Court of Appeal provides useful guidance on the test for remoteness of damages for breach of contract

Generally speaking, a two-step procedure will be adopted in determining what damages will arise from a breach of contract. First, the courts will need to consider what loss has been suffered. Secondly, they will consider whether any of those losses suffered are too remote to be recoverable. It is this second test of ‘remoteness’ that will be examined in this article.

The key case upon which the modern test for remoteness of damages in contract law is founded remains Hadley v Baxendale [1854], which laid down the principle that, for damages to be recoverable pursuant to a breach of contract, the loss must either have arisen naturally from the breach, or be said to have been in the contemplation of both parties as a probable result of the breach at the time they entered into the contract. However, since Hadley, a number of cases have further refined the test for remoteness of damages.

One particular case, that of Transfield Shipping Inc v Mercator Shipping Inc [2008] (more commonly known as The Achilleas), was considered by some to have altered the approach laid down in Hadley. In that case, the House of Lords found there to have been a presumed intention of the parties at the time of entering into the contract that certain foreseeable losses would not be recoverable, notwithstanding that they may arise naturally from the breach of contract.

Recently, in John Grimes Partnership Ltd v Gubbins [2013], the Court of Appeal considered the various
authorities and the way they have shaped the test for remoteness of damages for breach of contract and in particular the circumstances in which the principle laid down in *The Achilleas* would be applicable. Consequently, *Gubbins* has provided us with a useful overview of the test for remoteness and the way in which the relevant principles operate. *Gubbins* also highlights for parties the importance of considering what the possible consequences of a breach might be from the start, as the potential liabilities arising from a breach may well be significantly higher than amounts paid in performing the contract.

**JOHN GRIMES PARTNERSHIP LTD V GUBBINS**

**The facts**

Mr Gubbins owned land that he sought to develop for residential purposes. The development included a road to serve the new dwellings that Mr Gubbins hoped would be adopted by the highway authority so that the road would be maintained by the authority. The road’s adoption depended on the local County Council’s agreement, which in turn depended on the Council’s approval of the design of the new development road. Mr Gubbins employed John Grimes Partnership Ltd (the partnership), a geological and engineering consultancy partnership, to design the road and obtain the Council’s approval for it. There was initially an oral agreement between the two parties, which was followed by a formal letter of engagement from the partnership. It was a finding of fact by the Court at first instance that it was an express oral term of the contract that the partnership would complete the agreed work by March 2007 and additionally that this deadline did give the partnership reasonable time within which to complete the work.

The work was not completed by March 2007. Indeed, initial approval was not obtained from the Council until February 2008, and even then not all the work had been completed. On 8 May 2008 Mr Gubbins engaged another consulting engineer to take over from the partnership. The new engineer completed the road design and submitted it to the Council on 16 June 2008 and it was approved two days later.

The partnership had been paid fees of just under £20,000 and invoiced Mr Gubbins for a final £2,893 for work carried out. Mr Gubbins refused to pay and the partnership commenced proceedings for the outstanding amount. Mr Gubbins counterclaimed for all the sums previously paid out to the third-party consulting engineer who ultimately completed the work. Furthermore, Mr Gubbins sought damages for the partnership’s failure to complete the work by the agreed date, which he argued had resulted in a significant reduction in the market value of the development and an increase in building costs.

**Decision of the County Court**

At first instance, Judge Cotter QC allowed the partnership’s claim for unpaid fees on the basis that the work had been useful to some degree, which meant there had not been a total failure of consideration. However, Mr Cotter QC also allowed Mr Gubbins’ counterclaim to set-off the monies paid to the third-party consulting engineer who ultimately completed the work. Furthermore, Mr Cotter QC found that the partnership had in fact breached the contract by not having complied with its obligations by the March 2007 deadline, and awarded Mr Gubbins damages representing the diminution in the value of the development site by reason of that period of delay (i.e the difference in price between March 2007 and July 2008).

The partnership appealed the decision to allow Mr Gubbins’ counterclaim on the basis that the damages should not have taken into account the fall in market value of the development as they were too remote. Leave was granted on the basis that it marked an issue of considerable importance with regard to the law on remoteness of damages in cases of breach of contract.
Submissions on appeal

Counsel for the partnership submitted that the decision to award damages representing the diminution of property value was wrong in law and relied heavily on the principles laid down in *The Achilleas* and to a lesser extent the House of Lords decision in *South Australia Asset Management Corp v York Montague Ltd* [1997] (commonly known as the SAAMCO case).

It was argued that for a loss to be recoverable, the type of loss must be reasonably foreseeable, and that, as had been established in *The Achilleas*, the Court was to consider objectively whether the partnership could be said to have accepted, when entering into the contract, responsibility for that type of loss. Counsel for the partnership pointed to the lack of authorities whereby professionals within the property market had been held liable for losses flowing from falls in the market, which demonstrated that there was no such assumption of responsibility. Counsel also pointed out that the damages arising out of this loss were disproportionate to the fee payable to the partnership under the contract it had entered into with Mr Gubbins.

On the other hand, it was Mr Gubbins’ position that the correct approach was to ask whether, at the time of entering into the contract, a reasonable person in the position of the partnership would have realised that this kind of loss was not one that was unlikely to result from a breach of contract. It was submitted that this was the approach established in *Hadley* and further developed by the House of Lords in *Koufos v C Czarnikow Ltd* [1969] (commonly referred to as *The Heron II*).

Counsel for Mr Gubbins submitted that the principle laid down in *The Achilleas* only allowed for the traditional approach to be departed from where the nature of the contract and/or commercial background indicated that the entity breaching the contract could not be taken to have assumed responsibility for that type of loss, which was not the situation in the case before the Court of Appeal. Furthermore, Counsel for Mr Gubbins argued that, according to the decision in *Siemens Building Technologies Ltd v Supershield Ltd* [2010], the standard approach applied notwithstanding that it meant substantial damages flowed from a contract under which only a small fee was payable.

Court of Appeal judgment

Sir David Keene, in giving the lead judgment of the Court of Appeal, reaffirmed that the test of remoteness could still be traced back to the legal test set out in *Hadley*. He commented that this had been reformulated, and cited *The Heron II* as authority for the modern test. While acknowledging that the judges sitting in the House of Lords for that case each expressed the test slightly differently from one another, he noted there was consensus between them as to the relevance of what the parties to the contract ought reasonably to have contemplated would result from a breach of the contract. Sir David Keene concluded that the test left by *The Heron II* was:

‘... if the type or kind of loss was, at the time of contract, reasonably foreseeable by the defendant as not unlikely to result from his breach (had he contemplated a breach), then such a type or kind of loss is not too remote’.

However, given the partnership’s reliance on *The Achilleas*, Sir David Keene considered whether and, if so, in what way, the long-established approach to remoteness had been modified by the House of Lords’ decision
Sir David Keene commented that:

‘The essence of *The Achilleas* was an emphasis upon the presumed intention of the parties at the time of contract.’

In other words, where circumstances (such as the industry within which the parties were doing business) dictated that the parties to a contract would not be liable for a particular type of loss, it would be presumed that they did not intend for such losses to be recoverable. He quoted from the judgment of Lord Hoffmann in that case, adding the emphasis:

‘It must in principle be wrong to hold someone liable for risks for which the people entering into such a contract in their particular market would not reasonably be considered to have undertaken’.

Sir David Keene observed that Lord Hoffmann had not intended the approach adopted in *The Achilleas* to mark a ‘wholesale departure’ from the traditional test of remoteness, but rather, that the traditional approach might not be applicable in particular circumstances, where the parties will be presumed not to have assumed liability for losses that would otherwise be reasonably foreseeable (and thus not too remote).

Sir David Keene noted that not all members of the House in *The Achilleas* provided their judgments in a similar way to Lord Hoffmann. However, he pointed out that the Court of Appeal had considered the effect of the ruling in determining *Supershield*. Lord Justice Toulson in that case described the test of reasonable contemplation from *Hadley* and *The Heron II* as being one that ‘reflects the expectation to be imputed to the parties in the ordinary case’. Toulson LJ explained the decisions in *The Achilleas* and *SAAMCO* as being examples of where, given the commercial background:

‘… the standard approach would not reflect the expectation or intention reasonably to be imputed to the parties’.

While Sir David Keene agreed with Toulson LJ’s approach, he preferred to explain the test for remoteness as essentially one of contractual terms: where there are no express contractual terms dealing with what types of losses the parties are accepting liability for upon any breach, the courts will consider what term should be implied, and in doing so seek to give effect to the parties intention as at the time the contract was entered into. The principle formulated in *The Achilleas* can therefore be explained by its impact on the parties’ presumed intention and the consequent term that was implied into the contract.

In considering the submission made on behalf of the partnership that there was a notable lack of authorities in which professionals within the property market had been held liable for losses flowing from falls in the market, Sir David Keene considered the case of *SAAMCO*, which had been relied upon by the partnership. Sir David Keene observed that *SAAMCO* was not itself a delay case, but had been one where the breach of contract was due to a negligently high valuation being given. He noted that in the only case cited where
there had been a significant delay causing loss in property prices, the claimant had been entitled to recover the difference between what the property would have been worth and what it was eventually sold for.

Finally, Sir David Keene was not swayed by the argument that the damages, when finally assessed, were likely to be disproportionate to the amount payable under the contract. He considered that this was merely one factor to be considered in determining whether the parties had undertaken potential liability and would not of itself prove that the parties had not intended to be liable for such losses.

**Decision**

The Court of Appeal upheld Mr Cotter QC’s decision and interpretation of the relevant legal principles and dismissed the appeal. Mr Cotter QC had been correct in considering whether losses arising from movement in the property market were reasonably foreseeable at the time of the contract as a result of the delay, and finding that they were. He had also been correct to consider whether the current case was one of those unusual cases that fell outside the traditional approach to remoteness of damages found in *Hadley and The Heron II*. In doing so, Mr Cotter QC considered the commercial background of the contract and whether the standard approach would reflect the expectation or intention reasonably to be imputed to the parties. He found that this was not a situation to which the traditional approach did not apply. The Court of Appeal agreed with Mr Cotter QC and found that it was not the type of case to come within the confines of the principle developed in *The Achilleas*.

Consequently, Mr Gubbins was entitled not only to set-off the costs of employing an additional consultant engineer from the fees payable to the partnership, he was also entitled to claim damages from the partnership representing the diminution in the value of land between March 2007 and July 2008.

**WHAT DOES THE DECISION TELL US?**

Sir David Keene’s comments regarding the interaction between the traditional approach and that adopted in *The Achilleas*, would suggest that *The Achilleas* does not so much represent an alternative approach, but rather requires consideration of whether there are circumstances which require a different intention to be imputed to the parties at the time they enter into the contract (or, to use Sir David Keene’s language, when implying the relevant term into the contract).

On the basis of the *The Achilleas* and *SAAMCO*, it would appear that circumstances will often be limited to where a contract is entered into in the context of an industry where certain losses are generally not assumed by either party upon breach. For example, in *The Achilleas*, it was held that parties to a shipping contract will not assume liability for the loss of a follow-on charter in the event that a ship is returned late, rather, the party in breach will only be liable in damages for further charges directly associated with the period of late delivery. While it was argued by the partnership in *Gubbins* that there were no authorities demonstrating professionals in the property industry should be liable for reductions in property value, to demonstrate the case was the type considered in *The Achilleas*, the partnership would have perhaps had to show there was in fact a tradition or presumption that in the property industry whereby professionals do not assume responsibility for such losses.

The Court of Appeal noted that while in some markets, prices can be volatile, this was not the case in *Gubbins*, where the value of property fell by 14% in just over a year. The fact that it was the scale of the delay which itself magnified the loss seems to have been taken into account in the Court of Appeal’s reasoning. However, it should be noted that Lord Justice Tomlinson, in approving the judgment of Sir David Keene, took the opportunity to revisit his judgment in *Pindell Ltd v Air Asia Berhad* (2011) in which he had said that losses attributable to extremely volatile market conditions were irrecoverable.
Tomlinson LJ cast doubt on his earlier comments when he indicated in *Gubbins* that losses caused by extremely volatile market conditions might be foreseeable in certain circumstances and hinted that in such an instance, the answer to whether those losses would be recoverable would not be a straightforward one.

**COMMENT**

While *Gubbins* does not appear to create any fundamental new principles in the area of remoteness of damages for breach of contract, it provides useful guidance on the modern test adopted by the courts and the way decisions such as that in *The Achilleas* will be construed alongside the traditional approach found in *The Heron II*.

The decision is also a stark reminder that liability arising out of breach of a contract has the potential to be much greater than the basic consideration being paid under that contract, and parties should therefore consider at the outset what the potential consequences of a breach might be, and exclude certain losses within the contract if appropriate.