent party waives not only his right to terminate performance of the contract but also his right to claim damages. The former is an example of waiver by election and so is governed by the rules relating to election, while the latter appears to be an example of estoppel (because the innocent party is purporting to abandon all of his rights under the contract, without any consideration being

provided for that abandonment) and so should be subject to the rules relating to waiver by estoppel.

19.9 Anticipatory Breach

One contracting party may inform the other party, before the time fixed for performance under the contract, that he will not perform his obligations under the contract. This is called an anticipatory breach of contract, which entitles the innocent party to terminate performance of the contract immediately. The novel feature of anticipatory breach is that acceptance of the breach entitles the innocent party to claim damages at the date of the acceptance of the breach. He does not have to wait until the date fixed for performance, even though this has the effect of accelerating the obligations of the party in breach. It does seem somewhat illogical to say that a party can be in breach of contract *before* the time fixed for performance under the contract. The doctrine of anticipatory breach can best be rationalised as a breach of an implied term of the contract that neither party will, without just cause, repudiate his obligations under the contract before the time fixed for performance.

The operation of the doctrine of anticipatory breach can be illustrated by reference to the case of *Hochster* v. *De La Tour* (1853) 2 E & B 678. In April of 1852 the defendant agreed to employ the claimant to act as his courier for 3 months from 1 June. But on 11 May the defendant wrote to the claimant informing him that his services would no longer be required. The claimant commenced his action on 22 May and it was held that he was entitled to commence his action for damages at that date; he did not have to wait until 1 June when performance was due.

Once again the innocent party is not obliged to exercise his right to terminate performance of the contract; he can elect to affirm the contract and demand performance from the other party at the time stipulated in the contract. But where the innocent party does decide to terminate performance of the contract he must give notice to the party in breach that he is accepting the anticipatory breach (or otherwise overtly evidence his acceptance of the breach, see 19.8) and he must not act inconsistently with his decision to accept the breach.

Where the innocent party does decide to affirm the contract and demand performance at the stipulated time, a number of consequences flow from this decision. The first is that affirmation does not prevent the innocent party accepting the breach if, at the date fixed for performance, the other party still refuses to perform. The second is that the innocent party, in addition to affirming the contract, may continue with the per-

formance of his obligations under the contract, even though he knows that the performance is not wanted by that other party. This is what happened in the controversial case of *White and Carter (Councils) Ltd* v. *McGregor* [1962] AC 413. The defendants entered into a contract with the claimants under which the claimants agreed to display advertisements of the defendants' garage for a period of three years on plates attached to litter bins. Later the same day, the defendants wrote to the claimants stating that they no longer wished to continue with performance of the contract. The claimants refused to accept the cancellation and proceeded to display the advertisements and then brought an action to recover the contract price. The House of Lords held, by a majority of three to two, that the claimants were entitled to recover the contract price. The minority held that the claimants were not entitled to succeed because they had failed to mitigate their loss. But the majority held, quoting from the judgment of Asquith LJ in *Howard* v. *Pickford Tool Co Ltd* [1951] 1 KB 417, 421, that 'an unaccepted repudiation is a thing writ in water and of no value to anybody'. The claimants were not under an obligation to accept the defendants' breach, even though it was 'unfortunate' that the claimants had 'saddled themselves with an unwanted contract causing an apparent waste of time and money'. The vital factor as far as the majority was concerned was that the claimants' claim was one in debt (for the contract price) and not for damages and so the mitigation rules simply had no application. Lord Hodson expressly refused to turn an action for debt into a 'discretionary remedy' by introducing a 'novel equitable doctrine that a party was not to be held to his contract unless the court in a given instance thought it reasonable so to do'.

The principle laid down in *White and Carter* is, in fact, the subject of a number of qualifications. The first is that the innocent party cannot compel the party in breach to co-operate with him so that, where the innocent party cannot continue with performance without the co-operation of the party in breach, he will be compelled to accept the breach (*Hounslow LBC* v. *Twickenham Garden Developments Ltd* [1971] Ch 233). The second qualification is derived from the speech of Lord Reid in *White and Carter* when he said that

> 'it may well be that, if it can be shown that a person has no legitimate interest, financial or otherwise, in performing the contract rather than claiming damages, he ought not to be allowed to saddle the other party with an additional burden with no benefit to himself.'

Lord Reid's view on this point did not appear to be shared by the other members of the majority in *White and Carter* (Lord Tucker and Lord

Hodson), but it has subsequently been regarded as part of the ratio of the case (see *Hounslow LBC* v. *Twickenham Garden Developments Ltd* (above)) and it has been developed in subsequent cases as a means of limiting the principle established in the case. In *Clea Shipping Corp* v. *Bulk Oil International Ltd (The Alaskan Trader)* [1984] 1 All ER 129, after an extensive review of the authorities, Lloyd J concluded that:

> 'there comes a point at which the court will cease, on general equitable principles, to allow the innocent party to enforce his contract according to its strict legal terms.'

Since the general rule is that there is no requirement that the innocent party must act reasonably in deciding whether or not to accept the breach, the onus is upon the party in breach to show that the innocent party had no legitimate interest in completing the contract and claiming the contract price rather than damages. Here it is vital to note that the defendants in *White & Carter* did not set out to prove that the claimants had no legitimate interest in continuing with performance (probably because they did not know that they had to do so). Had the defendants sought to prove that the claimants had no such legitimate interest, it may well be that the case would have been decided differently. Defendants in subsequent cases have been quick to invoke this qualification and the line which the courts have now drawn is between 'unreasonable' behaviour and 'wholly unreasonable' behaviour. This 'equitable principle' cannot be invoked simply because the innocent party has behaved 'unreasonably'. But, where the innocent party acts 'wholly unreasonably' (*The Odenfield* [1978] 2 Lloyd's Rep 357, 373), then the court may refuse to allow the innocent party to continue with performance and claim the contract price. Such was the case in *The Alaskan Trader* (above). The claimants chartered a ship to the defendants for 24 months. After one year the ship required extensive repairs. The defendants stated that they had no further use for the ship but the claimants nevertheless spent £800,000 in repairing the ship and, when it was repaired, they kept the ship and its crew ready to receive instructions from the defendants. The arbitrator held that the claimants had acted wholly unreasonably in refusing to accept the breach and this finding was upheld on appeal to Lloyd J so that the liability of the defendants was in damages and not for the contract hire.

On the other hand, a decision to affirm the contract may work to the disadvantage of the innocent party. The first disadvantage is that an innocent party who affirms the contract may lose his right to sue for damages completely if the contract is frustrated between the date of the unaccepted anticipatory breach and the date fixed for performance (*Avery* v.

Bowden (1856) 6 E & B 953). Secondly, an innocent party who affirms the contract but subsequently breaches the contract himself cannot argue that the unaccepted anticipatory breach excused him from his obligation to perform under the contract. Where the breach is not accepted the parties remain subject to their obligations under the contract, so that the 'innocent party' may find himself liable to pay damages for breach of contract if he fails to accept the breach and subsequently breaches the contract himself (*The Simona* [1989] AC 788).

Summary

1 A breach of contract is committed when a party without lawful excuse fails or refuses to perform what is due from him under the contract, performs defectively or incapacitates himself from performing.
2 The question whether or not a particular contract has been breached depends upon the precise construction of the terms of the contract. Many contractual duties are strict.
3 A breach of contract does not automatically bring a contract to an end. A breach of contract gives to the innocent party a right to claim damages and it may give him the additional right to terminate performance of the contract.
4 When the performance of a contract is terminated because of breach, the obligations to perform are only terminated for the future. The contract is not set aside *ab initio*.
5 An innocent party is not obliged to exercise his right to terminate performance of the contract; he can elect to terminate or to affirm, although the effect of the doctrine of mitigation is to reduce the scope for affirmation.
6 A party who is in breach of contract may be unable to enforce the contract against the innocent party. But where the breach is of an independent, rather than a dependent obligation, breach will not entitle the innocent party to abandon performance of his obligations under the contract.
7 One contracting party may inform the other party, before the time fixed for performance under the contract, that he will not perform his obligations under the contract. This is called an anticipatory breach of contract, which entitles the innocent party to terminate performance of the contract immediately.
8 An innocent party who affirms the contract after an anticipatory breach may continue with the performance of his obligations under the contract, even though he knows that the performance is not wanted by that other party, provided that contractual performance does not require the co-operation of the other party to the contract and he has a 'legitimate interest' in the performance of the contract.

Exercises

1 What is a breach of contract and what are its consequences?
2 Distinguish between 'rescission for breach' and 'rescission for misrepresentation'.
3 Distinguish between a primary obligation and a secondary obligation.
4 What is an anticipatory breach?

5 What 'legitimate interest' did the claimants in *White and Carter (Councils) Ltd* v. *McGregor* have in the performance of the contract?

6 Did the claimants in *The Alaskan Trader* (above) act 'wholly unreasonably'? (see further Burrows, 1994, pp.317–22).

7 Adam Ltd employ Steve to go to Japan and prepare an elaborate report for the company on the state of the Japanese market. Two days before Steve's departure, Adam Ltd inform Steve that they no longer require the report because they have decided not to commence trading in Japan. Steve nevertheless goes to Japan and prepares the report at a cost of £25,000. Adam Ltd are now refusing to pay for the report. Advise Steve.

20 Damages for Breach of Contract

20.1 Introduction

We have already noted that a breach of contract gives rise to an action for damages, whether the term broken is a condition, a warranty or an innominate term. In this chapter we shall discuss the principles which are applied by the courts when assessing the damages payable on a breach of contract. The principles applied by the courts are of great significance to the debate about the basis of the law of contract, to which we referred in Chapter 1. The claim that contract law can be separated from the law of tort and the law of restitution rests, to a large extent, on the proposition that the law of contract seeks to fulfil the expectations engendered by a binding promise (see 1.4). In this chapter we shall put that claim to the test by asking ourselves the fundamental question: does the law of contract really fulfil the expectations engendered by a binding promise? But before we seek to answer that question we must define the 'expectation interest' with greater precision and we must also examine the question whether the law of contract protects either the 'reliance interest' or the 'restitution interest'.

20.2 Compensation and the Different 'Interests'

The starting point must be that the aim of an award of damages is to compensate the claimant for the loss which he has suffered as a result of the defendant's breach of contract. The aim is not to punish the defendant. A breach of contract is a civil wrong; it is not a criminal offence. Although punitive damages can, in certain narrowly defined circumstances, be awarded in a tort action, they cannot be awarded in a purely contractual action, even where the defendant has calculated that he will make a profit from his breach of contract (*Cassell & Co* v. *Broome* [1972] AC 1027). The defendant may be said to have behaved 'badly', but he will not be punished by an award of punitive damages (the Law Commission has recommended (1997, p.120) that punitive damages should continue to be unavailable for a breach of contract).

The proposition that damages are compensatory gives rise to a further question. That question is: for what is it that the claimant is entitled to be

compensated? Theoretically, a claimant could claim compensation on one of a number of different grounds (see Fuller and Perdue, 1936 and the discussion by the High Court of Australia in *Commonwealth of Australia* v. *Amann Aviation Pty Ltd* (1991) 66 ALJR 123, noted by Treitel, 1992). In the first place, a claimant could claim the protection of his 'expectation interest'. The basis of such a claim is that the claimant's expectations, engendered by the promise of the defendant that he will perform his contractual obligations, have not been fulfilled and that damages should compensate him for his disappointed expectations by putting him 'in as good a position as he would have occupied had the defendant performed his promise'. Secondly, a claimant may claim the protection of his 'reliance interest', that is to say, as a result of the defendant's promise to perform his contractual obligations, the claimant has acted to his detriment in entering into the contract and the award of damages should compensate him to the extent that he has relied to his detriment upon the promise of the defendant. The aim here is 'to put the claimant in as good a position as he was in before the [defendant's] promise was made'. Finally, a claimant may assert that his 'restitution interest' should be protected. A claimant who claims the protection of his restitution interest does not wish to be compensated for the loss which he has suffered; rather, he wishes to deprive the defendant of a gain which he has made at the claimant's expense. Which of these 'measures' can be claimed by a claimant in an action for damages for breach of contract? More importantly, what factors would persuade a claimant to elect to seek the recovery of one measure rather than another?

The most important factor is obviously the amount of damages which a claimant can recover by way of compensation. Which is more advantageous to the claimant: the expectation measure, the reliance measure or the restitution measure? A very simple example will help us to answer this question. Let us suppose that I enter into a contract to purchase a computer for £2000. Let us make the further assumption that the market value of such a computer is, in fact, £2000. In breach of contract the seller provides me with a defective computer which is worth only £1000. I fulfil my side of the bargain and pay £2000.

An award of damages which protected my expectation interest would aim to put me in the position which I would have been in had the contract been performed according to its terms. Had the contract been performed according to its terms, I would have obtained a computer worth £2000, whereas I have obtained a computer which is worth only £1000. Therefore the expectation measure is calculated by deducting the value of what I have actually received (£1000) from the value of what I expected to receive (£2000). Damages would therefore be assessed at £1000.

An award of damages which sought to protect my reliance interest would seek to put me in the position which I would have been in had I not entered into the contract. Had I not entered into the contract, I would not have parted with my £2000 and I would not have received a computer worth £1000. So the reliance measure is calculated by deducting the value of what I have received (£1000) from the amount which I have paid out (£2000). Damages would, once again, be assessed at £1000 so that, on the facts of this case, the expectation measure and the reliance measure would be exactly the same.

An award which sought to protect my restitution interest would restore to me the benefit which I had conferred upon the seller. So I would be entitled to the return of the £2000 and the seller would be entitled to the return of the computer.

Although we have noted that the reliance measure and the expectation measure can be exactly the same, in other cases they can be radically different. The reason for the coincidence in my example was that the contract price and the market value of a computer which complied with the contractual specifications were exactly the same. Had these figures been different, then the measures would have been different. Let us suppose that I had promised to pay £2000 but that the computer was, in fact, worth only £1500. This time the expectation measure would be £1500 (the value of what I expected to receive) less £1000 (the value of what I actually received), which equals £500. But the reliance measure would be £2000 (what I paid out) minus £1000 (the value of what I received), which equals £1000. So a claimant will wish to resort to the reliance measure where he has made a bad bargain, in an effort to escape from the consequences of his own bargain. On the other hand, if I had made a good bargain so that the market value of the computer was £2500, the expectation measure would be £2500 less £1000, which equals £1500, whereas the reliance measure would remain at £2000 less £1000, which equals £1000. Therefore it is principally where the claimant has made a bad bargain that he will want to claim the reliance measure; in other cases the expectation measure will be more advantageous to a claimant.

20.3 The Expectation Interest

The general rule is that an award of damages for breach of contract seeks to protect the claimant's expectation interest. The classic statement of this general principle can be found in the judgment of Parke B in *Robinson* v. *Harman* (1848) 1 Ex 850, 855:

> 'the rule of the common law is, that where a party sustains 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.'

The justification for the award of the expectation measure is that a binding promise creates in the promisee an expectation of performance and the remedy granted for the breach of such a binding promise seeks to fulfil or to protect that expectation. But there is an element of ambiguity in the proposition that damages seek to put the claimant in the position he would have been in had the contract been performed. The first ambiguity relates to the identification of the loss and the second concerns the measurement of that loss.

When we talk about loss and about placing the innocent party in the same situation as if the contract had been performed, what do we mean? Do we mean financial loss and financial situation or do we take into account a broader range of factors? The answer is generally understood to be the former, 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* [1996] Trading Law Reports 69, 73, when he stated that the *Robinson* v. *Harman* 'formulation assumes that the breach has injured [the claimant's] financial position; if he cannot show that it has, he will recover nominal damages only'. In many cases it will suffice to take account of the financial position of the parties because the contract will have been entered into with a view to making a profit and the protection of that expectation of profit will adequately protect the interests of the innocent party. But in the modern world parties frequently enter into contracts for reasons other than to make a profit. Suppose that a houseowner enters into a contract with a builder to have a swimming pool built in her garden and that she stipulates that it must be built to a depth of seven feet six inches. Or suppose that a son enters into a contract with a builder under which the builder agrees to repair the roof of his parents' house. Finally, imagine that a local authority enters into a contract with a contractor for the provision of a fire service. The first case is an example of a contract to enhance leisure time, while the latter two are examples of contracts which are entered into for the purpose of providing a service to third parties. A legal system which focuses only upon the profit motive to the exclusion of the values of leisure and community service fails to reflect the values of the modern world. As Lord Mustill stated in *Ruxley Electronics and Construction Ltd* v. *Forsyth* [1996] AC 344, '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'. The recognition of the 'consumer surplus' in *Ruxley* (20.13) is an open acknowledgement of the need for a broader perspective which takes account of the wide range of purposes which contracting parties have in mind when entering into contracts (see McKendrick, 1999). But there is a long way to go. One of the most important purposes which a party has in entering into a contract is of course to secure the promised performance but the commitment of the law to the protection of the claimant's interest in performance is, in fact, rather weak. Specific performance has traditionally been seen as a secondary remedy and the reluctance to compel specific performance is carried through to the damages remedy, where the courts tend to seek to put the claimant in the financial position which he would have been in had the contract been performed according to its terms and not to give him the funds necessary to secure actual performance. This takes us into our second problem which is the approach which the courts adopt when seeking to measure the damages payable.

Two possible measures could put the claimant in the position which he would have been in had the contract been performed according to its terms. The first is the difference in value between what the claimant has received and what he expected to receive and the second is the cost of putting the claimant into the position which he would have been in had the contract been fully performed. In many cases the two measures will produce the same result. For example, if, in breach of contract, a seller fails to deliver the promised goods, and the buyer goes out into the market place and purchases substitute goods, the diminution in value and the cost of cure will be exactly the same. But in some cases the two measures can produce very different results. The facts of *Ruxley Electronics and Construction Ltd* v. *Forsyth* [1996] AC 344 neatly illustrate such a divergence. The claimant builders agreed to construct a swimming pool for the defendant. In breach of contract the claimant built the pool to a depth of six feet when its depth should have been seven foot six inches. How should damages be assessed for this breach? The trial judge measured the diminution in value as zero but the cost of cure was found to be £21,560. Which was the correct measure? The first point which the House of Lords made was that they were not confined to a straight choice between the two measures. Such a stark choice could produce an unjust outcome. For example, Lord Mustill noted that it was

> 'a common feature of small building works performed on residential property that the cost of the work is not fully reflected by an increase in the market value of the house, and that comparatively minor

> deviations from specification or sound workmanship may have no direct financial effect at all.'

In such a case the diminution in value might well be zero or a very small sum indeed. To award such a sum by way of damages for the breach would, Lord Mustill conceded, make part of the builders' promise 'illusory' because there would be no adequate remedy available to the consumer in the event of breach. On the other hand, Lord Mustill noted that it would be equally unsatisfactory if the law were to jump to the conclusion that damages were necessarily to be assessed on a cost of cure basis because the cost of cure might not accurately reflect the loss which the innocent party had suffered either. To the argument that there were only two measures of damages, Lord Mustill replied that there was only one, namely 'the loss truly suffered by the promisee'. On the facts of *Ruxley*, the loss which the defendant had suffered was the disappointment which he had experienced in not getting a swimming pool of the correct specifications and that loss was best reflected in an award of loss of amenity damages of £2500 (see 20.13).

Having concluded that the defendant was entitled to loss of amenity damages, their Lordships considered the question whether the defendant was entitled to recover cost of cure damages. They concluded that he was not. In reaching their conclusion the House of Lords underlined the role of reasonableness and 'common sense' in deciding whether to award damages on a cost of cure basis or a diminution in value basis. The court was therefore entitled, indeed obliged, to have regard to the reasonableness of the course of action pursued or proposed by the defendant when seeking to assess the loss which he had, in fact, suffered. On the facts of the case, it was held that it was not reasonable for the defendant to recover cost of cure damages because the cost of carrying out the work was out of all proportion to the benefit which the defendant would obtain by its performance. What was it that made it unreasonable for the defendant to recover cost of cure damages? It is suggested that it is a combination of two factors: the first is the cost of the repairs (£21,560) and the second is the fact that the work would have resulted in little by way of benefit to the defendant. It is important to note that it was the *combination* of these factors which was important: taken in isolation they may not be decisive. This point can be illustrated by changing the facts of *Ruxley*.

Let us say that the work would have resulted in a considerable benefit to the defendant because, in its existing state, the pool was not safe to dive into. In such a case cost of cure is likely to emerge as a reasonable way of ensuring that the defendant obtains the financial value of the promised performance. Thus Lord Jauncey stated that 'if a building is constructed

so defectively that it is of no use for its designed purpose the owner may have little difficulty in establishing that his loss is the necessary cost of reconstructing'. But *Ruxley* was not a case in which the pool was of no use for its designed purpose. On the contrary, the trial judge made the following findings of fact: the pool was safe for diving, the defendant had no intention or desire to fit a diving-board, the shortfall in depth did not decrease the value of the pool, the defendant had no intention of building a new pool and to spend £21,560 on a new pool would have been unreasonable.

A more difficult question would have been posed if the cost of cure had been lower. What would have been the position if the cost of cure had been less, let us say £5000? Would such a cost have been 'out of all proportion' to the benefit to be obtained by the defendant? Is the proportion to be measured simply by reference to the diminution in value (which was found to be zero) or by reference to the diminution in value together with the loss of amenity? The answer is not entirely clear, but it is suggested that the latter is the figure which should be used because the court is endeavouring to measure the loss which the innocent party has suffered and that is either the cost of cure or the diminution in value together with, where appropriate, loss of amenity damages. If this analysis is correct then cost of cure damages may have been recovered had the cost of repairs been in the region of £5000.

The final issue in this context relates to the role of intention in the assessment of damages. What is the significance of the fact that the innocent party has declared his intention to use the sum awarded by way of damages to cure the defect in the building? While the courts are not generally concerned with the use which a party makes of the damages awarded to him, it does not follow, as Lord Lloyd pointed out, that the intention of the innocent party is not relevant to the issue of reasonableness. Where the innocent party is not genuine in his desire to carry out the repairs, this will be a factor which counts against the award of cost of cure damages. But it does not follow that a genuine intention to carry out the work will act as a passport to the award of cost of cure damages. This is because a party cannot be 'allowed to create a loss, which does not exist, in order to punish the [party in breach] for [its] breach of contract'. So the vital test is the reasonableness test and the intention of the parties is only one factor to be considered when resolving that issue.

Ruxley is a fascinating case because it is so simple yet so rich in issues. In awarding loss of amenity damages it can be argued that the House of Lords took one step forwards and one step backwards. The step forward was the award of damages to reflect the defendant's loss of amenity. The step backwards was that it can be argued that the House of Lords failed

adequately to protect the defendant's performance interest because he was not given the money which he needed to obtain the swimming pool of the promised proportions. But, given that the courts would not have specifically enforced the contract and that the defendant was held not to be entitled to withhold payment of the price because he had obtained substantially what he had bargained for (the doctrine of 'substantial performance' is discussed at 21.2), it is perhaps not surprising that the House of Lords refused to award him cost of cure damages. On its facts it may well be that *Ruxley* was correctly decided. But the decision does have its dangers (see Coote, 1997 and McKendrick, 1999). The principal danger is that it may make it much harder for a party who wants to receive a particular type or form of performance to ensure that he actually obtains that performance instead of the economic end-result of performance. Take the case of a decorator who puts the wrong wallpaper on the wall. Is the homeowner entitled to recover cost of cure damages or only diminution in value plus loss of amenity damages? If the latter is the answer then *Ruxley* has added a further limit (see 20.9–20.14) to the willingness of the courts to protect the expectation interest. On the other hand, if emphasis is placed on the exceptional facts of *Ruxley* (namely that the claimant had substantially performed its obligations under the contract, the difference in depth did not impair the defendant's use of the pool, the cost of cure was high and the finding of the trial judge that the defendant had no intention of building a new pool), then the danger can, in large part, be avoided. In support of *Ruxley* it can also be argued that the House of Lords through its employment of 'reasonableness' as the control device, allied to the greater availability of loss of amenity damages, has set up a framework which is sufficiently flexible to ensure a fair outcome in the resolution of the vast majority of cases.

20.4 The Restitution Interest

Can a claimant seek the protection of his restitution interest rather than his expectation interest? The answer is that a claimant does not have a free choice between the two measures. A claimant can obtain a restitutionary remedy only when he can establish that the defendant was enriched, that the enrichment was at the claimant's expense and that it is unjust that the defendant retain the benefit without recompensing the claimant. The classic example of a restitutionary claim is a claim to recover money paid under a mistake of fact (see, for example, *Barclays Bank Ltd* v. *W J Simms Ltd* [1980] 1 QB 677). But, where the ground on which restitution is sought is that the defendant has broken his contract

with the claimant, then a restitutionary remedy is available only within very narrow confines. There are essentially two grounds (20.5 and 20.6) on which a claimant may seek to protect his restitution interest consequent upon a breach of contract by the defendant.

20.5 Failure of Consideration and Enrichment by Subtraction

The first ground on which a claimant may seek a restitutionary remedy is that the *basis* upon which he has conferred the benefit on the defendant has failed because of the defendant's breach of contract. The argument of the claimant is that he has conferred a benefit upon the defendant only for the purpose of the performance of the contract and, now that performance has been abandoned because of the defendant's breach of contract, the benefit ought to be restored to him. However, a restitutionary claim to recover upon a total failure of consideration cannot be brought where the contract has not been set aside or is not otherwise ineffective. Where the contract is valid and enforceable, it governs the rights and remedies of the parties and these cannot be subverted by resort to a restitutionary claim (a view challenged by Smith, 1999).

But money paid to a defendant is only recoverable where there has been a total failure of consideration, that is to say, the claimant has received no part of what he has bargained for. Where the failure of consideration is only partial, so that the claimant has received some part, no matter how small, of the promised performance then the restitutionary claim is barred (*Whincup* v. *Hughes* (1871) LR 6 CP 78). A case which illustrates the distinction between a total and a partial failure of consideration is *White Arrow Express Ltd.* v. *Lamey's Distribution Ltd* [1996] Trading Law Reports 69. The claimants entered into a contract with the defendants under which the defendants agreed to provide the claimants with a de luxe delivery service. In fact they provided only the standard measure of service. The claimants experienced some difficulty in proving that they had suffered a loss as a result of the defendants' breach because none of their customers complained about the level of service provided. So the claimants framed their claim as one to recover that proportion of the price that related to the enhanced level of service which the defendants were obligated to provide but did not in fact provide. The Court of Appeal dismissed the claim on the ground that it was a claim to recover money paid on a partial, not a total failure of consideration. The claimants were held to be entitled to recover only nominal damages. This seems unfair. But the source of the problem may in fact be the way in which the

case was pleaded. The claimants could and should have sued for damages for breach of contract in the normal way, and sought to recover damages by reference to the difference between the price which they paid for the service (or, if it is lower, the market value of what was contracted for) and the market value of what was obtained.

The restitutionary claim tends to assume particular significance where the claimant has entered into a bad bargain or claims to have suffered a loss which the law of contract does not recognise. An illustration of the former case is provided by the following hypothetical example. Suppose that I agree to buy a desk for £200. The desk is in fact worth only £150. If, for some reason, the seller refused to deliver the desk, I would be entitled to recover the £200 because the consideration for the payment has wholly failed. An example in the second category is provided by a variant of *Ruxley* v. *Forsyth* (above). Suppose that the builder had saved himself some money by building the swimming pool to the wrong depth. Could the defendant have recovered the saving on the ground that he had paid for this service and not received it? He would appear to be unable to recover it as contractual damages because, on the facts of *Ruxley*, there appeared to be no difference between the price paid and the market value of what he received. A restitutionary claim to deprive the builder of the gain made would here have performed a useful function from the defendant's perspective but of course any attempt to recover a proportion of the price would seem to fall foul of the rule that the law does not allow recovery based on a partial failure of consideration (as in the *White Arrow* case).

The requirement that the failure of consideration must be total has, however, been widely attacked by academic lawyers (see, for example, Burrows, 1993c, pp.259–61). It is argued that the unjust enrichment is as real in cases of partial as in cases of total failure because in both cases the basis upon which the money was paid has failed. Secondly, the total failure requirement does not apply to a claim brought by the provider of goods or services (see Birks, 1985, pp.242–44), although this argument is considerably weakened by the fact that the law has not yet recognised that a claim to recover in such cases is based on 'failure of consideration' reasoning. Thirdly, the law has proved to be rather arbitrary in its application because the courts have tended to strain to find a total failure of consideration in some cases, and they have done this by ignoring or discounting practical benefits received by the party seeking to set aside the transaction in order to find that there has, in fact, been a total failure of consideration (see, for example, *Rover International Ltd* v. *Cannon Film Sales Ltd (No. 3)* [1989] 1 WLR 912). The courts seem to be slowly moving in the direction of the abolition of the total failure requirement and,

indeed, where counter-restitution can easily be made it has already been effectively abandoned (see *Goss* v. *Chilcott* [1996] AC 788, 798 (Lord Goff)). It is suggested that the law should develop further so that it reaches the position where a partial failure should suffice to generate a restitutionary claim, subject only to the requirement that the claimant make counter-restitution for any benefit which he has received at the expense of the defendant.

Where the claim is not for the return of money but for the value of goods supplied or services rendered under the contract then more difficult questions arise. It is clear that, where the contract is terminated on the ground of the defendant's breach of contract, the claimant has a right to elect either to proceed in contract or in restitution (*Planché* v. *Colburn* (1831) 8 Bing 14), but it is not clear whether in a restitutionary action the contract price acts as a ceiling on the sum recoverable. Dicta can be found to support the proposition that the contract price does not act as a ceiling (*Lodder* v. *Slowey* [1904] AC 442 and *Rover International Ltd* v. *Cannon Film Sales Ltd* (No. 3) [1989] 1 WLR 912) and such a rule was adopted in the American case of *Boomer* v. *Muir* 24 P 2d 570 (1933). But it is suggested that, given that breach operates prospectively (19.7), and the goods were supplied and services rendered under what was, at the time, a valid subsisting contract, it is difficult to see why the courts should ignore the contract in assessing the value of the goods supplied or services performed.

20.6 Enrichment by Wrongdoing

Secondly, a claimant may seek a restitutionary remedy on the ground that the defendant has, as a result of his breach of contract, obtained an unjust benefit, in the form of a profit which he would not otherwise have made. This claim differs from the first type of restitutionary claim because here the defendant's enrichment is not by subtraction from the claimant (see Birks, 1985). In the 'failure of consideration' claim, the defendant was enriched by the receipt of a benefit which passed from the claimant to the defendant. But in this type of case the defendant has been enriched by his wrongdoing, namely his breach of contract, and, in such a case, there is no requirement that the enrichment be by subtraction from the claimant.

The nature of such a claim can be illustrated by the fact situation of *Teacher* v. *Calder* (1899) 1F (HL) 39. The claimant agreed to invest £15,000 in the defendant's timber business. In return, the defendant promised that he would keep at least £15,000 of his own money in the

business. In breach of contract, the defendant withdrew much of his capital from the business and invested the money in a distillery, where he earned large profits. The claimant sought to recover, by way of damages, the profits which the defendant had made as a result of his investment in the distillery. But it was held that the damages should be assessed by reference to the loss which the timber business had suffered as a result of the failure of the defendant to keep the promised sum of money invested in it.

This approach is consistent with the traditional expectation measure of recovery; that is to say, the aim of the award of damages was to put the claimant in the position which he would have been in had the defendant carried out his obligations under the contract. The aim of the award of damages was to compensate the claimant, not to require the defendant to disgorge the gain which he had obtained from his breach. But is it ever possible for a claimant to recover the gains which the defendant has made from his breach of contract? Should such a claim have succeeded on the facts of *Teacher*?

The answer to the first question is that gain-based damages are not generally recoverable for a breach of contract. The issue was considered by the Court of Appeal in *Surrey County Council* v. *Bredero Homes Ltd* [1993] 1 WLR 1361. The claimants entered into a contract with the defendant development company, under which the claimants agreed to sell to the defendants a portion of land which they no longer required. The defendants covenanted to develop the land in accordance with the planning permission given and to pursue diligently the development of the land to its completion, complying with the planning permission and the scheme approved for the development of the land. The defendants subsequently obtained fresh planning permission which had the effect of rendering the development more profitable for them by increasing the number of dwellings from 72 to 77. They did not, however, apply to the claimants for a variation of their covenant to build in accordance with the initial grant of planning permission. The claimants sought to recover damages assessed by reference to the profits which the defendants had made from their breach of covenant. The Court of Appeal rejected their claim and held that the claimants were only entitled to recover nominal damages because they had suffered no loss as a result of the breach. This seems unsatisfactory. Here we have a flagrant breach of contract for which there was no effective remedy.

The claimants put forward a number of arguments to support their claim to gain-based (or restitutionary) damages. All were rejected. The first was that the defendants' breach of contract was deliberate or cynical. The court refused to regard this is as the vital factor. Steyn LJ stated that

to focus on the motive of the party in breach was contrary to the general approach of contract law. It is also a test which is difficult to apply in practice. One reason why a party breaks a contract is that he has found a better deal elsewhere. Such a breach is deliberate but English law does not allow gain-based damages to be recovered solely on this ground. As Steyn LJ remarked, a rule which compelled a contract-breaker to disgorge gains on such a ground might have a tendency to discourage economic activity.

Secondly, the claimants argued that a court should be prepared to award gain-based damages where the party in breach could have been restrained by an injunction from committing the breach or been compelled by specific performance to perform the contract. It is an observable phenomenon that jurisdictions which are more willing to grant specific performance are also more willing to award gain-based damages. But the Court of Appeal rejected the argument on the ground that the availability of gain-based damages should not depend upon the availability of the wholly different remedy of specific performance. However a rather different approach was taken by a differently constituted Court of Appeal in *Jaggard* v. *Sawyer* [1995] 1 WLR 269, where it was held that a court, when exercising its discretion to award damages in lieu of an injunction could, in certain cases, award damages on the basis of the sum which the claimant would have demanded for the sale of her right which had been infringed. Millett LJ was of the view that it was the ability to claim an injunction which gave the benefit of the covenant much of its value. This reasoning is open to attack on the ground that it fails to give sufficient weight to the value of the covenant itself. But, in the light of *Jaggard*, it would appear that the mistake which the claimants made in *Bredero* was to delay until the court had no jurisdiction to entertain an application for an injunction. The delay deprived the claimants of both an injunction and an effective claim for damages.

Despite the general hostility of the Court of Appeal in *Bredero* to the award of gain-based damages, the matter is far from being closed. This is so for four reasons. The first is that a claimant can recover gain-based damages where it can also characterise the breach of contract as a breach of confidence or as a tort which generates restitutionary damages. An example of this phenomenon is provided by the case of *Penarth Dock Engineering* v. *Pound* [1963] 1 Lloyd's Rep 359. The defendants bought a floating dock and, in breach of contract, they failed to remove it from its berth. The claimant sellers sued both for damages in the tort of trespass and for damages for breach of contract. The defendants argued that damages should be nominal because the sellers would not have made any other use of the berth as the docks were to be shut down. This argument was rejected by Lord Denning on the ground that the measure of damages

was not what the claimants had lost, but the benefit which the defendants had obtained as a result of the breach, and so damages were awarded on the basis of a fair market rental of the berth. Although this case can be characterised as a case in which the claimants recovered gain-based damages for a breach of contract, the difficulty with the case is that the claimants also brought a claim in trespass and trespass is a tort which can give rise to a claim for gain-based damages.

Secondly, it may be possible to obtain what is in effect gain-based damages by adopting a more expansive conception of loss. This can be done in a case such as *Penarth* by arguing that the claimants did suffer a real loss, namely the loss of the right to sell to the defendants the right to use their property (see Sharpe and Waddams, 1982). Although *Penarth* can be squeezed within the compensatory framework in this way, the more natural interpretation of it is that it is a case in which the aim of the award of damages was to strip the defendants of the gain which they had made as a result of their breach of contract (and see the rejection of the loss of opportunity to bargain analysis by Steyn LJ in *Surrey County Council* v. *Bredero* (above)). The loss of opportunity to bargain analysis can be rather artificial (for example, in the case where it is clear that the defendant would not have been willing to negotiate with the claimant) and, if it is felt desirable to award gain-based damages, this should be done openly and not by the subterfuge of artificially expanding the definition of loss.

Thirdly, the Court of Appeal in *Attorney-General* v. *Blake* [1998] Ch 439, in an extended obiter dicta, stated that the general rule that damages in contract are based on the claimant's loss and not the defendant's gain was not an absolute rule but was in fact subject to exceptions. They identified two such exceptions (while acknowledging that these exceptions were not necessarily exhaustive). The first exception they termed the case of 'skimped performance'. They had in mind an example such as the American case of *City of New Orleans* v. *Firemen's Charitable Association* 9 So 486 (1891). Here the defendants entered into a contract with the claimants in which they agreed to provide the claimants with a fire-service to certain specifications. In breach of contract they failed to meet these specifications but the claimants did not discover this until after the expiry of the contract. It was held that the claimants were entitled to recover only nominal damages because they could not show that they had suffered any loss as a result of the defendants' breach. So the result of the case was that the defendants were able to keep the savings which they had made as a result of their 'skimped performance'. The Court of Appeal in *Blake* stated that 'justice surely demands an award of substantial damages . . . and the amount of expenditure which the defendant has

saved by the breach provides an appropriate measure of damages'. An alternative approach to a case such as *City of New Orleans* is to conclude that the claimants did suffer a loss in that they did not get the performance for which they had contracted. But this approach was rejected in *Blake* on the ground that it was 'preferable, as well as simpler and more open' to award gain-based damages instead of expanding the definition of loss. One potential difficulty with the 'skimped performance' analysis is that it is not entirely easy to reconcile with a case such as *White Arrow Express Ltd* v. *Lamey's Distribution Ltd* (above), where the Court of Appeal refused to allow the claimant to recover that proportion of the consideration which they had not in fact obtained. The reconciliation would appear to be effected by stating that the money can be recovered by seeking a gain-based remedy for the breach of contract but not by framing the claim as one to recover upon a partial failure of consideration. This reconciliation is not entirely easy and it should be noted that the Court of Appeal in *Blake* appeared to be entirely unaware of the potential inconsistency with the result in *White Arrow*.

The second exception where the Court of Appeal in *Blake* thought that the claimant ought to be entitled to recover gain-based damages is 'where the defendant has obtained his profit by doing the very thing which he contracted not to do'. This exception covered the facts of *Blake* itself where the defendant, a former member of the Secret Intelligence Service, published a book without submitting the manuscript to the Crown for prior approval. His breach of contract lay in not submitting the book for approval and it was this breach which enabled him to make the profit which he made from the sales of the book: 'he earned the profits by doing the very thing which he had promised not to do'. The scope of this exception is particularly unclear because it can be said that every breach of contract involves the defendant doing something which he had contracted not to do.

Blake has not left the law in a satisfactory state, both because its relationship with *Bredero* is difficult and because the scope of the exceptions which it recognised is in some respects unclear (see Chen-Wishart, 1998). But it is important to note that, while the Court of Appeal envisaged a role for gain-based damages after a breach of contract, they did not envisage that gain-based damages would be readily available as a remedy for a breach of contract. They affirmed that the fact that a breach of contract is deliberate does not by itself establish an entitlement to gain-based damages and, equally, the mere fact that the defendant's breach has enabled him to enter into a more profitable contract with someone else should not entitle the claimant to gain-based damages. This seems correct. For example, in *Teacher* v. *Calder* (above) the claimant was made whole

and his expectations fulfilled by the award of compensatory damages and he was not entitled to the profits made by the defendant as a result of the breach. Finally, the Court of Appeal accepted that the fact that, by entering into the later and more profitable contract, the defendant has put it out of his power to perform his contract with the claimant does not entitle the claimant to gain-based damages. While *Blake* may have its loose-edges and in precedent terms it is vulnerable (because it is clearly all obiter), it is welcome in so far as it represents an improvement on the narrow, traditional approach taken in *Bredero*.

Finally, the Law Commission Report on 'Aggravated, Exemplary and Restitutionary Damages' (1997) decided to leave it to the courts to develop the law in relation to the recovery of gain-based damages for a breach of contract. In the case of torts and equitable wrongs, they recommended that restitutionary damages should be available where the defendant's conduct shows a deliberate and outrageous disregard of the claimant's rights but they expressly did not apply that approach to a breach of contract and, instead, inserted a provision into the draft Bill to the effect that the express right to recover gain-based damages set out in the Bill did not 'prejudice any power to award restitutionary damages in other cases'. The matter will therefore be left to the judges so that judicial development of the law remains possible.

It seems clear from *Blake* that the question is not whether gain-based damages should ever be available for a breach of contract, but in what circumstances they should be available. There is, however, a need to progress cautiously. The most outrageous cases seem to be those in which the defendant has made a gain from the breach and the compensatory damages awarded to the claimant are manifestly inadequate (an example in this category might be *Tito* v. *Waddell (No. 2)* [1977] Ch 106, 328–38). Professor Birks has argued (1987) that a claimant should only be entitled to claim restitutionary damages where compensatory damages are 'demonstrably an inadequate remedy, having regard to the objectives which the victim of the breach had hoped to achieve through full performance of the contract'. While there is much to be said for this analysis, the difficulty with it is that it suggests it is the assessment of compensatory damages which is defective and that the response should be to reform the rules relating to the assessment of compensatory damages and not to award gain-based damages. The reality would appear to be that there is no one theory which has yet been able to explain the circumstances when gain-based damages are available or should be available for a breach of contract. As Burrows has argued (1993b), 'consolidation of the present range of restitutionary damages is more important than problematic and

controversial expansion'. What is therefore required is a rationalisation of *Blake* and *Bredero* in order to put the law in this area on a secure footing.

20.7 Reliance Interest

The claimant may wish to claim the protection of his reliance interest so that he is put in the position which he would have been in had he not entered into a contract with the defendant. It should be noted, however, that, where damages are awarded to fulfil the claimant's expectation interest, then the sum awarded will often include both gains prevented and losses caused because, had the contract been performed according to its terms, the claimant would have been reimbursed for his expenditure incurred as well as being rewarded by the receipt of his profit. A claimant is really only interested in attempting to recover his reliance interest alone where that interest exceeds his expectation interest.

The general rule, affirmed in *CCC Films (London) Ltd* v. *Impact Quadrant Films Ltd* [1985] QB 16, is that a claimant has an unfettered right to elect whether to claim for loss of bargain damages or for wasted expenditure. The general right of election is subject to an exception where the claimant seeks to recover his reliance loss in an attempt to escape the consequences of his bad bargain. In *C and P Haulage Co Ltd* v. *Middleton* [1983] 3 All ER 94, the claimant was given a licence to occupy premises on a renewable six-monthly basis. He spent some money on improving the property, even though it was expressly provided in the contract that the fixtures were not to be removed at the end of the licence. The defendants ejected the claimant from the premises in breach of contract and the claimant sought to recover as damages the cost of the improvements which he had carried out to the property. His action failed on the ground that the breach had not caused him any loss because he would have been in the same position had the contract been terminated lawfully. The Court of Appeal held that the claimant's loss did not flow from the breach but from the fact that he had entered into a contract under which he had agreed that he would not be able to remove the fixtures at the end of the lease. It was held that a claimant could not recover his reliance losses where that would enable him to escape from his bad bargain or would reverse the contractual allocation of risk. It is for the defendant to show that the bargain was a bad one for the claimant. The only situation in which an innocent party can escape the consequences of his bad bargain is where there has been a

total failure of consideration (see 20.5). In such a situation there has been no performance under the contract, the claimant's claim is one in restitution and so there is no objection to the reversal of the contractual allocation of risk.

A claimant may, however, wish to recover his reliance loss where he has incurred reliance expenditure before the conclusion of the contract. In *Anglia Television Ltd* v. *Reed* [1972] 1 QB 60, the claimants engaged the defendant to star in a film which they were making. At the last moment the defendant repudiated the contract and the claimants had to abandon the film because they were unable to find a replacement actor. Lord Denning said that, where the claimants claimed their loss of expenditure, they were not limited to expenditure incurred after the contract was concluded but that they could also claim for expenditure incurred before the contract was concluded provided that it was within the reasonable contemplation of the parties that it would be likely to be wasted as a result of the defendant's breach. Such pre-contract expenditure could not be regarded as part of the claimants' expectation interest on the facts of the case, because the claimants decided not to claim their loss of profit on the ground that they could not say what that loss of profit would have been.

On the other hand, a claimant may be confined to the recovery of his reliance losses where he cannot prove what his expectation losses would have been. Such was the case in *McRae* v. *Commonwealth Disposals Commission* (1951) 84 CLR 377 (see 14.6), where the speculative nature of the enterprise made it impossible for the claimants to quantify their expectations with any degree of precision. The High Court of Australia confined the claimants to the recovery of their expenses incurred in mounting the salvage expedition and to the return of their prepayment. But *McRae* is an extreme case and the courts are extremely reluctant to conclude that the claimant's expectations are so speculative that they cannot be valued. In *Chaplin* v. *Hicks* [1911] 2 KB 786, the defendant, by his breach of contract, denied the claimant the opportunity to participate in a beauty contest. The court could not assess the likelihood of the claimant winning the contest but they awarded her damages of £100 to represent her loss of a chance to win the contest.

One of the problems which these cases present relates to the basis upon which the courts award the reliance measure of damages. Professor Friedmann has argued (1995) that the reliance interest is not a 'contractual interest' because a party does not enter into a contract with a view simply to recovering his detrimental expenditure. The most convincing explanation for the award of reliance damages is that it is the best way of protecting the expectation interest when that interest cannot be

proved. Thus Toohey and McHugh JJ in *Commonwealth of Australia* v. *Amann Aviation Pty Ltd* (1991) 66 ALJR 123, 153, 164 argued that there was no right of election between the different 'interests' and that a claim for reliance loss was only available where the claimant had not suffered or could not prove a loss of profit. On this view the reliance loss is simply a way of putting the claimant into the position which he would have been in had the contract been performed.

20.8 The Date of Assessment

One very important point relates to the date on which damages fall to be assessed. It was established in *Johnson* v. *Agnew* [1980] AC 367, that damages are to be assessed as at the date of breach. But, where the claimant is unaware of the breach, damages will generally be assessed as at the date on which the claimant could, with reasonable diligence, have discovered the breach. Similarly, where it is not reasonable to expect the claimant to take immediate steps to mitigate his loss, the date of assessment will be postponed until such time as it is reasonable to expect the claimant to mitigate his loss (*Radford* v. *De Froberville* [1977] 1 WLR 1262).

20.9 The Commitment to the Protection of the Expectation Interest

Although the stated purpose of the law of contract is to put the innocent party in the position which he would have been in had the contract been performed, there are a number of doctrines and rules which weaken the commitment of the law of contract to the protection of the expectation interest. In the following sections (20.10–20.14) we shall consider some of these doctrines.

20.10 Mitigation

A claimant is under a 'duty' to mitigate his loss. It is, however, technically incorrect to state that the claimant is under a 'duty' to mitigate his loss because he does not incur any liability if he fails to mitigate his loss. The claimant is entirely free to act as he thinks fit but, if he fails to mitigate his loss, he will be unable to recover that portion of his loss which is attributable to his failure to mitigate. The aim of the doctrine of mitigation is

to prevent the avoidable waste of resources. There are two aspects to the mitigation doctrine.

The first is that the injured party must take all reasonable steps to minimise his loss. The claimant is not required to 'take any step which a reasonable and prudent man would not ordinarily take in the course of his business' (*British Westinghouse Co* v. *Underground Electric Ry Co* [1912] AC 673); he is only obliged to take *reasonable* steps to minimise his loss. Thus, where a seller fails to deliver the goods, the buyer must generally go out into the market-place and purchase substitute goods. But a claimant need not take steps which would embroil him in complicated litigation (*Pilkington* v. *Wood* [1953] Ch 770), nor is he required to put his commercial reputation at risk (*James Finlay & Co Ltd* v. *Kwik Hoo Tong* [1929] 1 KB 400), but he may be required to consider an offer of substitute performance by the party in breach (*The Solholt* [1983] 1 Lloyd's Rep 605; at first instance ([1981] 2 Lloyd's Rep 574) Staughton J went so far as to say that the innocent party might be required to *make* an offer of substitute performance to the party in breach which, if correct, would effectively render his right to terminate performance of the contract illusory). The second aspect of the mitigation doctrine is that the claimant must not unreasonably incur expense subsequent to the breach of contract (*Banco de Portugal* v. *Waterlow & Sons Ltd* [1932] AC 452).

As Professor Atiyah has pointed out (1986b), the doctrine of mitigation 'does in practice make an enormous dent in the theory that the promisee is entitled to full protection for his expectations'. In Chapter 1 we discussed the following example. I enter into a contract to sell you 10 apples for £2. I refuse to perform my side of the bargain and am in breach of contract. But you must mitigate your loss. So you buy 10 apples for £2 at a nearby market. If you sue me for damages, what is your loss? You have not suffered any and you cannot enforce my promise. As Professor Atiyah has stated (1979):

> 'the reality is that the bindingness of executory contracts protects not the expectation of performance, but the expectation of profit; and even that is only protected so long as the promisee cannot secure it elsewhere.'

This point is an extremely good one. Professor Fried (1981) has argued that the 'duty' to mitigate is

> 'a kind of altruistic duty, towards one's contractual partner, the more altruistic that it is directed to a partner in the wrong. But it is a duty

> without cost, since the victim of the breach is never worse off for having mitigated.'

But, as Professor Atiyah has pointed out (1986g), altruism finds little favour within a liberal theory of contract and it is surprising to find it being invoked here in favour of a contract breaker. He has also challenged the view that the 'duty' to mitigate is a duty without cost on the ground that, in practice, it 'often places the innocent party in a dilemma. If he fails to mitigate, his damages will be cut, and if he does mitigate, he may find that his only recoverable damages are trivial reliance costs not worth pursuing'. It is probably true to say that there is no one factor which explains the present role of mitigation within the law of contract (see Bridge, 1989), but that it is attributable to such factors as the need to avoid waste, the remoteness of the loss and the responsibility of the claimant to seek to minimise the loss. It underlines the fact that the law of contract is not wholeheartedly committed to the protection of the expectation interest but that, in the words of Burrows (1983), the doctrine of mitigation simply adds:

> 'a supplementary policy to those policies justifying protection of the expectation interest; and this supplementary policy is that the promisee should not leave it simply to the courts to ensure fulfilment of his expectations, but should rather take it upon himself to adopt other reasonable means to ensure the fulfilment of his expectations.'

20.11 Remoteness

A claimant's expectation interest will not be fully protected where some of the loss which he has suffered is too 'remote' a consequence of the defendant's breach of contract. The doctrine of remoteness limits the right of the innocent party to recover damages to which he would otherwise be entitled. The principal justification for the existence of this doctrine is that it would be unfair to impose liability upon a defendant for all losses, no matter how extreme or unforeseeable, which flow from his breach of contract. The general test is that the claimant can only recover in respect of losses which were within the reasonable contemplation of the parties at the time of entry into the contract. But the courts have experienced great difficulty in deciding when a loss is, or is not, within the reasonable contemplation of the parties.

The foundation of the law can be traced back to the case of *Hadley* v. *Baxendale* (1854) 9 Exch 341. A shaft in the claimants' mill broke. The defendant carriers agreed to carry the shaft to Greenwich so that it could be used as a pattern in the manufacture of a new shaft. The shaft was delayed in transit because of the negligence of the defendants and, in consequence, production was halted at the claimants' mill. The claimants sought to recover their loss of profits as damages for breach of contract. Alderson B held that:

> 'where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, that is, according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.'

This test can usefully be divided into two parts. The first is that the defendant is liable for such losses as occur 'naturally' or as a result of the 'usual course of things' after such a breach of contract. To qualify as a loss which has occurred 'naturally' there must have been a 'serious possibility' or a 'real danger' or a 'very substantial' probability that the loss would occur (*Koufos* v. *C Czarnikow Ltd (The Heron II)* [1969] 1 AC 350). A defendant who agrees to supply or repair a chattel which is obviously being used for profit-making purposes is liable for the ordinary loss of profits suffered as a result of his failure to supply or repair the chattel timeously (*Fletcher* v. *Tayleur* (1855) 17 CB 21). Why could the claimants not recover their loss of profits in *Hadley* when it must have been obvious to the carrier that the mill was being used for profit-making purposes? The answer is that the stoppage of the mill was not a 'natural' consequence of the carrier's delay because the claimants might have had a spare shaft which could have kept the mill in production while the new shaft was being made. It has also been held that a defendant who supplies a commodity for use in a complicated construction or manufacturing process is not to be assumed, merely because of the order for the commodity, to be aware of the details of all the techniques undertaken by the claimant and the effect of any failure of or deficiency in the commodity supplied (*Balfour Beatty* v. *Scottish Power plc* 1994 SLT 807).

Under the second limb, a defendant may be liable for losses which did not arise 'naturally' but were within the reasonable contemplation of both parties at the time they made the contract. This test was not satisfied on the facts of *Hadley* because, although the claimants were aware of the

consequences of delay, they had not informed the defendants that delay would result in the halting of production and so the loss could not be said to have been in the reasonable contemplation of *both* parties. The defendant must at least know of the special circumstances (*Simpson* v. *London and North Western Railway Co* (1876) 1 QBD 274 and *Seven Seas Properties Ltd* v. *Al-Essa (No. 2)* [1993] 1 WLR 1083), and there is some suggestion in the case law that the claimant must go further and establish that the defendant agreed to assume liability for the exceptional loss (*Horne* v. *Midland Railway* (1873) LR 6 CP 131).

The distinction between losses which arise 'naturally' and 'special' losses is illustrated by the case of *Victoria Laundry (Windsor) Ltd* v. *Newman Industries Ltd* [1949] 2 KB 528. The defendants contracted to sell and deliver a boiler to the claimants. The defendants knew that the claimants wished to put the boiler into immediate use in their laundry business. The boiler was delivered some five months late. The claimants sued to recover the loss of profits which they had suffered as a result of the late delivery. The Court of Appeal held that the defendants were liable for the loss of profits which naturally flowed from their breach of contract. But the defendants were not liable for the loss of profits on some exceptionally lucrative contracts which the claimants had entered into with the Ministry of Supply. The defendants did not know of the existence of these contracts and so the loss of profit on these contracts was not within the reasonable contemplation of both parties. However, the decision of the Court of Appeal has not escaped criticism, largely on the ground that the only difference between the two losses was one of extent, not kind, and the law does not generally require that the extent of the loss be foreseen. The case was distinguished by the Court of Appeal in *Brown* v. *KMR Services Ltd* [1995] 4 All ER 598, albeit that Stuart Smith LJ (at 620 and 621) and Hobhouse LJ (at 640–3) offered different reasons for distinguishing it. It is suggested that the law cannot ignore the extent of the economic loss in contract cases because parties enter into a contract to make a profit. So the kind of loss is always foreseeable. If the extent of the loss of profit was irrelevant there would be no adequate control device to keep liability within reasonable bounds. Thus the courts are entitled to distinguish between 'ordinary' loss of profits and 'exceptional' loss of profits or between 'ordinary' consequential losses and 'exceptional' consequential losses, however difficult it may be to distinguish between these categories on certain facts.

The effect of the second limb of the test established by Alderson B is to encourage contracting parties to disclose exceptional losses which may be suffered as a result of the breach. Where, as in the *Victoria Laundry* case, the claimant suffers an unusually large loss, he will be unable to

recover that loss unless he draws it to the attention of the defendant at the time of contracting. The rule therefore encourages risk sharing, it enables the parties to assess the scope of their likely liability and to take out insurance cover accordingly.

One difficult question which remains to be discussed is whether the test for remoteness of damage in contract differs from the test for remoteness of damage in tort. In a negligence action, damage is too remote a consequence of the defendant's breach of duty where the kind of damage which the claimant has suffered was not reasonably foreseeable by the defendant (*Overseas Tankship (UK) Ltd* v. *Morts Dock and Engineering Co Ltd (The Wagon Mound) (No. 1)* [1961] AC 388). Despite suggestions that reasonable foresight of loss is also the determining factor in a contractual action (see Asquith LJ in *Victoria Laundry (Windsor) Ltd* v. *Newman Industries Ltd* (above)), it was established by the House of Lords in *The Heron II* (above) that the remoteness test in contract is narrower than the remoteness test in tort because in a contractual action the loss must be within the reasonable contemplation of the parties at the time of entry into the contract. However, this view was challenged by Lord Denning in *H Parsons (Livestock) Ltd* v. *Uttley Ingham & Co Ltd* [1978] QB 791, when he argued that, at least in relation to physical damage cases, the remoteness test was the same in contract and in tort. Although Lord Denning was in the minority in *Parsons*, it must be noted that Scarman LJ did state that it would be absurd if the amount of damages recoverable were to depend upon whether the claimant's cause of action was in contract or in tort. This issue awaits clarification by the House of Lords. In *Henderson* v. *Merrett Syndicates Ltd* [1995] 2 AC 145, 185 Lord Goff stated that 'the rules as to remoteness of damage . . . are less restricted in tort than they are in contract'. While this is generally true it is suggested that, where the parties are in a contractual relationship, the claimant should not be allowed to have resort to the wider tort rules. The rationale for having a wider sphere of liability in tort is that claimants in a tort action do not generally have the opportunity to disclose unusual losses, as contract claimants do. But, where the parties are in a contractual relationship, the claimant has had the opportunity to disclose any unusual losses and so he should not be allowed to avail himself of the wider tort rule.

20.12 Causation

A claimant will be unable to recover damages in respect of the loss which he has suffered if he cannot establish a causal link between his loss and

the defendant's breach of contract. The defendant's breach need not be the sole cause of the loss to the claimant, but it must be a cause of the loss.

For example, the independent act of a third party may break the chain of causation between the defendant's breach and the claimant's loss, unless the defendant has actually promised to guard against the very thing which has actually happened (*London Joint Stock Bank* v. *Macmillan* [1918] AC 777). Natural events may also break the chain of causation, as was argued in the case of *Monarch Steamship Co* v. *Karlshamns Oljefabrieker* [1949] AC 196. The defendants entered into a contract in April 1939 to carry goods from Manchuria to Sweden. In breach of contract, the defendants failed to provide a ship which was seaworthy. This resulted in a delay in the voyage so that the ship failed to get to Sweden before the outbreak of war in September 1939. As a result of the outbreak of war, the ship was ordered to a Scottish port where the goods had to be transferred to neutral vessels before being shipped to Sweden. The claimants had to pay the cost of the transport in the neutral vessels and they sought to recover the sums paid as damages for breach of contract. The defendants argued that the outbreak of war broke the chain of causation between their breach of contract and the cost incurred by the claimants in shipping the goods to Sweden in neutral vessels. This argument was rejected by the House of Lords on the ground that the outbreak of war was a likely event at the time that the contract was concluded in April 1939 and so it could not be held to amount to a break in the chain of causation.

An act of the claimant may be so unreasonable that it breaks the chain of causation between the defendant's breach and the claimant's loss. In *Lambert* v. *Lewis* [1982] AC 225, a farmer continued to use a trailer coupling after it was broken. The farmer was held to be liable in damages to persons who were injured in an accident caused by the coupling giving way. The farmer sought to recover an indemnity from the supplier of the coupling. It was held that the farmer could not recover because his continued use of the coupling, in the knowledge that it was damaged, broke the chain of causation between the supplier's breach of contract and the 'loss' suffered by the farmer in having to pay damages to the accident victims.

Where the claimant has been negligent and that negligence has contributed to the damage which he has suffered, but it is not sufficient to break the chain of causation, the question then arises whether the damages payable to the claimant can be reduced under the Law Reform (Contributory Negligence) Act 1945. This is a vexed issue. The answer depends upon the nature of the obligation which the defendant has

broken. Three different contractual duties must be carefully distinguished. The first is a breach of a strict contractual duty; the second is a breach of a contractual duty to take care which does not correspond to a common law duty to take care; and the third is a breach of a contractual duty of care where the breach also constitutes a tort. At present contributory negligence can operate as a defence in the third category, but not in the first or the second (see *Forsikringsaktieselskapet Vesta* v. *Butcher* [1989] AC 852 and *Barclays Bank plc* v. *Fairclough Building Ltd* [1995] QB 214). This can result in the *overcompensation* of the claimant as no reduction is made to reflect the claimant's contribution to the loss which has arisen (see Burrows, 1993a). The Law Commission has recommended (1993) that contributory negligence be available as a defence in category two as well as three (but not in category one). However, with the recognition of concurrent liability in *Henderson* v. *Merrett Syndicates Ltd* [1995] 2 AC 145, the courts today are more likely to find that a case falls within category three rather than two, so that little would in fact be gained by implementing the Law Commission's recommendation and there are no immediate signs of it being implemented.

20.13 Damages for Pain and Suffering and the 'Consumer Surplus'

Damages are generally assessed by reference to the market value of the promised contractual performance; that is to say, the claimant's loss is objectively assessed. Such an objective approach may lead to the undercompensation of a claimant because it does not take account of the claimant's subjective valuation of the contractual performance, which may be considerably more than the market value (called the 'consumer surplus', see Harris, Ogus and Phillips, 1979). A significant step forward was taken by the House of Lords in *Ruxley Electronics and Construction Ltd* v. *Forsyth* [1996] AC 344 (see further 20.3) when they recognised that the defendant was entitled to loss of amenity damages and Lord Mustill expressly recognised the concept of a 'consumer surplus'.

Prior to *Ruxley*, the courts were generally unwilling to compensate a claimant for his purely 'subjective' losses. Yet consumers frequently suffer such 'subjective' losses. For example, the value of family wedding photographs will generally exceed their market value because of their sentimental value to members of the family. But the courts traditionally refused to award damages to compensate a claimant for any mental distress which he suffered as a result of the defendant's breach of contract.

In *Addis* v. *Gramophone Co Ltd* [1909] AC 488, the claimant sought to recover damages for the indignity which he had suffered in being sacked from his job in a 'humiliating' manner. The House of Lords held that the claimant was not entitled to be compensated for the injury to his feelings.

However there is no longer an absolute rule that damages cannot be recovered for mental distress. The courts have recognised that damages for mental distress can be awarded where the predominant object of the contract was to obtain some mental satisfaction (such as a holiday, *Jarvis* v. *Swan's Tours Ltd* [1973] QB 233), or to relieve a source of distress (*Heywood* v. *Wellers* [1976] 1 QB 446). It is not enough for this purpose that the claimant hoped to obtain peace of mind as a result of the defendant's contractual performance; the defendant must have promised, expressly or impliedly, that he would provide the claimant with peace of mind or freedom from distress. In *Watts* v. *Morrow* [1991] 1 WLR 1421, the claimant house purchasers no doubt hoped to enjoy peace of mind and freedom from distress as a result of a survey carried out by the defendant surveyor on a house which they were planning to buy. But the defendant did not promise that he would provide the claimants with such peace of mind or freedom from distress and so he was not liable for the mental distress which the claimants suffered as a result of his failure to discover significant defects in the property (although he was liable for mental distress caused by the physical discomfort or inconvenience resulting from his breach of contract).

How much of a change has *Ruxley* introduced? The answer is not entirely clear and, to some extent, it depends upon whether subsequent courts follow the approach of Lord Lloyd or the wider analysis of Lord Mustill. Lord Lloyd saw *Ruxley* as a 'logical application or adaptation' of the existing exception to a new situation. So the vital factor for Lord Lloyd was that the contract was one for 'the provision of a pleasurable amenity' and he refrained from giving a 'final answer' to the question which would arise where the contract was for the construction of something which was not a 'pleasurable amenity'. The difficulty with this approach is that it all hinges on the definition of a 'pleasurable amenity' and leaves open the possibility that damages for loss of amenity cannot be awarded outside this narrow category. So it is suggested that the speech of Lord Mustill is more likely to provide a secure foundation for the future development of the law.

It is suggested that a useful way of developing the law, which derives support from the speech of Lord Mustill, is to distinguish between commercial and consumer contracts. English courts are unlikely to be willing

to award loss of amenity damages in purely commercial contracts. As Staughton LJ put it in *Hayes* v. *James & Charles Dodds* [1990] 2 All ER 815, 823:

> 'I would not view with enthusiasm the prospect that every shipowner in the Commercial Court, having successfully claimed for unpaid freight or demurrage, would be able to add a claim for mental distress suffered while he was waiting for his money.'

This attitude is unlikely to change as a result of *Ruxley*. Rather, it is contracts between consumers and businesses which are likely to fall within the new principle. This approach recognises that consumers may enter into contracts for non-economic reasons or may place a higher value upon contractual performance than the market value. It is wider than the analysis of Lord Lloyd, with its emphasis upon the loss of a pleasurable amenity, and it will enable consumers to recover damages where they attach especial but non-economic importance to a particular specification (for example, a consumer who wishes the house to be painted a particular colour) and that specification is not complied with. One further consequence of this development may be that English contract lawyers will have to learn to distinguish more clearly between commercial contracts (where loss of amenity damages will not generally be recoverable) and consumer contracts (where such damages will be more widely available). But it should not be thought that *Ruxley* brings an end to our problems. While it is a useful step forward, it leaves a number of problems in its wake. For example, it is not entirely clear how *Watts* v. *Morrow* (above) would be decided in the light of *Ruxley*, and the scope of *Addis* v. *Gramophone Co Ltd* (above) is somewhat uncertain. In *Mahmud* v. *Bank of Credit and Commerce International SA* [1998] AC 20, the House of Lords held that the claimant employee was entitled to recover damages from his employer in respect of the financial consequences which he could prove followed from a breach by the employer of the obligation of trust and confidence. *Addis* was distinguished but it was not overruled. The claim in *Mahmud* was one for financial loss; it was not a claim for any non-financial losses caused by a breach of the contract of employment. But *Addis* was explained by Lord Steyn (at p.51) as a case in which the loss in respect of which the claimant brought the action was not caused by the breach of contract upon which he based his case. It would therefore appear to be the case that damages for loss of reputation cannot be recovered in an action for damages for wrongful dismissal (see *Johnson* v. *Unisys Ltd* [1999] 1 All ER 854), but that damages for loss of reputation may be recoverable where the employee

alleges that the employer has broken the obligation of trust and confidence (*Mahmud*).

20.14 Conclusion

It can be seen that there are a number of doctrines which limit the commitment of the law of contract to the protection of the claimant's expectation interest. The existence of these rules and doctrines throws into doubt the validity of the claim that the law of contract protects the expectation interest. However, before reaching a conclusion on this fundamental issue, it is necessary to consider the steps which can be taken by contracting parties to ensure that an adequate remedy is obtained and that the expectation interest is fully protected. These issues are the subject-matter of our final chapter.

Summary

1 The aim of an award of damages is to compensate the claimant for the loss which he has suffered as a result of the defendant's breach of contract. The aim is not to punish the defendant.
2 The aim of an award of damages is to put the claimant in the position which he would have been in had the contract been performed according to its terms. This may be measured either by the cost of cure measure or the diminution in value measure. A court will not award cost of cure damages where it would be unreasonable to do so.
3 A claimant can recover a benefit which he has conferred on the party in breach where there has been a total failure of consideration. A defendant is not generally required to disgorge the benefits which he has obtained as a result of his breach of contract.
4 A claimant may elect to recover his reliance rather than his expectation loss, unless he is seeking to escape the consequences of a bad bargain.
5 A claimant must take reasonable steps to mitigate his loss. The existence of a 'duty' to mitigate demonstrates that contract law is not wholeheartedly committed to the protection of the expectation interest.
6 Damages cannot be recovered where the loss which the claimant has suffered is too remote a consequence of the defendant's breach of contract. The general rule is that a loss is not too remote if it was within the reasonable contemplation of both parties at the time of entry into the contract.
7 The claimant must establish that his loss was caused by the defendant's breach of contract.
8 The general rule is that damages cannot be recovered for mental distress suffered as a result of the defendant's breach of contract, unless the predominant object of the contract was to obtain some mental satisfaction or to relieve a source of distress. Loss of amenity damages may now be more widely available for breach of consumer contracts.

Exercises

1 Define and distinguish between the expectation interest, the reliance interest and the restitution interest.
2 Is the law of contract committed to the protection of the expectation interest?
3 Is a court ever justified in awarding damages by reference to the gain which the defendant has made as a result of the breach rather than by reference to the loss which the claimant has suffered?
4 Fire Prevention Ltd entered into a contract with Borchester Town Council, under which they agreed to provide a fire-fighting service of 15 fire engines and 40 firemen. In breach of contract, Fire Prevention only supplied 12 fire engines and 35 men and thereby saved themselves £40,000. Borchester cannot show that they have suffered any loss as a result of Fire Prevention's breach because they cannot prove that Fire Prevention failed to extinguish any fire. Can Borchester recover damages from Fire Prevention? If so, on what basis would a court assess damages? (See *City of New Orleans* v. *Fireman's Charitable Association* 9 So 486 (1891), discussed in *Attorney-General* v. *Blake* [1998] Ch 439.)
5 John, who had recently left his wife, booked a holiday with Harry's Tour Company Ltd. The holiday did not live up to expectations. John now suffers from severe depression. He has been advised by his doctors to give up his job. The depression has been caused partly by the break up of his marriage and partly by the aggravation of his disappointing holiday. Advise John.

21 Obtaining an Adequate Remedy

21.1 Introduction

In Chapter 20 the point was made that the law of contract is not wholeheartedly committed to the protection of the claimant's expectation interest and that a damages award may therefore undercompensate the claimant. We also noted that such undercompensation throws into doubt the claim that contract law protects the expectation interest. In this chapter we shall consider the extent to which the law of contract provides alternative remedies or enables contracting parties to incorporate into their contracts clauses which will ensure that the 'innocent party' (that is, the party who is not in breach) can obtain an adequate remedy in the event of breach of contract.

At the beginning of this book (1.5) we noted that the role of the lawyer and of the law of contract is greater at the planning stage of a contract than after a breach has occurred. It is at the remedial stage that the role of the lawyer and of contract law is at its most important. On the one hand, one contracting party will probably wish to exclude or restrict his liability for breach of contract by an appropriately drafted exclusion or limitation clause, while the other party will wish to ensure that an effective and adequate remedy is available to him in the event of a breach of contract.

In seeking to ensure that a contracting party obtains an adequate remedy in the event of a breach of contract, we must extend our discussion beyond the remedy of damages. There are many methods which can be used in an effort to ensure than an effective remedy is obtained. In the first place the contract can be structured in such a way as to entitle one party to withhold the performance of his obligations (21.2) or to entitle one party to terminate performance and claim loss of bargain damages (21.3) or to make a claim in debt for the contract price (21.4). Such remedies may provide a powerful incentive to the other party to refrain from breaking the contract and to perform his obligations under the contract. Alternatively, the parties may make provision in their contract for a sum of money to be payable by way of damages in the event of breach (21.5–21.8). Finally, an adequate remedy can be obtained by seeking an

order of specific performance (21.9) or an injunction restraining a threatened breach of contract (21.10). We shall now consider these remedies in greater detail and conclude with a very brief assessment of the significance of the remedial consequences of a breach of contract for the basis, or the theory, of contract law.

21.2 The Entire Obligations (or 'Contracts') Rule

The ability of one contracting party to withhold performance of his obligations under the contract gives to the other party an extremely powerful incentive to perform his contractual obligations. An example will illustrate the point. A house-owner and a builder enter into a contract under which the builder agrees to build a garage for £8000. The contract states that payment shall be made only upon satisfactory completion of the work by the builder. The house-owner's obligation to pay the promised sum is therefore dependent upon satisfactory completion by the builder. Should the builder, in breach of contract, fail to complete the work he will, as a general rule, be unable to sue for payment. His claim will be barred by the entire obligations rule or, as it is more often known, the 'entire contracts' rule.

It is suggested that 'entire obligations' is the more accurate title for this rule. In some cases there may be little practical difference between an entire contract and an entire obligation. In our example involving the construction of a garage, the builder can only recover payment when he has completed contractual performance, so, from his perspective, there is no difference between an entire contract and an entire obligation: his obligation is to perform the contract in its entirety. But in other cases the difference between an entire contract and an entire obligation is clear. Where a construction contract makes provision for payment upon the completion of distinct stages of the project, the completion of each stage being a condition precedent to the right to claim payment, the obligation to complete each stage may be said to be entire, even though the contract as a whole is not entire.

The origin of the entire obligation rule can be traced back to the old case of *Cutter* v. *Powell* (1795) 6 TR 320. Cutter agreed with Powell to 'proceed, continue and do his duty as second mate' on a ship sailing from Jamaica to England. Cutter died on the journey to England and his widow sued to recover the wages which she alleged were payable in respect of the period of time in which Cutter had satisfactorily performed his duties before his death. Her action failed because Cutter was not entitled to payment unless he completed the voyage. The rule was no completion, no

pay. This rule gives a powerful incentive to a contracting party to ensure, as far as is possible, that the contract is carried out according to its terms. But it can lead to the apparent unjust enrichment of the 'innocent party'. In *Cutter* v. *Powell*, Powell obtained the services of Cutter for some seven weeks but was not required to pay for any 'benefit' which he had obtained.

In practice, the hardships to which this rule can give rise are mitigated by its many exceptions. The principal exception is that the rule is alleged not to apply where the party in breach has substantially performed his obligations under the contract (*Hoenig* v. *Isaacs* [1952] 2 All ER 176 and *Williams* v. *Roffey Bros & Nicholls (Contractors) Ltd* [1991] 1 QB 1). In such a case the innocent party must perform his obligations under the contract (usually pay the price) and content himself with an action for damages for any loss suffered as a result of the breach. But the doctrine of substantial performance has been heavily criticised by Professor Treitel (1999, at p.730) on the ground that 'it is based on the error that *contracts*, as opposed to particular *obligations*, can be entire'. He asserts that to 'say that an obligation is entire *means* that it must be completely performed before payment becomes due' and that in 'relation to "entire" obligations, there is no scope for any doctrine of "substantial performance"'. On this view a court is required to identify with some care the obligation which is alleged to be entire. Thus, he argues, the obligation to complete the work is generally entire but the obligation to do so in a workmanlike manner generally is not. So, in *Hoenig* v. *Isaacs* (above), where the builder had completed the work, albeit defectively, there was no need to resort to any doctrine of substantial performance. The obligation which was entire, namely the obligation to complete the work, had been performed and so the employer was required to pay the price, subject to a claim for damages in respect of the breach of the non-entire obligation to do the work in a workmanlike manner. Although there is much to be said for this view, it has not yet been expressly adopted by the courts, who still tend to insist that, upon substantial performance, the party in breach is entitled to claim the price, subject to a counterclaim for damages (see *Hoenig* v. *Isaacs* (above), *Bolton* v. *Mahadeva* [1972] 1 WLR 1009 and *Williams* v. *Roffey Bros & Nicholls (Contractors) Ltd* (above)).

The second exception is that an innocent party may be required to recompense the party in breach if he accepts the latter's part performance. This is usually difficult to establish because the acceptance of the innocent party occurs in the context of complete contractual performance and is generally not pro-ratable. Part performance was not what was requested. It was full performance or nothing. In our example, a garage is a benefit to the house-owner, but a partly built garage is not; indeed, it may be more of a nuisance (*Sumpter* v. *Hedges* [1898] 1 QB 673). Finally,

the court may interpret the contract as consisting of a number of obligations so that, once each obligation has been completely performed, the party in breach may claim the sum promised in relation to the performance of that obligation. Many contracts are so divided; for example, a building contract will often provide for payment at intervals, usually against an architect's or engineer's certificate.

The ability of contracting parties to take steps to minimise the impact of the entire obligations rule has probably preserved the rule as part of English law. Although the Law Commission originally recommended (1983) that the party in breach be given a restitutionary remedy for the value of his part performance, their recommendation did not gain much support and legislation to abrogate the rule is no longer forthcoming (see Burrows, 1984a).

21.3 The Creation of Conditions

Another effective remedy is to threaten to terminate performance of the contract in the event of a repudiatory breach of contract and claim loss of bargain damages. The effectiveness of such a step can be seen from the case of *Lombard North Central plc* v. *Butterworth* [1987] QB 527 (see 10.3). By providing in clause 2 of the agreement that the obligation to pay each instalment punctually was of the essence of the contract, the owners were able to terminate performance of the contract and claim loss of bargain damages when the hirer failed to pay an instalment timeously. Clause 2 was not subject to the penalty clause rule (see 21.5 and 21.6) because the Court of Appeal held that the parties were free to classify as a condition a clause which would not otherwise be regarded as a condition. Therefore, by careful draftsmanship which ensures that any term likely to be broken is elevated to the status of a 'condition' which is of the 'essence of the contract', the innocent party can be given the ability to threaten termination of performance of the contract and to claim loss of bargain damages. This will give the other party a powerful incentive to perform his obligations under the contract and, as far as the innocent party is concerned, ensure that, if the contract is broken, an effective remedy is obtained.

21.4 A Claim in Debt

A debt is a definite sum of money which the defendant, under the terms of the contract, is due to pay to the claimant. It is therefore distinct from

a claim in damages. The principal issue in a debt action is whether the money is *due* to the claimant. The claimant does not have to show that he has mitigated his loss, nor are the remoteness rules applicable. His action is simply to recover the sum due; no more, no less. The classic example of a claim in debt is an action to recover the contract price where goods have been delivered and the buyer has not paid for them. The advantage of a claim in debt can be seen from an examination of *White and Carter (Councils) Ltd* v. *McGregor* [1962] AC 413 (see 19.9), where the claimants were able to recover the contract price and were not obliged to take steps to mitigate their loss. Such an action also enjoys certain procedural advantages (see Part 24 of the Civil Procedure Rules). There are therefore distinct advantages in drafting a contract in such a way as to create a debtor–creditor relationship between the parties so as to provide the creditor with an effective remedy should the 'debtor' default in making payment.

21.5 Liquidated Damages

An alternative method of avoiding undercompensation is to insert into the contract a clause which states the amount of money which shall be payable in the event of a breach of contract. Such a clause also helps to eliminate uncertainty because it enables the parties to know in advance the extent of their potential liability and to plan accordingly (for example, in relation to the calculation of the price and the allocation of responsibility for insurance). However, the courts have retained a jurisdiction to control the content of such clauses. The basic rules which the courts have established may be stated in the following terms. If the clause represents a genuine pre-estimate of the loss which is likely to be occasioned by the breach, then it is a 'liquidated damages clause' and is enforceable. The function of such a clause is to fix the sum which is to be paid irrespective of the actual damage suffered by reason of the breach. So, for example, if the loss suffered is greater than the sum stipulated, the innocent party cannot ignore the clause and sue for his actual loss (*Diestal* v. *Stevenson* [1906] 2 KB 345). In quantifying the 'loss' which is likely to be occasioned by the breach, it is the *actual* loss which is the relevant sum, so that it is no objection that part of that loss would have been irrecoverable on the ground that it was too remote (*Robophone Facilities Ltd* v. *Blank* [1966] 1 WLR 1428, 1447). The sum stipulated in the liquidated damages clause is the sum recoverable, even though that sum is greater or smaller than the loss which has actually been suffered.

But if the sum stated in the clause is not a genuine pre-estimate of loss,

it is a 'penalty clause' and is unenforceable. The aim of such a clause is to punish the party in breach and the courts have held that such an aim is impermissible. A clause which is held to be a penalty clause is not struck out of the contract, but it will not be enforced by the court beyond the actual loss of the party seeking to rely on the clause (*Jobson* v. *Johnson* [1989] 1 All ER 621). The court is not required to consider whether the party in breach is entitled to relief; the court automatically relegates the party seeking to rely on the penalty clause to a claim in damages.

The distinction between a liquidated damages clause and a penalty clause rests ultimately on the intention of the parties at the time of entry into the contract: that is to say, was the clause a genuine or bona fide attempt to assess the loss likely to be occasioned by the breach or was it designed to punish the party in breach? The fact that the parties have described the clause as a 'liquidated damages clause' or a 'penalty clause' is a relevant factor but it is not conclusive (*Elphinstone* v. *Monkland Iron and Coal Co* (1886) 11 App Cas 332). The difference between a liquidated damages clause and a penalty clause is in fact a question of construction and the courts have established a number of rules of construction which they apply in deciding whether a particular clause is a penalty clause or a liquidated damages clause.

The source of these rules of construction can be found in the judgment of Lord Dunedin in *Dunlop Pneumatic Tyre Co Ltd* v. *New Garage & Motor Co Ltd* [1915] AC 79. Lord Dunedin stated (at p.87), firstly, that a clause will be held to be a penalty clause

> 'if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach.'

The second rule is that a clause is a penalty clause

> 'if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid.'

The third rule is that

> 'there is a presumption (but no more) that it is penalty when "a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage".'

This presumption can act as a trap for the unwary. Contract draftsmen must seek to distinguish between serious and trifling breaches of contract

because a failure to distinguish between the two may result in the clause being held to be a penalty clause. The fourth rule of construction is that

> 'it is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties.'

When applying these presumptions to the facts of a particular case, it must be remembered that the penalty clause jurisdiction is an exceptional one and that the courts will generally be slow to conclude that a formula is oppressive or penal, especially when it has been agreed by commercial parties who are capable of protecting their own interests in the bargaining process. That this is so can be demonstrated by reference to the decision of the Privy Council in *Philips Hong Kong Ltd* v. *Attorney-General of Hong Kong* (1993) 61 Build LR 41. Lord Woolf, giving the judgment of the Privy Council, expressly recognised the value of liquidated damages clauses in enabling the parties to 'know with a reasonable degree of certainty the extent of their liability and the risks which they run as a result of entering into the contract' and he refused to adopt an approach to their construction which would undermine these purposes. He therefore emphasised the exceptional nature of the penalty clause jurisdiction: 'the principle was always recognised as being subject to fairly narrow constraints and the courts have always avoided claiming that they have any general jurisdiction to rewrite the contracts that the parties have made'. He adopted the following passage from the judgment of Mason and Wilson JJ in the High Court of Australia in *AMEV UDC Finance Ltd* v. *Austin* (1986) 162 CLR 170:

> '[t]he courts should not . . . be too ready to find the requisite degree of disproportion lest they impinge on the parties' freedom to settle for themselves the rights and liabilities following a breach of contract.'

The particular argument which was put to the Privy Council in *Philips* was that, although the sum claimed was not exorbitant in the light of what had actually happened, the clause was nevertheless a penalty clause on the ground that there were various hypothetical situations (none of which had actually occurred on the facts) in which the application of the clause could have resulted in a sum larger than the actual loss being recovered by the innocent party. The Privy Council, adopting a robust approach, rejected the argument in the following terms:

> 'Except possibly in the case of situations where one of the parties to the contract is able to dominate the other as to the choice of the terms of a contract, it will normally be insufficient to establish that a provision is objectionably penal to identify situations where the application of the provision could result in a larger sum being recovered by the injured party than his actual loss. Even in such situations so long as the sum payable in the event of non-compliance with the contract is not extravagant, having regard to the range of losses that it could reasonably be anticipated it would have to cover at the time the contract was made, it can still be a genuine pre-estimate of the loss that would be suffered and so a perfectly valid liquidated damage provision. The use in argument of unlikely illustrations should therefore not assist a party to defeat a provision as to liquidated damages.'

Of course, it must be remembered that the question whether a particular clause is a liquidated damage clause or a penalty clause must be asked at the date of the formation of the contract, not the date of breach. Therefore what has actually happened cannot be conclusive evidence of the status of the clause because the court must have regard to the wider range of events which were in the contemplation of the parties at the time of entry into the contract. But equally, as Lord Woolf stated, this does not mean that what happens after the formation of the contract is irrelevant. What actually happened can 'provide valuable evidence as to what could reasonably be expected to be the loss at the time the contract was made'. The approach and tenor of the judgment of Lord Woolf suggests that, in future, the courts will not be receptive to technical arguments which seek to set aside a clause which has operated in a fair and reasonable manner and further that, in the absence of compelling evidence, they will be reluctant to set aside an agreed pre-estimation of loss by parties of equal bargaining power. The penalty clause jurisdiction is the anomaly, not the rule.

We have already noted that a penalty clause is invalid and unenforceable. This leads to a potential anomaly where the loss which the innocent party has suffered is greater than the sum stipulated in the contract. In such a case, can the innocent party argue that the clause is a penalty clause so that it can be ignored and he can recover his actual loss? In *Wall* v. *Rederiaktiebogalet Luggude* [1915] 3 KB 66, it was held that the innocent party could do this and recover his actual loss, although the decision was only at first instance, the reasoning is not at all clear and the issue has been the subject of vigorous debate among academic lawyers (see Hudson, 1974, Gordon, 1974, Hudson, 1975 and Barton, 1976). It should also be noted that a liquidated damages clause may validly provide for the payment of a sum of money which is less than the estimated loss

(*Cellulose Acetate Silk Co* v. *Widnes Foundry (1925) Ltd* [1933] AC 20, although where the clause is held to 'exclude or restrict' liability for breach of contract it may be caught by s.3 of the Unfair Contract Terms Act 1977, see 11.11).

21.6 Evading the Penalty Clause Rule

Although the approach of the Privy Council in *Philips Hong Kong* (above) appears to suggest that contracting parties will, in future, have greater latitude in making provision for agreed damages in the contract itself, parties may wish to avoid any uncertainty by evading the clutches of the penalty clause rule entirely by clever draftsmanship. Three principal devices can be used to avoid the rule. The first is that the penalty clause rule does not apply to a clause which simply accelerates an existing liability. An example will illustrate the point. Suppose that two parties enter into a contract of hire under which the entire rental is stated to be payable at the date of entry into the contract. The contract further provides that the hirer shall be entitled to pay the rental by instalments provided that certain conditions are met but that, in the event of default in payment of any instalment, the whole balance shall immediately become payable. Such an acceleration of liability is not caught by the penalty clause rule (*Protector Loan Co* v. *Grice* (1880) 5 QBD 592). The same principle applies where a creditor agrees to accept part payment of a debt in full discharge of the debt, provided that certain conditions are met, but stipulates that, if the conditions are not met, he will be entitled to recover the original debt in full (*The Angelic Star* [1988] 1 Lloyd's Rep 122). The crucial ingredient in these cases is that there must be 'a present debt, which by reason of an indulgence given by the creditor is payable either in the future, or in a lesser amount, provided that certain conditions are met (*O'Dea v. Allstates Leasing System (WA) Pty Ltd* (1983) 57 ALJR 172, 174). So by careful draftsmanship a 'present debt' can be created and the subsequent 'acceleration' of that liability to pay is outside the scope of the penalty clause rule.

The second device is to stipulate that the sum shall be payable on an event which is not a breach of contract. The penalty clause rule applies *only* to sums of money which are payable on a breach of contract. A good example of the potential for evasion is provided by the case of *Alder* v. *Moore* [1961] 2 QB 57. The defendant, who was a professional footballer, suffered serious injury and he was certified as being disabled to such an extent that he was unable to play professional football. The claimant insurers paid him £500 under an insurance policy which had been taken

out to cover the defendant in the event of his suffering permanent total disablement. The defendant covenanted with the claimants that:

> 'In consideration of the above payment I hereby declare and agree that I will take no part as a playing member of any form of professional football and that in the event of infringement of this condition I will be subject to a penalty of [£500].'

The defendant later resumed his playing career and the insurers sought to recover the £500 which they had paid to him. The defendant argued that the clause was unenforceable because it was a penalty clause. But the majority of the Court of Appeal held that the penalty clause rule was not applicable. The defendant had not promised that he would not play football again. Therefore the £500 was not payable upon a breach of contract and the penalty clause rule was irrelevant. This rule can lead to anomalous results. For example, a hirer who breaks a contract of hire-purchase by failing to pay the instalments can invoke the penalty clause rule if the owners seek to recover an 'excessive' sum of money from him as a result of his breach of contract. But, where the hirer honestly admits that he can no longer pay the instalments, and exercises his right under the contract to return the goods, such a hirer will have no defence to an action by the owners for an 'excessive' sum of money because the sum is not payable on a breach of contract (see *Bridge* v. *Campbell Discount Co Ltd* [1962] AC 600). Lord Denning pointed out the absurdity of this rule. He stated that equity has committed itself to the 'absurd paradox' that 'it will grant relief to a man who breaks his contract but will penalise the man who keeps it'. The response of the courts has been that the penalty clause rule only regulates the sums payable upon a breach of contract; any unfairness which lies in other parts of the contract cannot be dealt with by the penalty clause rule (see *Export Credits Guarantee Department* v. *Universal Oil Products Co* [1983] 1 WLR 399). The 'absurdity' which Lord Denning has pointed out stems from the fact that English law has refused to recognise the existence of a general doctrine of unconscionability (see 17.4). Instead, it has sought to deal with problems of contractual unfairness in a piecemeal manner. The price of such an approach is that, where the weaker contracting party is unable to bring his case within one of the existing identifiable categories, his claim for relief is likely to fail.

The third device which can be used to evade the penalty clause rule is to avoid the use of a clause which states that a specified sum of money shall be payable in the event of a breach of contract because there is always a risk that such a clause will be held to be a penalty clause. But, if the parties simply provide that the term is a condition which is of the

essence of the contract, breach of that term will entitle the innocent party to terminate performance and claim loss of bargain damages. The elevation of a particular term into a condition is not caught by the penalty clause rule (see *Lombard North Central plc* v. *Butterworth* (above), noting in particular that clause 6, which did seek to quantify the sum payable on breach, was held to be a penalty clause and was therefore unenforceable. Contrast the decision of the Court of Appeal in *Financings Ltd* v. *Baldock* [1963] 2 QB 104).

21.7 Deposits and Part Payments

A clause in a contract which states that a certain sum of money shall be payable on a breach of contract inevitably runs the risk that it will be held to be a penalty clause. It also has the disadvantage that the innocent party has to take the initiative to obtain the money. A preferable alternative might therefore be to obtain payment of a sum of money in advance and then refuse to return it in the event of the other party breaking the contract.

In such a case, can the party in breach recover the prepayment? The answer to that question depends upon whether the money was paid as a deposit or as a part payment of the price. A deposit is paid by way of security and is generally irrecoverable, whereas a part payment is paid towards the contract price and is generally recoverable. The difference between the two is a matter of construction. Where the contract is neutral then a payment will generally be interpreted as a part payment (*Dies* v. *British and International Mining and Finance Co* [1939] 1 KB 715).

Where the payment is held to be a deposit, the rule established in *Howe* v. *Smith* (1884) 27 Ch D 89 is that a deposit is irrecoverable. A deposit which was due before the date of discharge but which has not been paid is forfeitable (*Hinton* v. *Sparkes* (1868) LR 3 CP 161). The general rule that a deposit is irrecoverable is capable of causing great hardship to the party in breach because the deposit may have been much larger than the loss occasioned by the breach of contract. However a critical limit upon the ability of parties to stipulate for excessive deposits was firmly established by the Privy Council in *Workers Trust and Merchant Bank Ltd* v. *Dojap Investments Ltd* [1993] AC 573 (see Beale, 1993). Vendors of property sought to forfeit a deposit of 25 per cent of the purchase price when the purchaser failed to pay the balance of the purchase price within the 14 days stipulated in the contract, time being of the essence of the contract. The purchasers did tender the balance of the purchase price with interest a week later but the vendors returned the cheque and purported

to forfeit the deposit of almost three million Jamaican dollars. The Privy Council held that the vendors were not entitled to retain the deposit and ordered that it be repaid to the purchasers after subtracting from it any loss which the vendors could prove they had suffered as a result of the purchasers' breach.

Lord Browne-Wilkinson, giving the judgment of the Privy Council, stated that it was 'not possible for the parties to attach the incidents of a deposit to the payment of a sum of money unless such sum is reasonable as earnest money'. There is, however, some difficulty in establishing what is a 'reasonable deposit' given that even a reasonable deposit need not represent a genuine pre-estimate of the loss likely to be occasioned by the breach. On the facts, the Privy Council concluded that the customary deposit in the case of the sale of land has been 10 per cent and that 'a vendor who seeks to obtain a larger amount must show special circumstances which justify such a deposit'. This the vendors could not do. The Privy Council admitted that this reliance upon the practice of asking for a 10 per cent deposit was 'without logic' but they were nevertheless content to use it as a benchmark. It is not at all clear how the courts will decide what constitutes a 'reasonable deposit' where there is no such objective benchmark.

The most difficult aspect of the case was whether the court had jurisdiction to relieve against the forfeiture of the deposit when the party claiming relief was not ready and willing to perform his obligations under the contract. In *Stockloser* v. *Johnson* [1954] 1 QB 476, Romer LJ stated that the jurisdiction of the court was confined to allowing late completion by the defaulting party and did not extend to ordering the repayment of a sum which had been paid in accordance with the contract and which, on breach, was stated to be forfeit. On the other hand, both Denning and Somervell LJJ in *Stockloser* stated that a deposit may be recoverable in equity if the forfeiture clause was of a penal nature and if it was unconscionable for the innocent party to retain the money. Lord Browne-Wilkinson found it unnecessary to resolve this conflict. He distinguished *Stockloser* on the ground that it was a case in which the purchaser seeking relief against the forfeiture of instalments had been let into possession of the subject-matter of the contract (although it is not entirely clear what basis in principle there is for so distinguishing the case). Whatever the answer to the problem in *Stockloser*, Lord Browne-Wilkinson stated that a stipulation for the forfeiture of a 25 per cent deposit was a 'plain penalty' and, on the authority of *Commissioner of Public Works* v. *Hills* [1906] AC 368, he held that the court was entitled to order repayment of the sum paid, less any damage actually proved to have been suffered as a result of the default. One further point of note which arises out of *Dojap* is that, in the event of a deposit

being held to be unreasonable, the court will not rewrite the contract by inserting into it a 'reasonable' deposit. The vendors were therefore not entitled to retain 10 per cent of the sum paid because they had not contracted for a 10 per cent deposit. This refusal to rewrite the terms of the contract will give an incentive to contracting parties to err on the side of caution when setting the level of any deposit payable. *Dojap* is therefore to be welcomed in so far as it places limits upon the ability of contracting parties to provide for excessive deposits.

But the limits of *Dojap* must be noted. It deals only with the right of the innocent party to retain the deposit. It does not purport to restrict the right of the innocent party to terminate the contract in respect of the breach. In the latter context, the courts have generally been reluctant to interfere with the innocent party's right to terminate the contract, as can be seen from *Union Eagle Ltd* v. *Golden Achievement Ltd* [1997] AC 514. The claimant agreed to buy a flat in Hong Kong and paid 10 per cent of the purchase price (HK $420,000) as a deposit. The agreement specified the date, time and place of completion, and time was stated to be in every respect of the essence of the agreement. Completion was to take place on or before 30 September 1991 and before 5 pm on that day. Clause 12 of the agreement stated that, if the purchaser failed to comply with any of the terms and conditions of the agreement, the vendor had the right to rescind the contract and forfeit the deposit. The claimant failed to complete by the stipulated time and tendered the purchase price 10 minutes after the time for completion had passed. The vendors refused to accept late payment, rescinded the contract and forfeited the deposit. The claimant refused to accept the defendants' decision to rescind the contract and brought an action seeking to have the contract specifically enforced. His action failed. His argument that the court could and should intervene to restrain the enforcement by the vendors of their legal rights when it would be 'unconscionable' for them to insist upon them was rejected by the Privy Council on the ground that it was both contrary to the authorities and to the needs of the business world. Lord Hoffmann emphasised the need for certainty in commercial transactions and stated that a jurisdiction to grant relief from termination in cases of alleged unconscionability was not consistent with the promotion of certainty. In a volatile market a vendor will want to know whether or not he can terminate the contract and deal with someone else. The law should, as far as possible, enable the vendor to know whether or not he is entitled to terminate. But, while the need for certainty applies to the decision whether or not to terminate, it does not obviously apply to the financial consequences of termination. Thus the apparent harshness of the rule laid down in *Union Eagle* is mitigated by the possibility that a court will grant a

personal restitutionary claim to the purchaser where the vendor has been unjustly enriched as a result of the payment made or other work done by the purchaser prior to termination or where the deposit which has been paid is not a reasonable one. Such personal remedies do not undermine the promotion of certainty. In other words, the position which the law has adopted is that, while the vendor should have restored to him the 'freedom to deal with his land as he pleases', he should not enjoy the same freedom in relation to money paid to him or benefits conferred on him by the party in breach. (However, it should be noted that there are some very exceptional cases where equity will intervene to prevent a party from exercising his right to terminate; for example, where he is estopped from doing so. Equity may also intervene to grant relief in cases of late payment of money due under a mortgage or rent due under a lease (*G and C Kreglinger* v. *New Patagonia Meat and Cold Storage Co Ltd* [1914] AC 25, 35) and, more controversially, where the termination involves the forfeiture of a proprietary or possessory, as opposed to a contractual right of the party in breach (*BICC plc* v. *Burndy Corporation* [1985] Ch 232; cf. *The Scaptrade* [1983] 2 AC 694).)

Where the sum paid is held to be a part payment, the general rule is that the sum is recoverable by the party in breach. This rule can be traced back to the case of *Dies* v. *British and International Mining and Finance Co* (above). The claimant contracted to purchase ammunition and made a prepayment of £100,000. In breach of contract the claimant refused to accept delivery. The defendants terminated the contract and the claimant sued to recover the £100,000. Stable J held that the claimant was entitled to recover the money paid, subject to the right of the defendants to recover damages for the breach. The initial payment was a conditional one; it was conditional upon subsequent performance of the contract and, when that condition failed because of the termination of the contract consequent upon the claimant's breach of contract, the defendants' right to retain the money simultaneously failed (see Beatson, 1981). However, the rule in *Dies* did not emerge unscathed from a re-examination by the House of Lords in *Hyundai Shipbuilding and Heavy Industries Co Ltd* v. *Papadopoulos* [1980] 1 WLR 1129. Shipbuilders sought to recover an instalment which they alleged was due to them by the defendant guarantors. It was held that the shipbuilders were entitled to recover the instalment. Lord Fraser distinguished *Dies* on the ground that the latter case was not one in which the vendors were required to incur any expenditure or perform any work in the performance of their obligations under the contract. It was a simple contract of sale. *Hyundai*, on the other hand, involved a contract for work and materials, under which the shipbuilders incurred expense in the building of the ship. The conclusion that can be

derived from *Hyundai* is that, where it is clear from the contract that the payee will have to incur reliance expenditure before completing his performance of the contract, then, in the absence of a stipulation in the contract to the contrary, the part payment will be irrecoverable. A part payment is therefore recoverable only where it is clear from the contract that the payee will not have to incur reliance expenditure before completing his performance of the contract.

21.8 Liquidated Damages, Penalty Clauses and Forfeitures: An Assessment

Two groups of questions must be considered here. The first is: why should we differentiate between penalty clauses and deposits? Why not have a uniform set of rules? The answer may be that, after *Workers Trust and Merchant Bank Ltd* v. *Dojap Investments Ltd* (above), we no longer distinguish between the two: the penalty clause rule is simply applied to deposits. While it is true to say that, after *Dojap*, the difference between the two sets of rules is not as great as it once was, it is not yet possible to say that the rules have been completely assimilated. As we have noted, the distinction between a penalty clause and a liquidated damages clause rests on whether or not the clause is a 'genuine pre-estimate of the loss' (21.5). But, in the case of a deposit, the vital question is whether or not the deposit is 'reasonable' and, crucially in this context, Lord Browne-Wilkinson stated that, at least in the case of a contract for the sale of land, a deposit may be 'reasonable' notwithstanding the fact that it is not a genuine pre-estimate of the loss. So it cannot yet be said that the 'genuine pre-estimate of loss' test is applicable to deposits. On the other hand, it is vital to note that Lord Browne-Wilkinson's observation was confined to contracts for the sale of land and it may be that, in other contexts, the courts will have regard to whether or not the deposit was a genuine pre-estimate of the loss in deciding whether or not it was 'reasonable'. There is, in fact, much to be said for the assimilation of the rules. The only difference between an agreed damages clause and a deposit is that the latter is payable in advance and so belongs to the recipient before the breach, while the former only becomes payable upon breach. Although this distinction may have important practical consequences, in the sense that the recipient of a deposit is less likely than the intended recipient of a sum payable by way of agreed damages to have to engage in litigation to obtain the sum stipulated, it does not demand the existence of two sets of controls upon the freedom of the contracting parties to make provision for the consequences of breach. A single set of rules should suffice.

The second group of questions which must be asked is: can the existence of these jurisdictions to grant relief to defaulting contracting parties be justified? Should freedom of contract not prevail so that the parties can be left free to stipulate the amount of damages payable in the event of a breach? What is the point of these rules if they can be evaded by the clever draftsmanship of the more powerful party? These are all difficult questions to answer.

Given the tendency which we have noted for damages to undercompensate, a number of arguments can be adduced in favour of leaving the parties free to make their own assessment of the damages payable upon a breach. The first is the argument from freedom of contract, that the parties should be free to stipulate the sums payable on breach. The second is that it would avoid the artificiality of the present rules, many of which can be evaded by careful draftsmanship. The third is that it would reduce the uncertainty caused by the present possibility of judicial review.

On the other hand, a number of arguments can be adduced against the abolition of these equitable jurisdictions. It can be argued that it is for the courts to decide the compensation which is payable upon a breach of contract and that it is not for the parties to set compensation at a level higher than that permitted by the courts. The principal objection, however, is that the courts would have to create a doctrine of unconscionability to play the role once played by these equitable jurisdictions. Thus far, the English courts have refused to recognise the existence of a general doctrine of unconscionability (*National Westminster Bank* v. *Morgan* [1985] AC 686, see further 17.4). On the other hand, the case for incorporating these traditional equitable jurisdictions within a wider doctrine of unconscionability or unfairness appears to have been strengthened by the Unfair Terms in Consumer Contracts Regulations 1999 (see further 1.6 and 17.6). It includes within the list of terms which are indicatively unfair the following two terms, which overlap with the existing common law regulation of penalty clauses and deposits. The first is a term which has the object or effect of

> 'permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract' (Schedule 2, paragraph 1(d)).

This deals with deposits, but it does so in a manner unfamiliar to English lawyers. As Professor Treitel points out (1999, p.942), this provision is based on 'the civil law institution (which has no counterpart in the common law)

by which a contract can, in effect, be dissolved on forfeiture of a deposit or on the return by the payee of double the amount'. The second term is a term which has the object or effect of 'requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation' (Schedule 2, paragraph 1(e)). The latter provision clearly overlaps with the existing common law rules, but the extent to which it differs from them is unclear. The word 'disproportionately' is not defined in the regulations, nor is it clear what is meant by 'fails to fulfil his obligation'. Does this reproduce the common law rule that there must be a breach of contract or does it also catch the party who failed to perform but had a lawful excuse for his non-performance? These provisions, as part of a more general piece of regulation, are unlikely to be conducive to the interests of certainty (at least in the short to medium term) but they do have the merit of avoiding the artificiality inherent within the present rules and they also reduce the scope for the evasion of the rules by clever draftsman employed by the more powerful party to the contract (see further on these issues Goetz and Scott, 1977, Kaplan, 1977, Muir, 1985 and Milner, 1979).

21.9 Specific Performance

A claimant who wishes to secure an adequate remedy may, finally, seek an order of specific performance. An order of specific performance is an order of the court which requires the party in breach to perform his primary obligations under the contract. This is, of course, one of the most effective methods of protecting the expectation of performance because it orders that performance take place, albeit at a later point in time than originally agreed. We have already noted that damages are available as of right upon a breach of contract, but specific performance is an equitable remedy which is only available in the discretion of the court. Historically, English law has conceived of specific performance as a supplementary remedy, only to be granted when damages were inadequate. But the scope of the remedy has gradually expanded in recent years. The crucial case in the development of the law is *Beswick* v. *Beswick* [1968] AC 58 (see 7.2). In granting an order of specific performance to the claimant, it is clear that the House of Lords envisaged a wider role for specific performance, based upon the appropriateness of the remedy in the circumstances of the case, rather than as a supplementary remedy in a hierarchical system of remedies. Lord Reid awarded specific performance to achieve a 'just result' and Lord Pearce granted the order because it was 'the more appropriate remedy'.

The extent to which this more expansive view has been implemented in subsequent cases remains unclear. One commentator has gone so far as to cite *Beswick* for the proposition that there is now 'a right to specific performance of all contracts where there is no adequate reason for the courts to refuse it' (Lawson, 1980). Other commentators, while recognising the possibilities inherent in *Beswick*, have been more hesitant, as subsequent cases have not always followed the lead given in *Beswick* (see Burrows, 1984b). Cases can be found, however, which have adopted a more liberal approach (see *Evans Marshall and Co Ltd* v. *Bertola SA* [1973] 1 WLR 349 and *Sudbrook Estates Ltd* v. *Eggleton* [1983] 1 AC 444) and it is suggested that Professor Treitel is correct to conclude (1999, pp.954–5) that the 'availability of specific performance depends on the *appropriateness* of that remedy in the circumstances of each case'.

Nevertheless there remain a number of situations in which an order of specific performance is not normally available. The remedy is generally unavailable where it would cause severe hardship to the defendant (*Patel* v. *Ali* [1984] Ch 283), where the contract is unfair to the defendant, even though the unfairness is not such as to amount to a ground on which the contract can be set aside (*Walters* v. *Morgan* (1861) 3 D F & J 718), where the conduct of the claimant demonstrates that he does not deserve the remedy (*Shell UK Ltd* v. *Lostock Garages Ltd* [1976] 1 WLR 1187), where the claimant has sought to take advantage of a mistake by the defendant (*Webster* v. *Cecil* (1861) 30 Beav 62), where performance is impossible (*Watts* v. *Spence* [1976] Ch 165), where the contract is one of personal service, such as a contract of employment (s.236 of the Trade Union and Labour Relations (Consolidation) Act 1992), where the contract is too vague (*Tito* v. *Waddell (No. 2)* [1977] Ch 106, 322) and finally, the court 'will not compel a defendant to perform his obligations specifically if it cannot at the same time ensure that any unperformed obligations of the [claimant] will be specifically performed, unless perhaps damages would be an adequate remedy for any default on the [claimant's] part' (*Price* v. *Strange* [1978] Ch 337).

However, the law is in an uncertain state here because many of the cases which form the foundation of these rules were decided before *Beswick* and their status must be regarded as uncertain in the light of that decision. For example, in *Hill* v. *CA Parsons Ltd* [1972] Ch 305 and *Irani* v. *Southampton AHA* [1985] ICR 590 the courts were prepared to specifically enforce a contract of employment, even though it was a contract of personal service. Admittedly, the facts of each case were rather exceptional but both cases display a growing willingness to grant orders of specific performance.

The validity of this more expansive approach has been thrown into doubt by the decision of the House of Lords in *Co-operative Insurance Society Ltd* v. *Argyll Stores (Holdings) Ltd* [1998] AC 1. The claimants were the freehold owners of a shopping centre and they let the anchor unit to the defendants for use as a supermarket. The agreement was stated to run for 35 years from 1979 and the defendants covenanted to 'keep open the demised premises for retail trade . . .' for the duration of the agreement. In 1995, after the store had made a trading loss, the defendants decided to close it. They ignored the claimants request to keep open the store, stripped it and closed it. The claiments sought an order for specific performance of the 'keep-open' covenant. The trial judge refused to grant the order, but the Court of Appeal, by a majority, granted it. Two factors weighed heavily with the majority of the Court of Appeal in deciding to grant the order sought. The first was that the claimants would have had very considerable difficulty in proving the loss which they had suffered as a result of the breach, and the second was that the defendants had acted with 'unmitigated commercial cynicism'. But the House of Lords allowed the defendants' appeal and held that no criticism could be made of the way in which the trial judge had exercised his discretion. Their Lordships relied on a number of factors in reaching their conclusion: (i) there was a settled practice that an order would not be made which would require a defendant to run a business, (ii) an order compelling the defendants to trade could expose them to enormous losses, (iii) the task of framing the order was not an easy one, (iv) there was the possibility of wasteful litigation over compliance, (v) it was oppressive to the defendants to have to run a business under the threat of proceedings for contempt and (vi) it was argued that it could not be in the public interest to require someone to carry on a business at a loss if there was a plausible alternative by which the other party could be given compensation. Cumulatively these factors demonstrated that the settled practice was based on 'sound sense' and that the trial judge had acted within his discretion in refusing to grant the order sought. The case is obviously a difficult one but it is suggested that the reasoning of the House of Lords is open to attack on the ground that it pays too much attention to the position of the defendants and does not focus on the need to ensure that the claimant is given an adequate remedy in the event of breach (the damages remedy may well prove to be inadequate in the light of the problems of proof and quantification).

Can the parties contract for an order of specific performance? In *Quadrant Visual Communications Ltd* v. *Hutchison Telephone UK Ltd* [1993] BCLC 442, Stocker LJ stated that 'once the court is asked for the equitable remedy of specific performance, its discretion cannot be fettered' by the stipulation of the parties. The parties could not, by the terms of their

contract, confine the role of the court to that of a 'rubber stamp'. It should be noted, however, that this was a case in which the claimants had been guilty of 'trickery' in failing to disclose to the defendants an agreement which the court held that they should have disclosed to the defendants: the claimants had not come to court with 'clean hands'. In such a case, it is easy to understand why the court paid little or no attention to any agreed stipulation for specific performance. But in other contexts, where there is no 'wrongdoing' on the part of the claimant, it is arguable that, while the parties should not be able to exercise the discretion for the court, their stipulation should be *a* factor which is taken into account by the court in the exercise of its discretion (see *Warner Bros Pictures Inc.* v. *Nelson* [1937] 1 KB 209, 220–1). So it is possible that some limited advantage can be obtained by contracting for specific performance.

Until the decision of the House of Lords in *Co-operative Insurance Society Ltd* v. *Argyll Stores (Holding) Ltd* (above), it could be said that the English courts had begun to display a gradual willingness to expand the scope of the remedy of specific performance. The effect of the latter decision is, however, to bring that more expansive approach to a halt, although it may turn out to be no more than a temporary halt. English law can, in this respect, be compared with civilian systems where specific performance is often stated to be the primary remedy for a breach of contract. But too much can be made of the contrast between the two systems. In *Co-operative Insurance*, Lord Hoffmann stated that there is in practice less difference between common law and civilian systems than one might suppose and that one would expect judges in civilian systems to take into account much the same matters as English judges do when deciding whether or not to order specific performance in any given case. Some support for this proposition can be gleaned from Article 9–102 of the Principles of European Contract Law which provides:

> '(1) The aggrieved party is entitled to specific performance of an obligation other than one to pay money, including the remedying of a defective performance.
> (2) Specific performance cannot, however, be obtained where:
> (a) performance would be unlawful or impossible; or
> (b) performance would cause the debtor unreasonable effort or expense; or
> (c) the performance consists in the provision of services or work of a personal character or depends upon a personal relationship, or
> (d) the aggrieved party may reasonably obtain performance from another source.

(3) The aggrieved party will lose the right to specific performance if it fails to seek it within a reasonable time after it has or ought to have become aware of the non-performance.'

It can be seen that the factors listed in paragraph (2) are very similar to those which would be taken into account by an English court in deciding whether or not to make a specific performance order. It may be that the difference between the two systems is ultimately one which concerns the location of the burden of proof. In English law the burden is on the claimant to establish that specific performance is the appropriate remedy, whereas in civilian systems it is for the defendant to show that the claimant is not entitled to specific performance. On the other hand, the difference in approach can lead to different outcomes in the courts. For example, the Scottish courts in *Highland and Universal Properties Ltd* v. *Safeway Propeties Ltd* 2000 SLT 414 held that a keep-open covenant was specifically enforceable as a matter of Scots law.

Should the English courts adopt this more expansive approach to be found in civilian systems and, in particular, should they go even further and take the step of holding that specific performance is generally available as a remedy in the event of the occurrence of a breach of contract? It can be argued that damages undercompensate in more cases than is commonly supposed and the fact that a claimant asks for specific performance is good evidence that damages are inadequate. Indeed, in many cases claimants have an incentive not to ask for an order of specific performance. They will want to go out into the market-place and purchase alternative goods and sue for damages for the difference in value rather than wait for a court to make an order of specific performance. A further consideration which must be borne in mind is that the performance obtainable from an unwilling contracting party may well be inferior to that obtainable from another, willing performer. So it can be argued that, where the claimant asks for specific performance, the remedy should be generally available because the mere fact that he has asked for the remedy demonstrates that damages are an inadequate remedy.

But a number of arguments can be adduced against such a proposition. The first is that some limitations must be placed upon the availability of the remedy in the case of contracts involving personal or intimate relations and in cases where it would be impossible for the court to supervise the order because of the vagueness inherent in the contract. It should not be assumed, however, that an order of specific performance will necessarily result in the performance of the contract. An order of specific performance gives to the claimant a choice. He can either insist upon

performance of the contract or he can sell his right, at a price of his own choice, to the defendant (see Calabresi and Melamed, 1972). A defendant who wished to be released from his contract with the claimant, in order to enter into a more lucrative contract with a third party, would then have to negotiate his way out of the contract with the claimant. It is suggested that, because of the fact that damages do tend to undercompensate, specific performance should be generally available and that the courts should be willing to grant the remedy unless the defendant can satisfy the court that there is a good reason to refuse the remedy, or that an order of specific performance would violate, or be inconsistent with, established rules and doctrines of contract law (see Kronman, 1978b, Schwartz, 1979; Bishop, 1985 and McKendrick, 1986).

21.10 Injunctions

A breach of a negative contract or a negative stipulation in a contract may, in an appropriate case, be restrained by means of an injunction. An injunction is also an equitable remedy which is available within the discretion of the court. An injunction will not be granted where its effect would be directly or indirectly to compel the defendant to perform acts which he could not have been required to do by an order of specific performance. An injunction is commonly sought in restraint of trade cases to restrain the employee or vendor acting in breach of his covenant (see further Treitel, 1999, pp.968–74).

21.11 Damages in Lieu of Specific Performance

Finally, the High Court has a discretion to award a claimant damages in lieu of an injunction or specific performance (s.50 of the Supreme Court Act 1981). Where the court decides to exercise its discretion to award damages, damages are assessed on the same basis as common law damages for breach of contract (*Johnson* v. *Agnew* [1980] AC 367, 400; cf. *Surrey County Council* v. *Bredero Homes Ltd* [1993] 1 WLR 1361, 1366–7, discussed in more detail at 20.6).

21.12 Conclusion

What is the significance of the remedial consequences of a breach of contract for the basis of contract law? It is suggested that there are three

principal lessons which we can glean from our brief survey of the remedies available on a breach of contract. The first is the scope which is given to the parties to make provision for their own remedies on a breach of contract. In this chapter we have seen that a number of options are open to the parties and, although the courts do place limitations upon the remedies available, in many cases these restrictions can be evaded by careful draftsmanship. It is not true to say that the law of contract resembles the law of tort in that it simply imposes remedies upon the parties. In many cases the remedies are dependent upon the agreement of the parties. The second point relates to the 'interests' which the law of contract seeks to protect. We have seen that the law of contract seeks to protect the expectation interest, rather than the reliance interest or the restitution interest, thus separating contract law from the law of tort and the law of restitution. A promise engenders in the promisee an expectation that the promise will be performed and, as a general rule, the courts will order the party in default to fulfil the expectations which he has so created.

Thirdly, and finally, our study of remedies has demonstrated that the law of contract is not whole-heartedly committed to the protection of the expectation interest. Supplementary policies, such as the doctrines of mitigation and remoteness and the reluctance of the courts to grant an order of specific performance in certain situations, weaken the commitment of the law to the protection of the expectation interest. This illustrates a point which was made in the opening chapter of this book (1.4). Contract law is committed to the protection of individual autonomy and the protection of the expectation interest but that commitment is tempered in its application by considerations of fairness, consumerism and altruism. These conflicting ideologies are present within the rules relating to remedies; sometimes the courts are committed to 'market-individualism' (see, for example, *White and Carter (Councils) Ltd* v. *McGregor* (above, 21.4)), but on other occasions the courts are committed to 'consumer-welfarism' (see, for example, *Patel* v. *Ali* (above, 21.9) and the cases on the penalty clause rule). Contract law is a complex subject in which competing ideologies battle for predominance. The struggle to resolve this endemic conflict will continue to be a feature of contract law in the years to come.

Summary

1 A party who, in breach of contract, fails to perform an obligation which is entire cannot generally make any claim for payment from the innocent party. But the rule is subject to exceptions where the party in breach has substantially performed his

obligations under the contract (although this exception is the subject of some controversy), where the innocent party has accepted the part performance and where the court holds that the obligation is not entire but divisible.

2 Where the term which is broken is a 'condition' which is of the 'essence of the contract', the innocent party can terminate performance of the contract and claim loss of bargain damages.

3 A claim in debt is a claim for a definite sum of money which the defendant is, under the terms of the contract, due to pay to the claimant. The claimant is not under a duty to mitigate his loss and the remoteness rules are inapplicable.

4 A liquidated damages clause is a genuine pre-estimate of the loss which is likely to be occasioned by the breach. Such a clause is enforceable and the sum recoverable is the sum stated in the clause, not the actual loss. A clause which seeks to punish the party in breach is a penalty clause. A penalty clause is unenforceable and is ignored for all purposes.

5 The penalty clause rule can be evaded by merely accelerating an existing liability, by making the sum payable on an event other than a breach of contract or by simply elevating the status of the term broken to a condition which is of the essence of the agreement.

6 A deposit is paid by way of security and is generally irrecoverable, provided that the sum payable by way of deposit is reasonable.

7 A part payment is a payment towards the contract price. Such a payment is recoverable where it is clear from the contract that the payee will not have to incur reliance expenditure before completing his performance of the contract.

8 Specific performance is an equitable remedy which is available within the discretion of the court. The availability of specific performance depends upon the appropriateness of the remedy on the facts of the case. There are a number of contexts in which specific performance is not normally available.

9 An injunction is an equitable remedy which may be used in an effort to prevent a threatened breach of contract. A court will not grant an injunction where to do so would be directly or indirectly to compel the defendant to do an act which he could not have been ordered to do by a decree of specific performance.

10 The court has a discretion in equity to grant damages in lieu of an injunction or specific performance.

Exercises

1 John agreed to build two houses on Brian's land. The contract price was agreed at £130,000 and the price was payable upon completion of the work. After completing work to the value of £65,000 John abandoned the contract. He is now seeking payment from Brian. Advise him. Would your answer differ if Brian had employed Julian to complete the work and had paid him £75,000 to complete the two houses?

2 What is a claim in debt?

3 Distinguish between a liquidated damages clause and a penalty clause.

4 A contractor enters into a contract with an employer to erect some buildings at a cost of £900,000. The contract states that, if the contractor fails to complete the work by the completion date, then the contractor has either to 'pay to or allow to the Employer the whole or such part as may be specified in writing by the Employer of a sum calculated at the rate stated in the Appendix as liquidated and ascertained damages'. The Appendix stated under the heading 'liquidated and ascertained damages' that the figure payable was '£ nil'. The contractor has failed to complete

the work on time and the employer is now seeking damages from the contractor in accordance with the clause set out above. What advice would you give to the employer?

5 Distinguish between a deposit and a part payment. When are such payments recoverable by the party in breach?

6 Should specific performance be the normal remedy for breach of contract?

7 Outline the circumstances in which the courts will normally refuse to grant an order of specific performance.

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