

# Remoteness of damage and assumption of responsibility – a discussion note



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An earlier discussion note looked at indirect loss<sup>1</sup>. Recently, the author had cause to revisit the point and to consider in more detail the decision of the House of Lords (as it then was) in 2008 in *Transfield v Mercator*<sup>2</sup>.

This note considers the impact of that case on the law around indirect loss and remoteness of damage.

## **Transfield v Mercator: the background**

The facts can be briefly stated. Transfield chartered a ship, the *Achilleas*, from its owners, Mercator. The ship was late returning from the charter with the result that the following charter had to be renegotiated. Mercator claimed damages for the period of delay and for the reduction in price of the following charter, which had been on especially lucrative terms.

The House of Lords awarded damages for the period of delay but did not allow Mercator to recover any losses in respect of the following charter.

English law assesses what damages may be recovered in the event of a breach of contract by reference to the rules set down in *Hadley v Baxendale*<sup>3</sup>. That rule tells us that loss is recoverable if it flows naturally from the breach of contract or if the loss could reasonably be supposed to have been in the contemplation of the parties at the time of the contract.

In the *Transfield* case, the following charter could not be satisfied and had to be renegotiated because of the delay. The arbitrator, the Commercial Court and the Court of Appeal all felt it appropriate to award damages for the period of delay and for the loss of the following charter.

The House of Lords reversed the Court of Appeal's position, suggesting that something more than simple contemplation of a potential loss under the second limb of *Hadley v Baxendale* was needed.

## **Transfield v Mercator: the House of Lords judgments**

Although the House of Lords unanimously allowed the appeal, five Law Lords gave five

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<sup>1</sup> See *Indirect loss – a discussion note* (August 2011)

<sup>2</sup> *Transfield Shipping Inc v Mercator Shipping Inc (The Achilleas)* 2008 UKHL 48

<sup>3</sup> 1854 9 Exch 341

judgments which are very broadly summarised below<sup>4</sup>:

- Lord Hoffman decided that the determining factor was whether or not the party in breach had agreed to assume responsibility for losses of the type claimed<sup>5</sup>.
- Lord Hope agreed that what mattered was whether the loss was the type of loss the party could reasonably be assumed to have taken responsibility for<sup>6</sup>.
- Lord Walker looked to commercial certainty and held that it was a question of what the contracting parties must be taken to have in mind having regard to the nature and object of the transaction<sup>7</sup>.
- Lord Rodger turned to what was in the ordinary contemplation of the parties – recovery was limited to losses which ‘generally happen in the ordinary course of things’ because the parties have no opportunity to provide for the unexpected<sup>8</sup>. Here, the extreme volatility of the market meant that the loss could not be said to be ‘not unlikely’<sup>9</sup>.
- Baroness Hale expressed her doubts about Lord Hoffman who, she felt was adding ‘an interesting but novel dimension’ to the question of remoteness. Ultimately, she preferred Lord Rodger’s approach and with reluctance allowed the appeal<sup>10</sup>.

### **Transfield v Mercator: the perceived consequences**

The immediate result was a great deal of discussion in legal circles. The perceived wisdom was that the House of Lords had tried to give the shipping world certainty by limited a charterer’s exposure to the extent of any delay and not to any loss of business suffered by the owner as a result.

But this left the rest of the world in turmoil (legally speaking). It had apparently introduced a requirement for the assumption of responsibility but at the same time, it was not at all clear what facts would confirm (or negate) such an assumption. Had the judgments changed the settled test for remoteness and if so, which of the five opinions set out the revised test? What was the status of the *Heron II*<sup>11</sup> – a House of Lords decision that most people viewed as the last word on remoteness? The 2008 edition of *Chitty on Contracts* hoped that the approach taken in the *Transfield* case would be applied only in exceptional circumstances<sup>12</sup>.

### **Transfield v Mercator: in practice**

As time has passed, so the dust settled. Two examples from 2010 illustrate how the lower courts have politely distinguished the *Transfield* decision.

The first of these dates from January 2010. *Siemens Building Technologies FE Ltd v*

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<sup>4</sup> In many cases, the language used reflected previous judgments and the author apologises for any apparent double negatives or for phrases that are not models of clarity.

<sup>5</sup> See [2008] UKHL 48 at 15 and 22

<sup>6</sup> See [2008] UKHL 48 at 30 to 32

<sup>7</sup> See [2008] UKHL 48 at 78

<sup>8</sup> See [2008] UKHL 48 at 52

<sup>9</sup> See [2008] UKHL 48 at 60

<sup>10</sup> See [2008] UKHL 48 at 93

<sup>11</sup> *Czarnikow Ltd v Koufos (The Heron II)* 1967 3 All ER 686

<sup>12</sup> See *Chitty on Contracts*, 30<sup>th</sup> Edition at 26-100G

Supershield Ltd<sup>13</sup> is a Court of Appeal decision. A sprinkler system installed in the basement of an office building was faulty, overflowed and caused a flood. Because the basement drains were blocked, the flood damage was significant. Supershield was a sub-contractor to Siemens. Supershield disputed that they were responsible for installing the valve and therefore argued that they should not be liable. But, if Supershield were held liable, they then challenged the assessment of damages.

Lord Toulson considered the reasonableness of the settlement and saw no reason to overturn the judge's conclusion. Supershield was liable.

In so doing, Lord Toulson considered the basis of the rules of remoteness and the judgment of Lord Reid in the *Heron II*<sup>14</sup>. Lord Reid examined *Hadley v Baxendale* and concluded that a loss was recoverable if it arose naturally and if it was of a type in the reasonable contemplation of the parties. It did not matter whether the parties had contemplated the actual extent of the loss. His view was that a type of damage that is foreseeable as a substantial possibility but that would only occur in a minority of cases cannot be described as occurring 'in the usual course of things' and cannot be supposed to have been in the contemplation of the parties. It is not enough that the breach caused the loss. If damages are to be recovered, the loss must be of a type that flows naturally from the breach or that should have been within the defendant's contemplation.

Lord Toulson reviewed the authorities and saw that it was implicit in Lord Reid's comments that the question of remoteness cannot be isolated from the purpose of the contract and the scope of the contractual obligation<sup>15</sup>. He turned to the *Transfield* case and noted that Lord Rodger and Baroness Hale restricted recovery to the period of delay on the basis that, applying *Hadley v Baxendale*, the subsequent loss was not an ordinary consequence of the breach. Lord Hoffman's approach was to give effect to the presumed intention of the parties. Lord Hope saw the assumption of responsibility as the basis for the law of remoteness of damage but that this should be determined by more than what was foreseeable at the time of the contract. Lord Walker allowed that the notion of assumption of responsibility might apply to cases falling under the second limb of *Hadley v Baxendale* but the underlying idea was 'what was the common basis on which the parties were contracting?'

Lord Toulson concluded that *Hadley v Baxendale* remained the standard rule albeit that it had been 'rationalised' to reflect the 'expectation to be imputed to the parties in the ordinary case'<sup>16</sup>. The defendant will be liable if a reasonable person in the defendant's shoes at the time of making the contract would have viewed damage of that kind as not unlikely to result from a breach. The *Transfield* case was simply an example of a case where the standard approach would not reflect the expectation of the parties.

The second case dates from October 2010 and concerned an aircraft lease<sup>17</sup>. An aircraft was returned late with the result that the owner was unable to complete the sale of the aircraft to a third party. Market conditions were such that owner was unable to re-sell the aircraft – this was happening at the time of the collapse of Lehmann Brothers. The Commercial Court

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<sup>13</sup> 2010 2 All ER (Comm) 1185

<sup>14</sup> *C Czarnikow Ltd v Koufos (The Heron II)* 1967 3 All ER 686 at 691

<sup>15</sup> 2010 2 All ER (Comm) 1185 at 1195

<sup>16</sup> 2010 2 All ER (Comm) 1185 at 1196

<sup>17</sup> *Pindell Ltd v Airasia Berhad* (2011 All ER (Comm) 396)

held that the loss of the sale could not be recovered. The loss that might reasonably be expected to follow on from a delay did not encompass the loss of a sale because it was unusual for such an elderly aircraft to be resold. Maintenance delays are commonplace and the judge would have expected the lessor to take this into account. In the same way, the mill owner could have been expected to have a spare crankshaft available. Any analogy with the facts of the *Transfield* case was 'far from exact'<sup>18</sup>. A ship is not an aircraft. Aircraft are by their nature more complex and vulnerable. An aircraft lease gives control and responsibility for maintenance and insurance to the lessee while under a shipping charter the owner remains responsible for the ship's operation.

Just for good measure, the judge acknowledged the *Siemens* case and did not consider that the *Transfield* case had effected any major change in the law<sup>19</sup>.

### **Did the *Transfield* case change the law?**

The *Transfield* case has not changed the general position at law. Subsequent events support Baroness Hale's doubts about the interesting but novel dimensions added to the question of remoteness by Lord Hoffman's judgment. The case arguably provided certainty for the shipping world but it did not upset the wider law relating to remoteness.

The *Transfield* case may have 'rationalised' the rule in *Hadley v Baxendale* such that if the Court takes the view that the standard approach does not reflect the expectation or intention reasonably imputed to the parties, the Court may deviate from the standard rule<sup>20</sup>.

But *Hadley v Baxendale* remains the standard approach.

### **Should *Transfield* have changed the general position at law?**

That said, there is an argument to be made that the notion of no liability without an assumption of liability is not all that novel<sup>21</sup>. It can be argued that it is not possible to assume responsibility for a loss or for a type of damages without knowing that a risk of such loss or damage exists. So, for example:

- In *Hadley v Baxendale*, the carrier was not liable because the mill owner had not explained that they did not have a spare crankshaft available. The second limb says that the defendant is only liable if the loss was in the parties' contemplation at the time of the contract;
- In *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd*<sup>22</sup>, a boiler maker delayed delivery of a new boiler leaving its customer unable to satisfy existing contracts or to win new and unusually lucrative government contracts. The boiler maker knew their customer wanted the boiler for immediate use and could have foreseen that delay would lead to some loss of business. But the boiler maker did not know about the government contracts and was only held liable for the 'normal' loss of business and not for the additional losses occasioned by not being able to win the government contracts.

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<sup>18</sup> *Pindell Ltd v Airasia Berhad* (2011 All ER (Comm) 396) at 417

<sup>19</sup> *Pindell Ltd v Airasia Berhad* (2011 All ER (Comm) 396) at 420

<sup>20</sup> 2010 2 All ER (Comm) 1185 at 1196

<sup>21</sup> Lord Hoffman in the *Transfield* case referred to academic articles suggesting that the extent of a party's liability is founded on an interpretation of the contract as a whole and as seen in its commercial setting. See: Robertson (2008) 28 *Legal Studies* 172 – 196; Tettenborn (2007) 23 *Journal of Contract Law* 120 – 147; and, Cohen & McKendrick (ed) *Comparative Remedies for Breach of Contract* (2004) 249 – 286. However, what follows here is the author's own suggestion.

<sup>22</sup> (1949) 1 All ER 997

- In the *Transfield* case, Lord Hope commented that a defendant is responsible for loss suffered not where the loss is simply foreseeable but only where that loss is a type for which the defendant can reasonably be assumed to have assumed responsibility. Moreover, the defendant cannot be expected to have assumed responsibility for something he cannot control and, because he does not know anything about, cannot quantify<sup>23</sup>.

There are other cases highlighting that the defendant must have a more than passing knowledge of the particular circumstances before being held responsible for a loss<sup>24</sup>.

Lord Reid commented that the rules of remoteness in contract exist to promote the exchange of information<sup>25</sup> and this must be sensible as it allows the parties to assess the risk and to apportion it between themselves using contractual provisions. So, if a party knows of the risk and still chooses to go ahead with the contract, is it harsh to treat them as having assumed responsibility for it?

Of course, the danger with this line of argument is that the weaker contracting party could find itself forced to accept responsibility simply because they have been made aware of a particular risk. But, this is not so very different from the position under the second limb of *Hadley v Baxendale* which relies on the construct of 'reasonable contemplation'. Adding a requirement for a positive assumption of responsibility would promote certainty, leaving parties clear on where the risk lay and giving the opportunity to manage the allocation of risk. Contracting parties would find it to be in their interest to set out their concerns and would be able to negotiate to restrict their exposure.

This theory appeals to the author because it would, amongst other things, help to shield parties from disproportionate exposure to risk. Lord Denning's apocryphal taxi driver would have a refuge<sup>26</sup>. Research institutions signing agreements, such as CDAs, which traditionally do not include any limitation of liability would have some defence against unlimited liability.

Of course, as things stand, this is also just a theory.

## Summary

*Hadley v Baxendale* and the *Heron II* remain the standard position on remoteness of damage.

The *Transfield* case did not change the general law although it did suggest that in some cases, if the Court concludes that the standard approach does not reflect the expectation or intention reasonably imputed to the parties, the Court may deviate from the standard rule.

There is an argument that introducing a requirement for the claimant to show that the defendant had assumed responsibility for a particular type of loss before the defendant can be held liable for it would add a degree of certainty and give more certainty to contracting parties in their allocation of risk.

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<sup>23</sup> 2008 UKHL 48 at 32 and 36

<sup>24</sup> For example, *Kemp v Intasun Holidays* (1987 2 FTLR 234) where a passing reference to asthma was not enough to fix the travel agent with responsibility for an asthma attack brought on by sub-standard accommodation.

<sup>25</sup> *C Czarnikow Ltd v Koufos (The Heron II)* 1967 3 All ER 686 at 692

<sup>26</sup> *Heywood v Wellers* (1976) 1 All ER 300 at 306