



Scottish Law Commission  
*promoting law reform*

| (DISCUSSION PAPER No 163)

# Discussion Paper on Remedies for Breach of Contract

discussion  
paper





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July 2017

**DISCUSSION PAPER No 163**

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**The Commission would be grateful if comments on this Discussion Paper were submitted by 6 October 2017.**

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# Abbreviations

1988 Report	Report on Civil Liability—Contribution (Scot Law Com No 115, 1988)
1999 DP	Discussion Paper on Remedies for Breach of Contract (SLC Discussion Paper No 109, 1999)
1999 Report	Report on Remedies for Breach of Contract (Scot Law Com No 174, 1999)
Black, “New Experience”	G Black, “A New Experience in Contract Damages? Reflections on <i>Experience Hendrix v PPX Enterprises</i> ” 2005 JR 31
Carter, <i>Breach of Contract</i>	J W Carter, <i>Carter’s Breach of Contract</i> (Hart edn, 2012)
Chitty	H G Beale (ed), <i>Chitty on Contracts</i> (32nd edn, 2015)
CISG	UN Convention on Contracts for the International Sale of Goods (1980), available at: <a href="http://www.uncitral.org/pdf/english/texts/sales/cisg/V1056997-CISG-e-book.pdf">http://www.uncitral.org/pdf/english/texts/sales/cisg/V1056997-CISG-e-book.pdf</a>
DCFR	C von Bar and E Clive (eds), <i>Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference</i> (2009)  Outline Edition available at: <a href="http://ec.europa.eu/justice/policies/civil/docs/dcf_r_outline_edition_en.pdf">http://ec.europa.eu/justice/policies/civil/docs/dcf_r_outline_edition_en.pdf</a>
Edelman, <i>Gain-based Damages</i>	J Edelman, <i>Gain-Based Damages</i> (2002)
Gloag, <i>Contract</i>	W M Gloag, <i>The Law of Contract: A Treatise on the Principles of Contract in the Law of Scotland</i> (2nd edn, 1929)
Liu, <i>Anticipatory Breach</i>	Q Liu, <i>Anticipatory Breach</i> (2011)
McBryde, <i>Contract</i>	W W McBryde, <i>The Law of Contract in Scotland</i> (3rd edn, 2007)
McGregor Code	H McGregor, <i>Contract Code: Drawn up on behalf of the English Law Commission</i> (Milan, 1993)
<i>McGregor on Damages</i>	H McGregor, <i>McGregor on Damages</i> (19th edn, 2014)
MacQueen and Thomson, <i>Contract</i>	H L MacQueen and J Thomson, <i>Contract Law in Scotland</i> (4th edn, 2016)
PECL	Principles of European Contract Law.  Parts I and II (revised 1998) and Part III (2002) available at: <a href="http://www.jus.uio.no/lm/eu.contract.principles.parts.1.to.3.2002/">http://www.jus.uio.no/lm/eu.contract.principles.parts.1.to.3.2002/</a>

PICC	The UNIDROIT Principles of International Commercial Contracts (3rd edn, 2010), available at: <a href="http://www.unidroit.org/english/principles/contracts/principles2010/blackletter2010-english.pdf">http://www.unidroit.org/english/principles/contracts/principles2010/blackletter2010-english.pdf</a>
Richardson, “Retention”	L Richardson, “Examining ‘Equitable’ Retention” (2016) 20 Edin LR 18
Richardson, “Set-off”	L Richardson, “Set-off – a concept divided by a common language?”, [2017] LMCLQ 238.
Rowan, <i>Remedies for Breach of Contract</i>	S Rowan, <i>Remedies for Breach of Contract, a Comparative Analysis of the Protection of Performance</i> (2012)
<i>SME, Remedies</i>	<i>The Laws of Scotland (Stair Memorial Encyclopaedia)</i> Remedies (Reissue)
Steven, <i>Pledge and Lien</i>	A J M Steven, <i>Pledge and Lien</i> (2008)
ULIS	Uniform Law on the International Sale of Goods (see Schedule 1 to the Uniform Laws on International Sales Act 1967).

# Glossary

Word or phrase	Definition	Paragraph
<i>Ab initio</i>	From the beginning.	4.3
<i>Actio quanti minoris</i>	An action derived from Roman law whereby the purchaser of goods could, while retaining defective goods, obtain reduction of the contract price to the goods' actual value. Misinterpreted as providing a claim where property (defective or not) was not worth its price, and rejected in 19th century. Implication taken to be that a purchaser could not claim damages for defective goods unless the contract was rescinded; this was corrected by Contract (Scotland) Act 1997 s.3.	5.4
Account of profits	An account of profits operates to strip a fiduciary of unauthorised gains.	8.20
<i>Ad factum praestandum</i>	For the performance of an act. In modern practice a decree or an obligation <i>ad factum praestandum</i> requires the performance or fulfilment of some physical rather than monetary obligation.	6.3
Alimentary debts	Sums owed for the purposes of aliment, in other words, for maintenance for the support of a spouse or child.	6.13
Avoidance (of a contract)	To reduce or set aside a contract.	4.4
Compensation	The extinction of mutual similar claims by setting one off against the other. Each party must be both debtor and creditor, in their own right, at the same time. Sometimes loosely (but inaccurately) termed "set-off" (qv).	2.36
Contributory negligence	Some careless or blameworthy act or omission by the pursuer which contributed, with the defender's fault or negligence, to the pursuer's loss or injury. Since 1945 the court may reduce an award of damages in proportion to the pursuer's share of responsibility for what happened.	10.1
<i>Dominus litis</i>	The master of the litigation: the effective party to legal proceedings which may be carried on in the name of another. The <i>dominus litis</i> may be ordered to pay the expenses involved.	9.55

<b>Word or phrase</b>	<b>Definition</b>	<b>Paragraph</b>
Equity	The judicial assessment of fairness as opposed to the strict and rigid rule of common law; developed as a method of ensuring justice when the strict application of law may have prevented that.	1.35
Fiduciary	A fiduciary is a person who is exercising particular powers or undertaking particular transactions for the benefit of another (the principal) and thus has as a matter of law an obligation to prefer the interests of the principal should there be a conflict with those of the fiduciary. Fiduciary obligations contrast with those arising in ordinary or "arm's-length" transactions, in which each party is generally entitled to consider only its own interests.	8.8
<i>Force majeure</i>	Something beyond the control of parties to a contract, preventing its performance.	1.18
Good faith	In obligations, the imposition of objective standards of behaviour between parties, such as honesty, cooperation and fair dealing.	11.14
Reduction (of a contract)	To set aside or annul, usually by an action of reduction, a deed, contract, decree or award.	4.3
Repudiation	Denial of the existence of a contract and/or refusal to perform a contractual obligation.	3.7
Rescission	The termination or cancellation of a contract which has been rescinded.	4.2
<i>Restitutio in integrum</i>	Entire restoration; the restoration of a person to the position they would have been in had the transaction or event not taken place.	4.3
Retention	(1) The withholding by one party to a contract of performance of its obligations under the contract until the other party performs its obligations under it.  (2) More particularly, retaining moveable property until a debt due by its owner is paid; a lien.  (3) The operation of the balancing of accounts in bankruptcy.	2.27

Word or phrase	Definition	Paragraph
Set-off	<i>(English law)</i> An equitable remedy which denotes the right of a debtor to balance mutual liquid debts with a creditor. Each party must be both debtor and creditor, in their own right, at the same time and there must be a close connection between the claims. Sometimes used loosely for compensation (qv).	2.36
<i>Solatium</i>	Damages given for injury to feelings or reputation, pain and suffering and loss of expectation of life caused by breach of obligation.	7.18
Special retention	The retention of a liquid debt on the basis of an illiquid claim that will shortly become liquid in order for set-off (qv) to extinguish the two debts to the amount of whichever is the lesser. There need not necessarily be a close connection between the claims.	2.37
Specific implement	A court order for the performance of a contractual or common law obligation, other than by the payment of money. It is enforced by decree <i>ad factum praestandum</i> , but damages may be awarded instead.	6.3
Specific performance	<i>(Scots law)</i> A court order for the performance of a non-contractual/statutory duty (see section 45 of the Court of Session Act 1988).  <i>(English law)</i> A court order for the performance of a contract, requiring its actual execution according to its stipulations and terms.	6.3
Transferred loss	When a breach of contract occurs and loss results, but that loss is sustained by a person who is not party to the contract.	9.1
<i>Ubi jus ibi remedium</i>	Where there is a right, there is a remedy; a right of action to protect the right.	7.35



# Chapter 1 Introduction

## Background

1.1 We are currently undertaking a general review of Scots contract law in the light of the Draft Common Frame of Reference (DCFR). This is now being conducted as part of our Ninth Programme of Law Reform, having begun under the Eighth Programme of Law Reform which ran from 2010 to 2014.<sup>1</sup>

1.2 This Discussion Paper is about remedies for breach of contract, a topic which we last considered in 1999.<sup>2</sup> In this Chapter, we set this Discussion Paper in the context of our wider review, explaining the origins of the DCFR and our previous work in this area. We go on to outline the concept of breach of contract and the remedies for it, both in Scots law and under the DCFR. We also review the extent to which our previous work has been implemented.

### *The Draft Common Frame of Reference*

1.3 The DCFR, which was compiled by a large group of mainly academic lawyers from across the European Union (including Scots representatives), was published in 2009. It elaborated the preceding Principles of European Contract Law (PECL), completed and published in 2003. That in turn had elaborated the contract law rules in the Vienna Convention on the International Sale of Goods 1980 (CISG).<sup>3</sup>

1.4 As a model law rather than legislation, the DCFR was part of an effort to promote more consistent and coherent legislation across the EU in the field of contract law. This included not just general contract law, but also the law of particular contracts such as sale, lease and services.<sup>4</sup> In previous publications in this project we have drawn attention to the influence that the DCFR is having in the reform of the domestic laws of the EU member states: more so, perhaps, than on EU legislation itself.<sup>5</sup>

1.5 The text of the DCFR is in codal form, along with explanatory commentary on each of its provisions plus short notes on the relevant law of each jurisdiction within the EU Member States (including Scotland). We have therefore seen it as an instrument with which the Scots law of contract can be given a systematic health check, with any serious ailments thus diagnosed open for possible curative work. This includes the terminology as well as the substance of the model rules. Further, the comparative information in the DCFR facilitates

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<sup>1</sup> The Ninth Programme can be found at <https://goo.gl/G74ORJ>.

<sup>2</sup> See paras 1.9 to 1.12 below.

<sup>3</sup> The CISG has been ratified by 86 states, although not by the United Kingdom, one of the very few major trading nations not to do so.

<sup>4</sup> The DCFR underpinned the European Commission's now abandoned proposal for a Common European Sales Law. In May 2015 the Commission instead proposed new rules as part of its Digital Single Market Strategy to clarify contractual rights in cross-border electronic commerce. Two draft Directives were published at the end of 2015, relating to contracts for the supply of digital content (COM/2015/0634) and to contracts for the online and other distance sales of goods (COM/2015/0635). We have not observed any subsequent development.

<sup>5</sup> See most recently our Report on Third Party Rights (Scot Law Com No 245, 2016) para 1.2.

our statutory task of keeping the law under review and obtaining information about the law of other countries in pursuit of that function.<sup>6</sup>

1.6 The impending exit of the United Kingdom from the EU has not lessened in any way the need to ensure that Scots contract law is kept up-to-date and in line with (or ahead of) international standards. The importance of the EU and its individual member states as trading partners for Scotland as well as the rest of the UK will continue notwithstanding the UK's departure. Nor has there been any diminution of the need to make our law as useful and useable as possible in order to ensure its value, not only to those who wish to do business across national borders, but also to those doing business within this jurisdiction. It thus still seems sensible to continue using the DCFR as an international benchmark in our considerations of contract law reform, while not of course neglecting other sources of guidance. These include, not only the CISG and its forerunner the Uniform Law of International Sales (ULIS),<sup>7</sup> but also (more significantly) the other soft law international instruments such as the PECL and the UNIDROIT Principles of International Commercial Contracts (PICC).<sup>8</sup>

1.7 We have also made use on this occasion of the Contract Code drafted in the 1960s by the late Harvey McGregor QC. This originated in a joint project between the Scottish Law Commission and the Law Commission for England and Wales to prepare such an instrument in advance of the United Kingdom's joining the European Economic Community, as it was then, in 1973. The document was never implemented, although it was eventually published in 1993. It contains much useful material on the subject of remedies for breach; not least on damages, on which subject the author was a leading expert.<sup>9</sup>

1.8 It should be re-emphasised that the objective of this review of contract law has never been the adoption of the DCFR as a legislative statement for Scots law. First and foremost, the review has used the DCFR as a yardstick for the existing Scots law of contract. The results may indicate whether legislative intervention is required in pursuit of this Commission's general objectives of simplification and modernisation of the law. Our recommended reform of third-party rights in contract exemplifies this.<sup>10</sup> The check may also throw up issues that are not directly considered in the DCFR, such as execution in counterpart, legislated for in the Legal Writings (Counterparts and Delivery) (Scotland) Act 2015 following our 2013 Report.<sup>11</sup>

#### *Previous SLC Reports on contract law*

1.9 The starting point for our work on the review of contract law in the light of the DCFR was a series of Reports on various aspects of the subject which we published in the 1990s. Each one of these had considered the then-existent instruments preceding the DCFR in

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<sup>6</sup> Law Commissions Act 1965, s 3.

<sup>7</sup> The ULIS was implemented in the UK by the Uniform Laws on International Sales Act 1967, which remains in force but is, so far as we know, a dead letter in practice. The CISG has not been implemented in the UK.

<sup>8</sup> The third edition was published in 2010.

<sup>9</sup> The Code was published in Italy as H McGregor, *Contract Code Drawn Up on Behalf of the English Law Commission* (1993). In what follows, we refer to it as the "McGregor Code". See also *McGregor on Damages*.

<sup>10</sup> See Report on Third Party Rights (Scot Law Com No 245, 2016). The Report is to be implemented by the Contract (Third Party Rights) (Scotland) Bill introduced in the Scottish Parliament on 31 January 2017.

<sup>11</sup> Report on Formation of Contract: Execution in Counterpart (Scot Law Com No 231, 2013).

developing its reform proposals. The Report on Three Bad Rules in Contract Law<sup>12</sup> was implemented by the Contract (Scotland) Act 1997 but four others remain unimplemented:

- Report on Formation of Contract: Scottish Law and the United Nations Convention on Contracts for the International Sale of Goods<sup>13</sup>
- Report on Interpretation in Private Law<sup>14</sup>
- Report on Penalty Clauses<sup>15</sup>
- Report on Remedies for Breach of Contract<sup>16</sup>

1.10 The reasons for this non-implementation are not easy to discern. There does not seem to have been any significant opposition to the substance of the Reports at the time. Those published in the later 1990s might have seemed suitable for implementation in the Scottish Parliament after its establishment in 1999, but the immediate priorities in civil law legislation then were the abolition of feudalism and associated reforms of property law.<sup>17</sup>

1.11 With the passage of two decades and more since the Reports were published, we did not think it right simply to press for their implementation without further consideration of the issues that they raise. Quite apart from the general evolution of the law and related practice in Scotland over that period, international and European developments in contract law needed to be taken into account. There was, therefore, a case for reconsidering the topics of the Reports, but this time taking into account the DCFR text as well as the preceding instruments, plus any other relevant developments in other jurisdictions, not least England & Wales.

1.12 We published our first Discussion Paper on Remedies for Breach of Contract (the 1999 DP) in April 1999, and produced a Report and draft Bill (the 1999 Report) in December that year. Our recommendations are summarised later in this Chapter and in Appendix A.

### **Breach of contract: the DCFR and Scots law compared**

1.13 Throughout this Discussion Paper, we generally begin consideration of particular issues by providing an overview of what the DCFR says on the subject in comparison with present Scots law. We therefore begin with an overall examination of breach of contract in the DCFR and in Scots law. Many of the issues that we touch on are explored in greater detail in later Chapters.

1.14 Definitions of breach of contract in Scots law are not easily found. The concept covers total or partial non-performance of a contract, delayed or late performance, and performance that falls short in some way of what the contract requires. In his standard work

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<sup>12</sup> Scot Law Com No 152, 1996. Note also the Requirements of Writing (Scotland) Act 1995, which implemented the Report on Requirements of Writing (Scot Law Com No 112, 1988).

<sup>13</sup> Scot Law Com No 144, 1993.

<sup>14</sup> Scot Law Com No 160, 1997.

<sup>15</sup> Scot Law Com No 171, 1999.

<sup>16</sup> Scot Law Com No 174, 1999.

<sup>17</sup> For example the Abolition of Feudal Tenure etc. (Scotland) Act 2000, which implemented the Report on Abolition of the Feudal System (Scot Law Com No 168, 1999).

on contract law, Professor William McBryde identifies three problems with defining breach as failure to comply with a contract's terms. A party's failure to exercise rights under a contract (e.g. an option to buy) is not necessarily breach; the failure may be excused or allowed by law (e.g. the law of frustration of contract); and a warranty (i.e. a contractual undertaking that something is true) is either true or not, regardless of the parties' action or inaction on the matter. "Breach," says McBryde, "is more a failure to perform an obligation, rather than a failure to comply with a term of the contract."<sup>18</sup> But even this does not quite explain breach of a warranty. Perhaps the warranty is best seen as a promise to pay damages or provide another remedy should a given statement be untrue.

1.15 In an earlier generation, Professor William Murray Gloag pointed out the significance of the variety of remedies available to the party not in breach to understanding the concept of breach: not just orders to perform, but also damages (which would apply in the breach of warranty case) and what Gloag termed "defensive" remedies:

"to minimise the loss which the default of the debtor threatens to entail, either by rescinding the contract which the other party has failed to implement, or by withholding performance of the obligations which are incumbent on him until those in which he is creditor are performed or secured."<sup>19</sup>

1.16 By contrast, the DCFR has a unified concept of what it calls "non-performance" rather than breach of the contract.<sup>20</sup> It follows the CISG, the PICC and the PECL in this regard.<sup>21</sup> This is most readily understood by first looking at the DCFR's definition of "obligation" as:

"a duty to perform which one party to a legal relationship, the debtor, owes to another party, the creditor"

and then at the definition of "performance of an obligation" as:

"the doing by the debtor of what is to be done under the obligation or the not doing by the debtor of what is not to be done".<sup>22</sup>

"Non-performance" then is:

"any failure to perform the obligation" [which] "includes delayed performance and any other performance which is not in accordance with the terms regulating the obligation".<sup>23</sup>

1.17 The DCFR also sometimes uses the words "conformity" and "non-conformity" to describe performances which do (or do not) live up to the requirements of the contract.

1.18 The DCFR divides non-performance according to whether it is "excused" or not.<sup>24</sup> This affects remedies: an excused non-performance cannot give rise to the remedies of

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<sup>18</sup> McBryde, *Contract*, paras 20.07 to 20.10 (quotation at para 20.08).

<sup>19</sup> Gloag, *Contract*, p 592.

<sup>20</sup> DCFR III.-1:102(3).

<sup>21</sup> See CISG arts 45, 61; PICC art 7.1.1; PECL art 8:101(1).

<sup>22</sup> DCFR III.-1:102(1), (2).

<sup>23</sup> DCFR III.-1:102(3).

<sup>24</sup> DCFR III.-3:101. See also PECL art 8:101.

specific performance or damages.<sup>25</sup> A party's non-performance is excused if it is due to an impediment which is beyond the party's control, and the consequences of which could not reasonably have been taken into account at the time the obligation was incurred. It amounts to a defence of *force majeure*.<sup>26</sup> In essence, the comparable part of Scots law appears to be impossibility and frustration of contract. These topics lie outside the scope of this Discussion Paper. We mention these particular DCFR provisions here only to give a complete understanding of its approach in this general area: this Discussion Paper is concerned with unexcused non-performance.

1.19 In the DCFR, the contract-breaker against whom a remedy is exercised is usually referred to as the "debtor", while the other party is the "creditor". We use that conveniently neutral terminology throughout the remainder of this Discussion Paper, whether discussing the DCFR or Scots law. It is less cumbersome than "party in breach" and "party not in breach", and less judgmental than "guilty party" and "innocent party".<sup>27</sup>

1.20 The major remedies provided for in the DCFR are similar in general to those recognised in Scots law. The creditor's withholding performance of its obligations as a response to non-performance of reciprocal obligations by the debtor is equivalent to retention, and termination of the contract for fundamental non-performance likewise to rescission for material breach. As in Scots law, these two remedies can be exercised by a creditor without the need first to raise a court action, and in consequence they can be characterised as "defensive" or "self-help" remedies.<sup>28</sup> But an important possible difference between the DCFR and Scots law is that the non-performance which justifies withholding performance does not have to be material, as it does with retention.

1.21 As in Scots law, the remedies which do require court action are damages and specific performance. The DCFR remedy of specific performance is wider than specific implement, as it also encompasses actions for payment. It includes a right to have a non-conforming performance repaired or replaced by the supplier. In Scots law, this is encountered only as the consumer remedy of cure (known as "repair or replacement" in the legislation).<sup>29</sup>

1.22 With regard to damages, the DCFR is broadly similar to Scots law in seeing the remedy as one of compensation for the loss suffered by the creditor, which is however limited by the requirements of causation, mitigation or minimisation, and remoteness. Account is to be taken of the creditor's contributory negligence by appropriate reduction of the damages awarded. The concept of loss and the application of contributory negligence are however wider than in present Scots law.

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<sup>25</sup> DCFR III.-3:101(2). Note that impossibility or unlawfulness of performance are grounds on which a claim for specific performance cannot be enforced (DCFR III.-3:302(3)(a)).

<sup>26</sup> DCFR III.-3:104(2). See also PECL art 8:108. There is a similar provision for *force majeure* in PICC (art 7.1.7). These rules are closely akin to those found in the CISG (art 79).

<sup>27</sup> It is also the terminology used by Gloag in the quotation set out at para 1.15 above. In the 1999 DP and 1999 Report we spoke of the party not in breach as the "aggrieved party", but in reality all parties may be aggrieved even if only one of them is in breach.

<sup>28</sup> Gloag, *Contract*, 592; MacQueen and Thomson, *Contract*, para 5.4.

<sup>29</sup> See now Part 1 of the Consumer Rights Act 2015, especially ss 19 and 23 (goods), 42 and 43 (digital content), and 54 and 55 (services), implementing Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees (OJ L 171 7.7.99 p 12).

1.23 A less familiar remedy in modern Scots law is price reduction, found in the DCFR for goods or services supplied that do not conform to the requirements of the contract. This does not necessarily require the raising of any action by the creditor. In Scots law, this is encountered only as a consumer remedy.<sup>30</sup>

1.24 In addition to these remedies the DCFR also provides various formal means by which the parties may be able to resolve problems of non-performance for themselves. The debtor may be allowed to attempt a cure of its non-performance in some circumstances. The creditor can also seek an assurance of performance where it fears fundamental non-performance by the debtor or, more generally, give the debtor a fixed additional period of time within which to perform. These remedies interact in various ways with all the other remedies, but in particular with withholding performance.

1.25 The Scottish courts have recognised the validity of what is usually known as a creditor's ultimatum to a debtor as a preliminary to rescinding,<sup>31</sup> and it has been suggested that in at least some cases a creditor must give a debtor a second chance to perform before the former can rescind for material breach.<sup>32</sup> There may however be problems for a party who seeks an assurance of performance, at least if it is done in a way which a court later sees as overly aggressive. With the latter at present the risk for the creditor is that a request can be read as a repudiation of the contract, especially if it mentions the possibility of terminating if the assurance is not given.<sup>33</sup> A right of cure for the debtor has been discussed for Scots law but has not emerged thus far.<sup>34</sup>

1.26 The DCFR scheme is a general yet default one for all contracts. Particular kinds of contracts may have their own regime of remedies, varying or departing from the general scheme, while parties may likewise create regimes of their own devising for the contract upon which they engage. In the DCFR itself, there are distinct regimes for sale and lease of goods, services contracts, mandate, commercial agency, franchise and distributorship, loans, and donation.<sup>35</sup> The text also emphasises party autonomy in making contracts, emphasising that, unless otherwise provided, its rules may be excluded, derogated from or varied by the parties.<sup>36</sup> This is also the present position in Scots law, where (outside consumer and employment protection) contractual freedom in these matters is regulated (rather than excluded) by such laws as the rule against penalties, the rules on irritancy of leases, and the Unfair Contract Terms Act 1977 as amended. We anticipate that this will continue to be the general position under the possible reforms discussed below.

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<sup>30</sup> See now Part 1 of the Consumer Rights Act 2015, especially ss 19 and 24 (goods), 42 and 44 (digital content), and 54 and 56 (services). The 2015 Act innovates in extending price reduction to digital content and services contracts.

<sup>31</sup> See paras 4.24 and 4.25 below.

<sup>32</sup> See para 5.11 below.

<sup>33</sup> See *GL Group v Ash Gupta* 1987 SCLR 149.

<sup>34</sup> See Report on Sale and Supply of Goods (Law Com No 160; Scot Law Com No 104, 1987) paras 4.11 to 4.14; McBryde, *Contract*, paras 20.122 to 20.127.

<sup>35</sup> See DCFR Book IV, which is divided into Parts corresponding to these topics.

<sup>36</sup> DCFR II.-1:102. None of the DCFR rules described and discussed in this Chapter is mandatory or non-excludable.

## Our 1999 Report: a review

1.27 The conclusion of our 1999 Report was that the existing Scots law was broadly satisfactory and consistent with the most recent international instruments on that subject at that time<sup>37</sup> (i.e. the CISG, the PECL,<sup>38</sup> and the first (1994) edition of the PICC<sup>39</sup>).

1.28 A number of proposals were made for reform or clarification of discrete issues within this area of law.<sup>40</sup> Four rules were identified as being in need of immediate legislative action.<sup>41</sup> These were:

- the rule which allows a party unreasonably to proceed with unwanted performance and claim payment for it;
- the rule preventing recovery of certain kinds of non-patrimonial loss caused by breach of contract;
- the rule preventing damages for breach of contract from being reduced because the aggrieved party has contributed to the loss; and
- the rule that interim decrees of specific implement of contractual obligations are not available as such.

1.29 The last of these rules has now been reformed by the Courts Reform (Scotland) Act 2014<sup>42</sup>, but the three other recommendations remain unimplemented. We return to each of them below in separate Chapters.

1.30 In all three cases we stated that our recommendations should also be extended to unilateral voluntary obligations.<sup>43</sup> We also considered that contracting parties could not reasonably have ordered their affairs under a contrary expectation of how the law would develop in relation to the second and third recommendations. The exception is in relation to the rule on payment for unwanted performance, and it was recommended that there should be appropriate transitional provision in the implementing legislation.<sup>44</sup>

1.31 A number of other reform proposals that received general support from consultees were thought not to require immediate legislative action. In Part 7 of our 1999 Report, we explained our reasons for reaching that conclusion. We did, however, express the view that they would feature in any general statutory restatement or codification of the law on remedies for breach of contract. We summarise these proposals, and the reasons for not making recommendations, in Appendix A. Some of them are also discussed in later Chapters.

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<sup>37</sup> 1999 Report, para 1.1.

<sup>38</sup> PECL was published in three Parts between 1995 and 2002. Parts I and II contain the relevant provisions on remedies for breach of contract and were both completed before the 1999 DP was published.

<sup>39</sup> Two updated editions of PICC have been published since the 1994 edition. The most up-to-date version, published in 2010, contains 211 Articles compared to 185 Articles in the 2004 version and 120 Articles in the 1994 version. For the purposes of analysis in this Discussion Paper, we will be referring to the 2010 version.

<sup>40</sup> 1999 DP, Part 11.

<sup>41</sup> 1999 Report, Part 8.

<sup>42</sup> Court of Session Act 1988 s 47(2A), inserted by Courts Reform (Scotland) Act 2014 s 90.

<sup>43</sup> 1999 Report, para 6.4.

<sup>44</sup> 1999 Report, para 6.5.

## **Structure of the Discussion Paper**

1.32 We have divided the Paper into 12 Chapters. The first group of Chapters concerns matters relating to defensive or self-help remedies (ones which may be exercised without first raising a court action):

- Chapter 2 Retention and withholding performance
- Chapter 3 Anticipatory or anticipated breach
- Chapter 4 Termination
- Chapter 5 Other self-help remedies

1.33 The second group of Chapters concerns judicial remedies:

- Chapter 6 Enforcing performance
- Chapter 7 Damages
- Chapter 8 Gain-based damages

1.34 The third group of Chapters deals with miscellaneous matters:

- Chapter 9 Transferred loss claims
- Chapter 10 Contributory negligence
- Chapter 11 A general statutory restatement?

1.35 Chapter 11 returns to the question of a general statutory restatement of the law on remedies for breach of contract within which the more specific reforms might be embodied. This introduces some new issues, some of which were referred to in our 1999 Report. They include questions such as the cumulation of remedies and the deployment of concepts of equity and good faith generally in the application of remedies.

1.36 The final Chapter simply lists the questions on which we seek the views of consultees.

### **General policy**

1.37 We think that it is helpful to set out the general policy considerations that we have had in mind in preparing this Discussion Paper as an aid to understanding the questions that have been asked throughout it. We have already indicated our belief that the legal rules on remedies should in general remain default in nature; that is, subject to adjustment by parties in their contracts.<sup>45</sup> That apart, however, at this stage we are not committed to any particular reform, and our final recommendations will be strongly guided by consultees' responses to our questions.

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<sup>45</sup> See para 1.26 above.

1.38 It has been said that a leading characteristic of the Scots law of remedies for breach of contract is its emphasis on the creditor's right to obtain performance of the debtor's obligations. So specific implement is sometimes described as the primary remedy for breach;<sup>46</sup> unlike the English law of specific performance, the adequacy of damages is not a ground for preferring that remedy to implement.<sup>47</sup> The remedy of retention, which has no precise parallel in English law,<sup>48</sup> involves the creditor suspending or withholding its performance to bring pressure to perform to bear on the debtor. In general, damages are awarded to put the creditor in the position it would have been in had the contract not been breached. Rescission for breach, which frees the creditor from its contractual obligations for the future, can only be used if the breach in question is material in the sense that the debtor is refusing to perform or it otherwise goes to the root of the contract.

1.39 We think that this emphasis on performance should be maintained in our law reform exercise. A similar philosophy inspires the DCFR, not only with regard to its equivalents to specific implement, retention, rescission and damages, but also in relation to its provisions for allowing parties to seek assurances of performance or to give notice extending the time for performance. The focus is on obtaining performance of the contract in accordance with its terms, and keeping the parties working together rather than ending up in court or terminating their contract altogether (and then litigating over whether that step was justified).

1.40 That too seems to us to be sound policy. However, if parties are to be facilitated by the law in solving their difficulties without resort to the courts, it is extremely important that the rules on the matter be clear and readily comprehensible. Parties may have to act quickly upon commercial and other decisions without necessarily having the time to take legal advice on the matter. In pursuit of this objective, it appears to us that the present terminology for remedies in breach of contract might be made more comprehensible and coherent. For example, McBryde comments that "[o]ne of the most confusing aspects of the Scots law on breach is the terminology".<sup>49</sup> He notes in particular the problems that arise with "the difference between the three Rs: repudiation, resiling and rescission".<sup>50</sup>

1.41 As this example alone illustrates, many of the words used in relation to remedies for breach are ones that have come down to us from the relatively far distant legal past. They are no longer (if they ever were) in widespread use outside the law. Often too these technical words are also used in other legal contexts, with a different meaning from that they have in the law of breach of contract. This has the possibility of creating at least lack of clarity, and sometimes undesirable confusion. Given in particular that an important group of remedies (the defensive or self-help remedies) is meant to be of use to people deciding what to do in response to breach without going to court, or even necessarily seeking professional advice, it is important that the terminology in this area be as transparent and comprehensible as possible. In particular this applies for businesses and also consumers.

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<sup>46</sup> Gloag, *Contract*, 592. See however McBryde, *Contract*, para 23.08.

<sup>47</sup> For English law see Chitty, Chapter 27. Specific implement is discussed further in Chapter 6.

<sup>48</sup> See for discussion G H Treitel, *Remedies for Breach of Contract* (1988), Ch VIII; A Tettenborn, "I'll Perform If and When You Do": Non-Performance and the Suspension of Contractual Duties", in K Barker, K Fairweather and R Grantham (eds), *Private Law in the 21st Century* (2017) Ch 16.

<sup>49</sup> McBryde, *Contract*, para 20.02.

<sup>50</sup> McBryde, *Contract*, para 20.02. Note too our 1999 DP, para 1.14.

1.42 There has been a general movement in recent years towards more transparent terminology and the adoption of plain English as far as possible in law.<sup>51</sup> A Report by the Business Experts and Law Forum in 2008 highlighted the lack of comprehensibility and accessibility of Scots law as a major factor for businesses when opting for English law rather than Scots law in the drafting of their contracts. It explained that whilst many of the terms used in contract law are individual and historic, they may “alienate those unfamiliar with Scots law”.<sup>52</sup> The report goes on to state that these terms:

“...may hinder the creation of an impression among businesses (both local and international) of the Scottish courts as modern, accessible, and user-friendly. The fact that Scotland is an English language jurisdiction should give it a competitive advantage over many other international jurisdictions as a dispute resolution forum; retaining archaic procedural terminology could limit this advantage.”

1.43 An overall aim of modernising terminology as well as substance is consistent with making Scotland a more attractive place to do business and improving accessibility for users of legal services (consumers and party litigants in particular). We think that drafters of commercial and other contracts also prefer modern terminology wherever possible. So, for example, “suspension” and “termination” appear to be standard terms in contemporary drafting practice for retention and rescission for breach.<sup>53</sup> In the rest of this Discussion Paper, we assess the DCFR terminology in relation to its Scots law equivalents, and also offer some further thoughts of our own on the current terminology in Scotland. We then invite views on whether reforms to the law on remedies for breach of contract should include adjustments to terminology.

1.44 We do not think, however, that this should extend to re-naming breach of contract “unexcused non-performance”, so the Discussion Paper continues to use the familiar word “breach” unless directly summarising what the DCFR says.<sup>54</sup> We also think the term “damages” is well understood by non-lawyers as well as lawyers, and it is used by the DCFR as well as Scots law to describe the monetary substitute for performance not made by the debtor. We therefore propose no change on these points, but will of course consider any comments that consultees wish to make on the matter.

1.45 A final policy consideration is that the law should seek to provide a platform not only for those drafting contracts, but also for clear, principled and consistent decision-making by the courts. Certainty is an important consideration, especially for business interests. As will emerge in the course of this Discussion Paper, in Scots law there is significant equitable control of remedies, notably in withholding performance and specific performance. A key

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<sup>51</sup> For example the Scottish Civil Justice Council’s [Report on the Consultation on the Draft Simple Procedure Rules](#), June 2016, paras 12 and 32. Consultees (including the sheriffs principal) were generally in favour of modernising legal terminology.

<sup>52</sup> [Report by the Business Experts and Law Forum](#), November 2008, para 1.2.1.

<sup>53</sup> See David Cabrelli, *Commercial Agreements in Scotland: Law and Practice* (2006) paras 13.35 to 13.40 (“Suspension of Performance”), 14.13 to 14.46 (“Termination”), 14.47 to 14.49 (“Consequences of Termination”). Note also the author’s styles for Standard Terms and Conditions of Sale at pp 716 to 717, Terms and Conditions of Purchase at pp 728 to 729, Agency Agreement at pp 751 to 755, Distribution Agreement at pp 784 to 788, Franchise Agreement at pp 830 to 835, and Terms and Conditions of Hire at pp 891 to 893. Note also Richard Christou, *Drafting Commercial Agreements* (6<sup>th</sup> edn, 2016), index, svv “Suspension”, “Termination”, and “Termination of Employment”.

<sup>54</sup> Note however McBryde, *Contract*, para 20.02 (“It has become common to say that a party can ‘breach’ a contract, with ‘breach’ being a verb and not a noun. Certainly there can be a breach of contract, but earlier usage would have said that a contract was broken by a party. The verb was ‘to break’.”)

overall question may be how much discretion the courts should be left with if certainty and consistency are to be achieved. The DCFR, true to continental European traditions, favours rules over discretionary exceptions. For example, it makes rules of the exceptions to the entitlement to specific performance where Scots (and English) law make them equitable considerations for the court.<sup>55</sup> At the same time, the DCFR provides an active role for considerations of good faith as a control on the exercise of remedies, perhaps most importantly in relation to the self-help remedies of withholding performance and termination. Fairness is therefore a consideration alongside the promotion of certainty and consistency.

### **Advisory Group**

1.46 We are very grateful to those who have provided advice to us in the course of the preparation of our Discussion Paper. In order to set our review of Scots law against the DCFR in context, we needed to gain an understanding of the problems currently faced in practice. The Advisory Group, whose members are listed in Appendix C, provided invaluable assistance in this regard. We also received valuable help from a Judicial Advisory Group of three Court of Session judges, also listed in Appendix C. None of the members of these advisory groups is to be held to have taken any substantive position on the various reform options discussed in this paper, which none of them has seen in its final version.

### **Impact assessment**

1.47 It is essential for us to attempt to assess the impact, particularly the economic impact, of any reform proposal that we may eventually recommend in the Report which will follow on from this Discussion Paper. We would be especially grateful for any evidence with which we can begin to quantify the issues raised, whether that evidence relates to the current situation or is concerned with the possible effects of any reform of the law. Clearly, assessment of the likely economic impact of a possible reform depends substantially on the economic impacts of the present law. Information on why and how parties use remedies for breach of contract, and on any effects arising when they are deployed, will also be extremely helpful.

1.48 A particular issue on which we would welcome more information is the impact of defensive or self-help remedies. We would especially value information about why and how these remedies are used, the effects of their deployment, and their impact for small and medium-sized enterprises. To assist us in our task of law reform as well as impact assessment, we ask:

- 1. Do consultees have any information or data on:**
  - (a) the economic impact of the current law relating to remedies for breach of contract; or**
  - (b) the potential economic impact of any proposed reform of that law?**

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<sup>55</sup> See further paras. 2.30 to 2.35 below.

## Legislative competence

1.49 A provision is outside the legislative competence of the Scottish Parliament if any of the matters specified in section 29(2) of the Scotland Act 1998 apply to it. They are:

- “(a) it would form part of the law of a country or territory other than Scotland, or confer or remove functions exercisable otherwise than in or as regards Scotland,
- (b) it relates to reserved matters,
- (c) it is in breach of the restrictions in Schedule 4,
- (d) it is incompatible with any of the Convention rights or with EU law,
- (e) it would remove the Lord Advocate from his position as head of the systems of criminal prosecution and investigation of deaths in Scotland.”

1.50 In our view, none of the proposals discussed in this Discussion Paper would form part of the law of a country or territory other than Scotland, or confer or remove functions exercisable otherwise than in or as regards Scotland. Nor would they remove the Lord Advocate from his position as head of the systems of criminal prosecution and investigation of deaths in Scotland.

1.51 The Discussion Paper is principally concerned with the law of obligations, which is an aspect of Scots private law.<sup>56</sup> The law of obligations is not a reserved matter (as set out in Schedule 5 to the Scotland Act 1998). The Discussion Paper examines remedies that are currently found in Scots law only under bespoke statutory regimes, such as the Consumer Rights Act 2015. Consumer protection is a reserved matter.<sup>57</sup> However, it does not propose any change to those regimes. It merely considers them as examples of particular remedies. Accordingly, we do not consider that the proposals in the Discussion Paper relate to reserved matters. We do not consider that they would breach any of the restrictions in Schedule 4 to the Scotland Act 1998 either.

1.52 Finally, we do not consider that any of the proposals, if enacted, would be incompatible with any of the Convention rights or with EU law.

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<sup>56</sup> Within the meaning given by section 126(4) of the Scotland Act 1998.

<sup>57</sup> Scotland Act 1998, Schedule 5, Part II, section C7.

# Chapter 2      Retention and withholding performance

## Introduction

2.1      In Scots law, remedies that may be exercised without first raising a court action are characterised as defensive or self-help remedies. These may be contrasted with judicial remedies where the intervention of the courts is necessary for their exercise. It is common for there to be contractual provision on the defensive remedies.

2.2      Scots law has two generally available self-help remedies: retention, and rescission for material breach. The DCFR recognises two similar remedies: withholding of performance by the creditor, and termination of the contract for fundamental non-performance. It also recognises other self-help remedies, but only in limited contexts such as consumer contracts. We discuss retention and withholding performance in this Chapter, before going on to consider rescission and termination in Chapter 4 and the other remedies in Chapter 5. We begin this Chapter with a discussion of terminology, before considering the relationship between the Scots law concept of mutuality and the DCFR concept of reciprocal obligations. We then examine retention and its equivalent, withholding performance, and conclude with a discussion of what has recently been dubbed “special retention” in Scots law.

## Terminology

2.3      McBryde describes retention as:

“a troublesome word because it has so many different meanings in the law. It could refer to (1) the operation of the mutuality principle in contract law under which one party may withhold performance of an obligation; (2) when items may be retained until debts are paid, including a right of lien; (3) the operation of the balancing of accounts in bankruptcy; (4) the reservation of ownership which prevents passing of title until a condition is satisfied.”<sup>1</sup>

2.4      We are primarily concerned with the first of McBryde’s senses. Sometimes this is known as “mutuality retention”, as a way of distinguishing it from the other forms of retention.<sup>2</sup> Dr Steven observes that the word retention came into Scots law from Roman law where *retentio* meant lien<sup>3</sup> – a link to which we return later in this Chapter.<sup>4</sup>

2.5      The DCFR’s equivalent term is “withholding performance”: this describes what the creditor does rather than the effect of what this is upon the contract. In our 1999 Discussion Paper and Report we used without discussion or explanation the phrase “suspension of performance”, which makes clear the effect of the remedy: the creditor has a right not to

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<sup>1</sup> McBryde, *Contract*, para 25.34. See also paras 20.62 and 25.37.

<sup>2</sup> See e.g. Richardson, “Retention”.

<sup>3</sup> Steven, *Pledge and Lien*, para 9.08.

<sup>4</sup> See paras 2.32 to 2.34 below.

perform its obligations, but it is temporary in nature. The contract is not terminated, and if the debtor remedies its breach, the contract resumes its role as an active source of obligations for both parties. “Suspension” sits easily alongside “termination” as a description of a distinct remedy with a distinct effect.

2.6 We remain inclined to think that, if “retention” is to be replaced as the term for the contractual remedy, “suspension” would be the preferable alternative. But we ask:

2. **Should the term “retention” be replaced by “suspension” or “withholding” of performance to describe the remedy under which a creditor is entitled as a temporary measure in response to the debtor’s breach not to perform its outstanding obligations under the contract?**

## **Reciprocal obligations and the concept of mutuality**

### *The DCFR and Scots law compared*

2.7 The DCFR regards the existence of reciprocal obligations in a contract as a factor of significance in the availability of withholding performance as a remedy for non-performance. It states that an obligation is reciprocal in relation to another obligation if:

- “(a) performance of the obligation is due in exchange for performance of the other obligation;
- (b) it is an obligation to facilitate or accept performance of the other obligation; or
- (c) it is so clearly connected to the other obligation or its subject matter that performance of the one can reasonably be regarded as dependent on performance of the other.”<sup>5</sup>

2.8 This concept can be compared with Scots law’s broader concept of mutuality of contract,<sup>6</sup> which plays an important role in relation to retention. Where both parties have rights and duties under the contract, these rights and duties are interdependent or reciprocal and the enforceability of one party’s rights is conditional upon the same party performing its own duties. This has two major consequences:

- if one party does not perform, the other need not perform, i.e. it can withhold performance;
- a party which has not performed or is not willing to perform its obligations cannot compel the other to perform.<sup>7</sup>

2.9 Before these effects of mutuality come into play, it must be shown that the obligations in question are indeed interdependent or “the causes of one another”.<sup>8</sup> The test to be applied in resolving that question has been the subject of debate for many years. There is sometimes said to be a presumption that a contract is to be regarded as a whole and that all

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<sup>5</sup> DCFR III.–1:102(4).

<sup>6</sup> This is sometimes described as the interdependence or unity of contract.

<sup>7</sup> See McBryde, *Contract*, para 20.47.

<sup>8</sup> See McBryde, *Contract*, paras 20.53 to 20.56, quoting Erskine, *Institute* III, 3, 86.

the stipulations on either side are interdependent for the purposes of mutuality. In McBryde's opinion:

"This approach has obvious commercial sense. Most business people regard the whole of a contract as a 'package' and each party's rights and obligations are counterparts for the other party's rights and obligations, which has an impact on, amongst other issues, the financial arrangements negotiated and agreed."<sup>9</sup>

2.10 In complex contracts, however, there is a view that it is not necessarily the case that each and every obligation on the one side is to be treated as the counterpart of each and every obligation on the other side. In *Bank of East Asia v Scottish Enterprise*,<sup>10</sup> for example, it was held that payment due for a particular phase of work in a major construction contract could only be withheld for breaches in that phase and not for others in the next one. The Lord President (Rodger) also adopted that approach in *Macari v Celtic Football and Athletic Co Ltd*,<sup>11</sup> where he referred to the comments of Lord Jauncey of Tullichettle in *Bank of East Asia* and stated that:

"the law does not regard each and every obligation by one party as being necessarily and invariably the counterpart of every obligation by the other."<sup>12</sup>

So the court held that a football club manager's duty to obey his employer's lawful instructions as to where to live was not counterpart to the employer's duty of trust and confidence, especially when the manager was otherwise carrying out his duties and drawing his salary.

2.11 However, when *Inveresk plc v Tullis Russell Papermakers Ltd*<sup>13</sup> reached the Supreme Court, Lord Hope restated the position on retention under reference to Gloag, *Contract* and the Lord President's comments in *Macari*:

"...the analysis should start from the position that all the obligations that it embraces are to be regarded as counterparts of each other unless there is a clear indication to the contrary."<sup>14</sup>

2.12 None of these views is necessarily irreconcilable – arguably *Macari* and *Bank of East Asia* are simply exceptions to the general rule. Difficulty has, however, arisen from the lack of certainty as to whether the general rule or the exception applies from contract to contract and case to case.

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<sup>9</sup> McBryde, *Contract*, para 20.55.

<sup>10</sup> 1997 SLT 1213.

<sup>11</sup> 1999 SC 628.

<sup>12</sup> 1999 SC 628 at 640.

<sup>13</sup> [2010] UKSC 19; 2010 SC (UKSC) 106.

<sup>14</sup> *Ibid* para 42.

2.13 A new approach to the determination of interdependence was suggested, however, by Lord Drummond Young in 2013 in *McNeill v Aberdeen City Council (No 2)*.<sup>15</sup> He avoided any reference to presumptions and spoke instead of withholding or temporary non-performance of the “substantive obligations under the contract” pending performance of its obligations by the other party:

“By the expression ‘substantive’ obligations, I mean the fundamental obligations that define what the contract is intended to achieve; in a contract of sale of goods these would be the supply of goods and the payment of the price, and in a contract of employment they are the performance of services by the employee and the provision of work and the payment of salary or wages by the employer.”<sup>16</sup>

2.14 The significance of this approach is that not every obligation on a party in a contract is counterpart to the other party’s obligations; indeed it may not even be necessary to analyse the counterpart nature of obligations in more than broad general terms of the substance of the contract concerned. The difficulty it involves may be the need to work out what the substantive obligations of any given contract are. That, it is suggested, is not a straightforward task for a non-lawyer. It is probably not a suitable test to apply in the context of remedies meant to be available to contracting parties on a self-help basis without the assistance of a court, often in a context where it is necessary to take swift decisions.

2.15 It therefore appears to us that there is some significant uncertainty in Scots law about the meaning and scope of mutuality, and we would be grateful for consultees’ views. There seem broadly to be three possible options: acceptance of the traditional approach, as most recently set out in *Inveresk*; moving to Lord Drummond Young’s “substantive obligations” test, as set out in *McNeill*; or departing from the principle of mutuality entirely and replacing it with the DCFR equivalent of reciprocal obligations.

3. **In view of the present uncertainty about the meaning and scope of mutuality in the law on breach of contract, do consultees consider that adoption of the DCFR’s formulation of its equivalent concept of reciprocal obligations would provide a useful and workable clarification of the position?**
4. **Alternatively, are other approaches canvassed in recent judicial decisions to be preferred?**

2.16 Mutuality typically applies within the confines of a single contract. As Gloag put it, “[a]s a general rule, it is no excuse for failure of performance that the other party is in default on another contract.”<sup>17</sup> There is an important contrast with compensation (or “set-off”) where liquid claims (that is, ones fixed in amount and presently payable, as distinct from illiquid ones not yet quantified or due) may extinguish each other even if they arise from different contracts or other obligations.<sup>18</sup> But it has been affirmed by the Supreme Court in *Inveresk* that mutuality justifying retention may arise where two or more contracts form part of a single

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<sup>15</sup> 2014 SC 335.

<sup>16</sup> *Ibid*, para 27.

<sup>17</sup> Gloag, *Contract*, p 624. See also McBryde, *Contract*, para 20.67.

<sup>18</sup> See McBryde, *Contract*, para 20.62 to 20.65.

transaction between the parties, with the obligations in each being interrelated as a result.<sup>19</sup> This is clearly wider than anything envisaged under the DCFR concept of reciprocity, and it blurs the distinction between mutuality and compensation. But the cases may show the rule to have been a useful and practical one in various commercial situations.<sup>20</sup> We therefore ask:

**5. If mutuality is redefined, should it nonetheless remain capable of stretching across more than one contract, the inter-relationship of which arises from their both being part of a single transaction between the parties?**

*Mutuality: effect on party in breach*

2.17 A possibly difficult effect of mutuality is the rule that a party which has not performed or is not willing to perform its obligations cannot compel the other to perform. We considered this effect in our 1999 Report,<sup>21</sup> where we noted that some judicial formulations of the rule could be read as saying that a party in breach could not exercise any rights under the contract or sue for damages for its breach by the other party.<sup>22</sup> In our view, however, this was neither what mutuality entailed, nor what it should. Rather, its meaning was that a party against whom the remedies of retention or rescission had been properly exercised could not sue for implement of the contract or for damages for its breach.

2.18 It appeared to us that this understanding was reinforced by a dictum of Lord Jauncey in *Bank of East Asia*, where he said:

“I do not consider that the authorities warrant so broad a proposition as that any material breach by one party to a contract necessarily disentitles him from enforcing any and every obligation due by the other party.”<sup>23</sup>

So it is clear, for example, that a contract-breaker can recover payments to which it had become entitled before the breach for which the contract was terminated.<sup>24</sup> There seems no reason to doubt that the same party can claim damages for breaches against it prior to the termination as well.

2.19 As a result, we thought it unnecessary to recommend corrective legislation, given that Lord Jauncey’s statement “...carries the authority of a unanimous decision of the House of Lords”.<sup>25</sup> However, two contrasting decisions of the Inner House in 2010 and 2014 suggest that the effect of this aspect of the mutuality concept may be less clear than we thought in 1999.

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<sup>19</sup> 2010 SC (UKSC) 106 at paras 34 to 38 per Lord Hope of Craighead.

<sup>20</sup> See also *Claddagh Steam Ship Co v Steven* 1919 SC (HL) 132. But cf *Glen Clyde Whisky Ltd v Campbell Meyer & Co Ltd* [2015] CSOH 97, where a whisky supplier claimed mutuality retention in respect of whisky which had been paid for, as a result of not having received payment for whisky previously supplied under a different contract. This was rejected by the court because, although the obligations were very similar, they arose from different contracts and were therefore not concurrent obligations. For the possibility that *Inveresk* should have been dealt with as a case of “special retention” rather than mutuality and retention see para 2.37 below.

<sup>21</sup> 1999 Report, paras 7.8 to 7.13.

<sup>22</sup> *Steel v Young* 1907 SC 360 at 366 per Lord Low; *Forrest v Scottish County Investment Co* 1916 SC (HL) 28 at 39 per Lord Wrenbury.

<sup>23</sup> 1997 SLT 1213 at 1216L. See also McBryde, *Contract*, paras 20.48 to 20.52.

<sup>24</sup> *Graham v United Turkey Red Co* 1922 SC 533.

<sup>25</sup> 1999 Report, para 7.13.

2.20 *McNeill* appears to confirm the position that we reached in our 1999 Report. It was an employment case involving the parties' obligations of mutual trust and confidence. The question was whether the employer could withhold performance of that obligation in response to the employee's breach of other obligations under the contract. An employee resigned during a prolonged investigation of his conduct by the employer, and then brought a claim for unfair constructive dismissal on the basis of the employer's breach of the trust and confidence obligation. It was established that for some time the employee had in fact been in breach of a kind meriting dismissal. In consequence the Employment Appeal Tribunal held that the doctrine of mutuality disabled the employee from bringing his unfair dismissal claim. This was however overturned by an Extra Division, which held that the employee's breach did not prevent him making a claim for the employer's breach of mutual trust and confidence. Otherwise, as Lord Drummond Young put it:

"any breach of contract by the employee of sufficient materiality to permit retention would allow the employer to behave in a wholly outrageous manner, without any redress for the employee."<sup>26</sup>

2.21 This may be contrasted with the earlier decision in *Forster v Ferguson & Forster, Macfie & Alexander*.<sup>27</sup> For reasons that are not clear, it was not cited in *McNeill*. In that case, a former partner in a law firm who had been convicted of embezzlement from the firm sued it and the continuing partners for a pension due to him under the partnership agreement upon his leaving the firm. An Extra Division held that he was unable, on the basis of mutuality, to enforce the obligation. His breach of the duty of utmost good faith incumbent between partners, which went to the root of the whole partnership contract, disabled him from enforcing any of the obligations under the agreement even although the partner had long before ceased to be a member of the firm. The majority view was that:

"no distinction fell to be drawn between a continuing contract and a terminated contract for the purposes of the operation of the principle of mutuality".<sup>28</sup>

Lord Marnoch, dissenting, thought that:

"the main practical application of the doctrine of mutuality is in relation to retention in the sense of withholding performance in the course of a continuing contract"

and that the only way in which the firm could have escaped the obligation was by rescinding the whole contract on the basis of the partner's material breach.<sup>29</sup>

2.22 The problems created by the view of the law given effect by the majority in *Forster* have been set out by MacQueen and Thomson:

"A supplies B with material which is admittedly not of the contractual quality but B is able to use it to manufacture other goods for resale and does so. Should A be denied payment?<sup>30</sup> C has sold land to D, the price payable in monthly instalments. D has discovered that C has failed to carry out certain works on the land despite a clause to

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<sup>26</sup> 2014 SC 335 at para 34.

<sup>27</sup> 2010 SLT 867.

<sup>28</sup> *Ibid*, para 15 per Lord Clarke.

<sup>29</sup> *Ibid*, para 35. Given that rescission is prospective and not a means of avoiding the contract altogether, this latter point may not hold good.

<sup>30</sup> Citing *NV Devos Gebroeder v Sunderland Sportswear Ltd* 1990 SC 291.

that effect in the contract. But D is in financial difficulties which means that he has fallen behind in paying the instalments before discovering C's failure (ie he is not exercising the right of retention). Can D raise the question of C's breach? – and, indeed, can C sue D for the unpaid instalments?<sup>31</sup> E builds a house for F which is conform to contract in every way except that the specified mortar has not been used. Can F refuse to pay, even if the mortar is every bit or just as good as the one specified?<sup>32</sup>

To deny the contract-breaker any claim in the kind of cases described above may well be disproportionate where he has in fact rendered a performance substantially complying with the contractual requirements or which the recipient is able to use. There may also be absurdity, as in the C–D case above, if both parties are in breach: must a court refuse to hear a dispute of this kind? This would make a nonsense of the existence of procedures (*counter-claims*) which enable the parties to an action both to make claims against each other ...<sup>33</sup>

2.23 The contrast between the *Forster* and the *McNeill* opinions suggests that the law is less clear and certain than we thought in 1999. Despite our confidence then as to the authority of Lord Jauncey's dictum in *Bank of East Asia*, subsequent decisions suggest that it might be as well to put matters beyond doubt. This would require a legislative statement to the effect that a party in breach of contract is not as a result disentitled from exercising any right or pursuing any remedy arising out of the other party's breach of contract. This does not mean that the first party has complete freedom of manoeuvre. Instead, as we put it in 1999, "[e]verything depends on the terms of the particular contract and on the law of suspension of performance".<sup>34</sup> We ask accordingly:

**6. Do consultees consider that party A who is in breach of contract should be entitled to exercise any right or pursue any remedy arising out of party B's breach of contract occurring before B has terminated the contract for A's breach?**

## Retention and withholding performance

### *The DCFR and Scots law compared*

2.24 The DCFR remedy of withholding performance is equivalent to what is usually known in Scots law as the right of retention. As we note above, it is based on the concept of reciprocal obligations between the parties.

2.25 The DCFR provides two model rules about withholding performance, depending on whether the obligations are to be performed simultaneously or sequentially. In the first situation, neither has to perform until the other party has tendered performance, much as in the Scots law of mutuality.<sup>35</sup> In the second situation, the party who is to perform first may withhold performance if it reasonably believes that the other party will not perform when that performance falls due. That right is lost if the other party gives an adequate assurance of

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<sup>31</sup> Citing *Hayes v Robinson* 1984 SLT 300.

<sup>32</sup> Citing *Steel v Young* 1907 SC 360.

<sup>33</sup> MacQueen & Thomson, *Contract*, paras 6.57 and 6.58.

<sup>34</sup> 1999 Report, para 7.13. For example, in the *Forster* case, as Lord Marnoch suggested, the pension clause on construction could be read as conferring the right upon the partner no matter the circumstances in which he left the firm.

<sup>35</sup> DCFR III.–3:401(1).

performance.<sup>36</sup> The DCFR provides a default rule on order of performance which applies if the order is not clear from the contract itself:

“If the order of performance of reciprocal obligations cannot be otherwise determined from the terms regulating the obligations then, to the extent that the obligations can be performed simultaneously, the parties are bound to perform simultaneously unless the circumstances indicate otherwise.”<sup>37</sup>

2.26 The standard works on contract in Scots law do not mention such a default rule. This may explain the absence of discussion on withholding performance for anticipated breach as distinct from a breach that has occurred or is occurring. We consider whether a rule about withholding performance for such an anticipated breach could usefully be introduced in Chapter 3.

2.27 In *McNeill*, Lord Drummond Young observed that retention is “a right to withhold performance of substantive obligations under the contract pending performance by the other party of its obligations.”<sup>38</sup> In his view the right went no further, and he added that “the principle of retention cannot generally be invoked in respect of a breach of contract that has occurred in the past and is unlikely to be repeated.”<sup>39</sup> Thus, if retention is security for counter-performance the claims must be outstanding at the time the debtor’s performance is due. But it has been argued on the basis of the *Inveresk* case that retention is not so limited, and that retention can be used as a defence to an action for performance, by which a party in breach may secure the performance due to it or damages for continued non-performance by the other party.<sup>40</sup> In *Inveresk*, for example, the creditor was held able to retain payment of a sum due to the debtor pending the outcome of a separate damages action for breach of contract which the creditor had already raised against the debtor.

2.28 Finally, the claim retained need not be liquid (that is, one fixed in amount and presently payable, as opposed to an illiquid one not yet quantified or due), nor for money. In this respect, therefore, Scots law appears to be wider than the DCFR, under which the respective performances must be due for one party to withhold, or the party withholding must reasonably anticipate the other party’s non-performance when it falls due.

2.29 Aside from the matters discussed above, we think that the remedy of retention is generally functioning well, and we do not propose further reforms to it at this time. However, we suggest that it is a matter that ought to be included in any general statutory restatement of the law on remedies for breach of contract (see Chapter 11). We therefore ask:

**7. If a general statutory restatement is pursued, should it provide for a creditor to withhold performance as a response to non-performance by the debtor?**

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<sup>36</sup> DCFR III.–3:401(2).

<sup>37</sup> DCFR III.–2:104.

<sup>38</sup> 2014 SC 335 at para 28.

<sup>39</sup> *Ibid*, para 29.

<sup>40</sup> Richardson, “Set-off”; Gloag, *Contract*, pp 623 to 624, 626 to 627.

### *Controls on use of the remedies*

2.30 The DCFR does not require that non-performance be in some sense material or fundamental before performance may be withheld.<sup>41</sup> For Scots law, it has been said as a control on the use of retention the breach giving rise to it must be material in the same way that it is for rescission (or termination).<sup>42</sup> But this has been doubted by McBryde on the basis that merely withholding or suspending performance is a very different thing from terminating the contract altogether.<sup>43</sup> He suggests that the breach justifying suspension need only be more than *de minimis*. Gloag certainly took the view that the breach needed to justify retention did not have to be of the same materiality as that required for rescission.<sup>44</sup> While a breach ought indeed to be very serious in order to justify the creditor in releasing itself and the debtor from future performance of the contract by rescinding, merely suspending the creditor's performance with the intent of pressing the debtor to perform does not seem to call for quite the same level of breach. Indeed, that might render the remedy much less useful than it would otherwise be.

2.31 The concern that a right to withhold performance might be abused<sup>45</sup> is probably met in the DCFR by the concept of good faith and fair dealing in deploying a remedy for non-performance.<sup>46</sup> In Scots law there is a relatively undeveloped notion that retention is subject to the equitable control of the court. It seems to be for the party against whom retention is being exercised to show that the remedy is being used inequitably. In *McNeill*, Lord Drummond Young stressed the court's equitable power to prevent retention becoming an "instrument of abuse",<sup>47</sup> which might occur when it was used otherwise than to secure future performance by the debtor. But this does not imply that the performance withheld should bear a close relationship in value to the non-performance on the other side, or to the adverse effects actually suffered by the creditor as a result of the non-performance.<sup>48</sup>

2.32 Some additional light may be thrown on the equitable control of retention by the equitable control of the closely parallel right of lien. A lien is:

"a real right to retain property until the discharge of an obligation or certain obligations, the property not having been delivered to the retaining party for the purpose of security."<sup>49</sup>

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<sup>41</sup> DCFR III.–3:401 Commentary B.

<sup>42</sup> MacQueen and Thomson, *Contract*, para 5.21.

<sup>43</sup> McBryde, *Contract*, paras 20.60, 20.88.

<sup>44</sup> Gloag, *Contract*, p 623.

<sup>45</sup> For example, where the debtor's non-performance is trivial, but the performance withheld by the creditor is significant.

<sup>46</sup> See paras 11.14 to 11.22 below.

<sup>47</sup> 2014 SC 335 at para 30.

<sup>48</sup> MacQueen and Thomson, *Contract*, para 5.21.

<sup>49</sup> Steven, *Pledge and Lien*, para 9.01.

Liens may be general<sup>50</sup> or special. As Steven points out, contract is the relationship within which special liens most often arise and the starting point in that context is mutuality. He continues:

“A special lien will only arise in a contractual situation where there are synallagmatic obligations between the parties. To be more precise, the obligation of the lien-holder to return the property must be reciprocal to the obligation which he or she is demanding that the other party perform. ... It must be said, however, that the courts have simply been willing to accept the right to retain as being mutual to the other party’s duty to pay the sum owed under the contract without a detailed explanation of why this is the case.”<sup>51</sup>

The classic example of special lien in the contractual context is where the creditor gains possession of the debtor’s property in order to carry out work upon it, such as repair.

2.33 The equitable control of lien consists in the court’s capacity to prevent abuse and unfair oppression of the debtor.<sup>52</sup> Examples can be found in the case law: where the debtor needs to have the property back for some pressing reason, such as completing a tax return or for business requirements, it may be delivered to that party upon its finding security (such as consigning in court the amount said to be due) for payment or performance of the disputed obligation.<sup>53</sup> It is not therefore some generalised fairness control, and the legitimate interests of the creditor are fully recognised and protected in their turn.

2.34 It may therefore be possible to apply the thinking seen in the lien cases to other cases of retention, and cease to apply a test of materiality of breach as a way of controlling unfair and oppressive use of the remedy. The lien approach has the attraction of enabling a balance to be held between the interests of the respective parties. On the other hand, were the test for an entitlement to terminate to be expressed in terms of fundamental rather than material breach, the breach justifying retention could be described as “material” without causing any confusion. Such a breach would be material simply in the sense of not being trivial (or immaterial).

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<sup>50</sup> General liens do not have the same requirement of reciprocity, and can therefore secure general debts owed between the parties. They are unusual and tend to be confined to certain trades and professions, where they have been established by custom and practice (e.g. bankers, factors and solicitors). See further *SME (Rights in Security)* paras 75 and 78 to 80.

<sup>51</sup> Steven, *Pledge and Lien*, para 11.15.

<sup>52</sup> Steven, *Pledge and Lien*, para 15.05.

<sup>53</sup> *Ibid.*

2.35 We do not suggest that reforms are presently required to the controls on the use of the remedy of retention. If consultees support a general statutory restatement (see Chapter 11), however, we suggest that provision should be made about those controls, and we would be grateful for consultees' view about the form of that provision. Accordingly, we ask:

- 8. Do consultees consider that any general restatement should provide that:**
- (a) the debtor's non-performance must be material before the creditor can exercise the remedy of retention or withholding performance; or**
  - (b) the courts have power to deal with abusive or oppressive use of the remedy?**

### **“Special retention” and set-off**

2.36 A point which practitioners have pressed us to clarify is the interaction between the law of retention and the law of compensation (sometimes described as “set-off”). Their concerns flow in particular from the decision in the *Inveresk* case discussed above.<sup>54</sup> The judgment of Lord Rodger of Earlsferry in that case showed in detail that in Scotland the court has an equitable power to allow a party to retain a liquid debt on the basis of an illiquid claim that will shortly become liquid in order for set-off—or, in the traditional language of Scots law, compensation—to extinguish the two debts to the amount of whichever is the lesser.<sup>55</sup> This tempers the strictness of the rules under the Compensation Act 1592, by which extinctive compensation takes place only between two liquid claims (not necessarily arising from the same source of obligation). The classic example of an illiquid claim will be an action of damages for breach of contract, the claim becoming liquid upon the court's decree quantifying the amount to be paid.

2.37 The rule set out by Lord Rodger has been dubbed “special retention”, to contrast it with the mutuality retention discussed above.<sup>56</sup> We adopt that terminology in this Discussion Paper. The essential point, which has been elaborated by Richardson, is that while the withholding or suspension of performance in mutuality retention tends to look to the eventual performance of the contract (or a substitute therefor), special retention is a step on the road to the extinction of its obligations by compensation.<sup>57</sup> *Inveresk*, in which the retaining creditor's damages action against the debtor was well under way, may have been a case where the latter concept should have been applied, rather than extending the principle of

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<sup>54</sup> *Inveresk plc v Tullis Russell Papermakers Ltd* 2010 SC (UKSC) 106. The key passage in Lord Rodger's judgment is found at paras 57 to 107. It is technically *obiter*.

<sup>55</sup> The rule is found but not elaborated to the same extent in such modern works as Gloag, *Contract*, p 646; Gloag & Henderson, paras 3.31, 10.15; Wilson, *Debt*, para 13.5; McBryde, *Contract*, paras 25.46, 25.57 to 25.58.

<sup>56</sup> Richardson, “Retention”.

<sup>57</sup> See McBryde, *Contract*, para 20.64. Richardson, “Set-off” further argues that “mutuality retention” can function in Scots law in the same way as “equitable set-off” in English law: that is, it can be applied by a creditor in respect of a breach that has already occurred in the past and for which the debtor is liable either to cure or to pay damages. Compensation, on the other hand, functions in much the same way as “independent set-off” in English law. In our Advisory Group Ms Richardson indicated that she had not identified an equivalent to special retention in the English law of set-off. Equitable set-off requires a close connection between the claims, where special retention does not. A stay of execution under CPR 87.3(4) may be the nearest equivalent.

mutuality across two different contracts.<sup>58</sup> As already noted, compensation may take place between two claims by the same parties where each arises from a different source of obligation.

2.38 There is an issue about whether special retention should be allowed by the law and, if so, what its limits should be. It is our view, however, that this subject falls outwith the scope of remedies for breach of contract, and lies closer to the law of compensation. We can best explain this conclusion by considering first how the DCFR deals with set-off.

#### *The DCFR and Scots law compared*

2.39 Set-off, as the DCFR denotes the subject, is treated by that text quite separately from the rules on remedies for non-performance. It is defined as:

“the process by which a person may use a right to performance against another person to extinguish in whole or in part an obligation owed to that person.”<sup>59</sup>

If two parties owe each other obligations of the same kind, either party may set off that party’s right against the other party’s right, if and to the extent that, at the time of set-off, (a) the performance of the first party is due; (b) the performance of the other party is due; and (c) each party has authority to dispose of that party’s right for the purpose of the set-off.<sup>60</sup>

2.40 The notes to the DCFR elaborate further upon the requirements of set-off. Crucially, the cross-right (that is, the right of the party declaring set-off) must be enforceable since set-off constitutes a form of enforcement of the cross-right, and the party declaring set-off must be entitled to oblige the other party to accept performance. So as soon as the holder of the cross-right may compel the other party to receive performance there is no reason to deny the first party the power to declare set-off. The second party may however reject an offer of *early* performance if it would suffer unreasonable prejudice as a result.

2.41 The holder of a cross-right that is as yet “unascertained as to its existence or value” may nonetheless declare set-off against the other party’s claim under the DCFR if this “will not prejudice the interests of the [other party]”.<sup>61</sup> Where the rights of the parties arise from the same legal relationship it is presumed that the other party’s interests will not be prejudiced.<sup>62</sup>

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<sup>58</sup> See para 2.16 above. As pointed out in our Advisory Group, however, special retention is not available as of right, unlike mutuality retention. Instead, the defender in *Inveresk* would have to show the equity of allowing retention, without having any exhaustive list of factors going to the equities to which to refer.

<sup>59</sup> DCFR III.–6:101(1). The rules are contained in section 1 of Chapter 6 of Book III of the DCFR, and they do not apply to set-off in insolvency (DCFR III.–6:101(2)).

<sup>60</sup> DCFR III.–6:102.

<sup>61</sup> DCFR III.–6:103(1).

<sup>62</sup> DCFR III.–6:103(2).

2.42 The commentary on this article of the DCFR suggests that it would “go too far” and “inhibit [the possibility of set-off] unnecessarily” to make liquidity a substantive requirement of set-off in all cases.<sup>63</sup> Where both claims arise from the same legal relationship, such as a contract between the parties, the judge may consider both claims together because this will not normally be prejudicial to the interests of the principal claimant. But where the claims arise from distinct legal relationships:

“the decision will normally go the other way ... Commercial predictability and fairness demand that a party who has an ascertained right should not be held up in pursuing this right.”<sup>64</sup>

In deciding what to do in such cases, the judge needs to take account of all the circumstances of the case, “such as the probable duration of the proceedings concerning both principal right and cross-right, or the effect of a delay on the [party with the principal right]”.<sup>65</sup>

2.43 The DCFR thus seems to reach broadly the same conclusions as Scots law with regard to the possibility of setting-off an illiquid claim. A party with an illiquid claim may declare set-off against another party’s liquid claim, provided that the process of making the illiquid claim liquid is not going to be prejudicial to the party with the liquid claim. Unless the respective claims arise from the same legal relationship, the set-off will normally not be allowed. But the DCFR commentary is explicit that the problems which it analyses:

“do not arise in situations where [a party] can make use of a right to withhold performance in terms. In these cases the (principal) right is not ready for adjudication.”<sup>66</sup>

#### *Conclusions on special retention and set-off*

2.44 There is no doubt as to the existence of special retention in Scots law. There can also be no doubt that its existence is supported by the relevant provisions of the DCFR. But it is of interest that in the DCFR the relevant rules are classified as part of set-off, dissociated from the law of remedies on breach of contract. Similar rules operate in the major Continental legal systems.<sup>67</sup>

2.45 It is no part of the present law reform exercise to propose legislation on set-off in Scots law, desirable though it may be to update a statute passed over 400 years ago. But it may be useful to make clear here that the reforms which we do discuss in relation to the breach remedy of suspension or withholding are not intended to affect special retention. Although special retention is not compensation, in that it does not give rise directly to the extinction of obligations, and although it allows a party to withhold its liquid performance where the other party has not performed another illiquid obligation between them, it is not based on mutuality of contract. The respective claims may be unconnected in the sense of not being reciprocal or interdependent or, indeed, of their arising from distinct sources of

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<sup>63</sup> DCFR III.–6:103 Commentary A, para 3.

<sup>64</sup> DCFR III.–6:103 Commentary A, para 4(b).

<sup>65</sup> DCFR III.–6:103 Commentary A, para 4.

<sup>66</sup> DCFR III.–6:103 Commentary B.

<sup>67</sup> See the national notes to DCFR III.–6:103. See also R Zimmermann, *Comparative Foundations of a European Law of Set-Off and Prescription* (2002 (2010 reprint)) pp 51 to 56; P Pichonnaz and L Gullifer, *Set-off in Arbitration and Commercial Transactions* (2014).

obligation. But, as Richardson has shown, it will be rare for special retention to be allowed where the two claims do not arise from the same contract. Finally, as she also points out, the court's allowing special retention is based upon it being equitable to do so in all the circumstances, whereas suspension or withholding performance is a generally available right which may be prevented on equitable grounds (but rarely seems to be so).

2.46 It may be, therefore, that it would be useful for any legislation arising from our current exercise to state explicitly that it is inapplicable to special retention.<sup>68</sup> We ask accordingly:

- 9. Would it be useful for any legislation on suspension or withholding of performance as a remedy for breach of contract to state that it does not apply to special retention?**

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<sup>68</sup> Especially if "special retention" is now accepted as a term of art. Should "retention" be retained as the name for the withholding performance remedy based on mutuality, it may be desirable to give special retention some other name linking it more to compensation.

# Chapter 3      Anticipatory or anticipated breach

## Introduction

3.1      Like Scots (and English) law, the DCFR recognises the possibility of anticipatory or anticipated breach. This is the concept that a contracting party may be entitled to exercise breach remedies in anticipation of a breach by the other party which has not yet occurred.<sup>1</sup>

3.2      This concept is most commonly encountered where a party repudiates a contract or contractual obligation by indicating that when the time comes it will not perform. This gives the other party an option (which, however, it need not exercise) to accept this, terminate the contract and claim damages immediately without waiting for the date when performance would have been due. In effect the repudiation, once accepted, is treated as if it were an actual breach.

3.3      Although there are some conceptual difficulties in the notion of anticipated breach, the power of a creditor to take measures before a breach occurs clearly serves a number of useful purposes, particularly in the commercial world.<sup>2</sup> McBryde says that the concept “makes business sense”, because “[i]t allows parties immediately to seek resolution of the consequences of the early termination, with all parties free to contract elsewhere”.<sup>3</sup>

3.4      In this Chapter, we consider the DCFR concept of anticipated breach, as well as examining the conclusions we reached in our 1999 Report and the developments in Scots law since then. We discuss whether the law in this area ought to be reformed, and in any event we would expect a general statutory restatement of the law on remedies for breach of contract to deal with the matter. We begin with a brief discussion of potential terminological issues in this area.

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<sup>1</sup> Like the ULIS (arts 48, 75) and the CISG (art 72).

<sup>2</sup> For a full discussion see Liu, *Anticipatory Breach*.

<sup>3</sup> McBryde, *Contract*, para 20.23.

## Terminology

### *Anticipatory or anticipated breach*

3.5 In this Chapter, we use the term “anticipated breach” rather than “anticipatory breach”. It is used to describe conduct by a debtor that will justify the creditor in beginning to exercise its breach remedies even although the time for the debtor’s performance has not yet arrived. We think that it is more accurate to characterise the situation as one of anticipated breach, rather than one of anticipatory breach. The Oxford English Dictionary defines the two adjectives as follows:

anticipatory, *adj.*

Of or pertaining to an anticipator; of the nature of anticipation.

anticipated, *adj.*

1. Taken or occurring in advance or beforehand.
2. Used beforehand, as money.
3. Apprehended beforehand, looked for, expected.

3.6 In our view, the definition of “anticipatory” is not particularly helpful. At best it might be taken to signify a breach which has been anticipated, but if so it might be simpler just to use “anticipated”. In any event, we think that it is the third sense of “anticipated” which most accurately describes the situation: the creditor apprehends that the debtor will be in breach when the time for performance comes, and it is this that justifies the exercise of the creditor’s remedies for breach. Alternatively, this could equally be described as “apprehended breach”—or it might be desirable to describe the concept in greater detail, as the DCFR does.<sup>4</sup>

- 10. Do consultees agree that “anticipated breach” is a more exact way of describing the situation in which a creditor may begin to exercise remedies for breach even although the time for the relevant performance by the debtor has not yet arrived?**

### *Repudiation*

3.7 Repudiation is a term used in Scots law which is apt to cause confusion. It is sometimes used to describe anticipated breach, but a party actually in material breach can be said to have repudiated the contract too.<sup>5</sup> The requirements and timing of anticipated breach and material breach are different and so are the options available to the innocent party when faced with either circumstance.<sup>6</sup> McBryde succinctly describes the difficulty caused by this shared terminology:

“Repudiation means to throw up, reject or disown. This can occur at various stages in the life of a contract, and may take various forms. While repudiation may be an accurate description of what in fact has happened, it is an unsatisfactory term to

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<sup>4</sup> See paras 3.13 to 3.27 below.

<sup>5</sup> McBryde, *Contract*, para 20.03.

<sup>6</sup> *Ibid.*

describe the legal consequences which vary with the circumstances. If anticipatory breach or material breach are involved it is better to use these more precise expressions. There has been judicial criticism of the different meanings of repudiation. Although difficult to avoid, the term 'repudiation' should probably not be used as a term of art. Its meaning varies with the context."<sup>7</sup>

3.8 If this is accepted, then it naturally follows that any reform of contract law terminology ought to include discussion of a possible alternative to repudiation, including its abandonment.

#### *Repudiation in the sense of anticipated breach*

3.9 There are further ways in which an anticipated breach may be established other than repudiatory statements. In *Edinburgh Grain Ltd (in liquidation) v Marshall Food Group Ltd*,<sup>8</sup> for example, Lord Hamilton said that repudiation of the contract could be shown by:

“conduct demonstrative of an intention not to perform fundamental contractual obligations as and when they fall due.”

He added:

“That intention may have its origin in a choice by the obligant not to fulfil his contract or in an inability on his part to do so.”<sup>9</sup>

If that view is correct, then repudiation becomes even less apt as a term of art.

#### *Repudiation in the sense of material breach*

3.10 In assessing whether the debtor's conduct constitutes a breach of contract, an unjustified refusal to perform when performance is due is likely to be seen as a “material” or “fundamental” or “substantial” breach justifying termination.<sup>10</sup> This is especially so where time is either expressly or impliedly of the essence. As a definite refusal (whether itself express or implied from the circumstances), it falls to be distinguished from the mere non-performance at the due date, which may or may not be material in the circumstances of the case. Other forms of non-performance—for example, by defective or faulty performance—might be seen as in their nature “repudiatory”.

3.11 In our view, it is difficult to see what the adjective “repudiatory” adds to the exercise of determining whether the breach is sufficiently fundamental or material or substantial to justify termination. The present law on the termination remedy seems to be that the creditor must notify the debtor of its termination, and we suggest below that this should continue to be the law. If that is correct, it is difficult to see what, if anything, the requirement that a repudiation be accepted by the creditor can add to the law. “Repudiation” in this context would become a redundant piece of terminology, or at least not one with any technical connotations.

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<sup>7</sup> *Ibid.*

<sup>8</sup> 1999 SLT 15.

<sup>9</sup> 1999 SLT 15 at 22.

<sup>10</sup> A refusal to perform may of course be justified as a retention based on breach by the other party.

3.12 That said, it is difficult to propose that a word be abolished as a legal term of art. We think that the better approach may simply be to make the concept of repudiation redundant through the suggested changes to the law that we discuss below. Should there be a general restatement of the law on remedies for breach of contract, the concept of repudiation could simply not be used.

11. **Do consultees agree that it is desirable to distinguish clearly between the concepts of anticipated breach and material breach, and that applying the term “repudiation” to both of them is undesirable?**
12. **If so, do consultees consider that the use of the term “repudiation” would become unnecessary as a result of the suggested changes to the law canvassed elsewhere in Chapter 3?**

### **The DCFR and Scots law compared**

3.13 Three scenarios that may be characterised as “anticipated breach” are identified in the DCFR:

- anticipated breach of a monetary obligation;
- withholding performance where the creditor reasonably believes that the debtor will not perform when performance of a subsequent obligation falls due; and
- termination for anticipated non-performance of the debtor’s obligation.

#### *Anticipated breach of a monetary obligation*

3.14 The first scenario contemplated by the DCFR arises where the debtor is due to make a payment in return for the creditor’s performance of a reciprocal obligation.<sup>11</sup> If the creditor has yet to perform its reciprocal obligation and it is clear that the debtor will be unwilling to receive the creditor’s performance, the creditor is entitled to proceed with performance and may recover payment. This right of the creditor is qualified, being unavailable where:

- “(a) the creditor could have made a reasonable substitute transaction without significant effort or expense; or
- (b) performance would be unreasonable in the circumstances.”<sup>12</sup>

3.15 As a general rule in Scots law, remedies for breach of contract cannot be pursued until the time of performance of the contract has arrived and a breach has occurred. The doctrine of anticipatory breach is an exception. The essence of this doctrine is clear from the dictum of Lord Reid in *White & Carter (Councils) Ltd v McGregor*.<sup>13</sup>

“The general rule cannot be in doubt. It was settled in Scotland at least as early as 1848, and it has been authoritatively stated time and again in both Scotland and England. If one party to a contract repudiates it in the sense of making it clear to the

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<sup>11</sup> DCFR III.–3:301.

<sup>12</sup> DCFR III.–3:301(2). See also PECL art 9:101(2).

<sup>13</sup> 1962 SC (HL) 1.

other party that he refuses or will refuse to carry out his part of the contract, the other party, the innocent party, has an option. He may accept that repudiation and sue for damages for breach of contract, whether or not the time for performance has come; or he may, if he chooses, disregard or refuse to accept it and then the contract remains in full effect.”<sup>14</sup>

3.16 Repudiation does not terminate the creditor’s obligations of performance automatically but rather provides the creditor with a choice to:

- accept the repudiation and treat the contract as terminated; or
- affirm the contract and insist upon performance, if necessary by specific implement or action for payment.

3.17 Acceptance of repudiation does not have to take any particular form and may be made by conduct or communication. Intimation or formal notice to the party repudiating the contract is not required, so non-performance of contractual obligations by the creditor may be sufficient.<sup>15</sup> Likewise, affirmation of the contract requires no particular form.

3.18 In Scots law, there is no general requirement that a decision to affirm a contract rather than accept a repudiation be reasonable. In *White & Carter*, a contract to place advertisements of the business of a Clydebank garage was repudiated by the customer but the advertising company affirmed the contract, placed the unwanted advertisements and sued for payment. The House of Lords held<sup>16</sup> that, despite the unwanted and wasteful nature of the performance, the creditor was entitled to be paid.

3.19 The DCFR is therefore broadly in accordance with the Scots law rule as set out in *White & Carter*, but the qualifications in the DCFR mean that the rigour of the decision is mitigated. We consider below whether Scots law should be reformed along those lines (as we recommended in our 1999 Report).

#### *Withholding performance in response to an anticipated breach*

3.20 The second scenario contemplated by the DCFR occurs where a creditor is to perform a reciprocal obligation *before* the debtor performs, and the creditor reasonably believes that there will be non-performance by the debtor when the debtor’s performance becomes due. The creditor may withhold performance of the reciprocal obligation for as long as the reasonable belief continues.<sup>17</sup>

3.21 The creditor must give the debtor notice as soon as reasonably practicable, and is liable for any loss caused to the debtor by a breach of this duty.<sup>18</sup> The right to withhold

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<sup>14</sup> 1962 SC (HL) 1 at 11.

<sup>15</sup> See, for example, *Vitol SA v Norelf Ltd (The Santa Clara)* [1996] AC 800; *Edinburgh Grain Ltd (In Liquidation) v Marshall Food Group Ltd* 1999 SLT 15.

<sup>16</sup> By a majority of three to two.

<sup>17</sup> DCFR III.–3.401(1).

<sup>18</sup> DCFR III.–3.401(3). For “notice” generally see DCFR I.–1:109 and see III.–3:106 for notices relating to non-performance in particular.

performance in this manner is lost if the debtor gives an adequate assurance of due performance.<sup>19</sup>

3.22 There is an alternative but overlapping procedure available to the creditor. This enables a party who reasonably believes that there will be a fundamental non-performance by the other party to demand adequate assurance of due performance, meanwhile withholding performance of his own obligations so long as such reasonable belief continues. When this assurance is not provided within a reasonable time, the creditor may terminate the contract if it still reasonably believes that there will be a fundamental non-performance by the debtor and gives notice of termination without delay.<sup>20</sup> The question of whether an assurance that is provided is adequate or not depends on the circumstances. It is envisaged that in some circumstances a declaration of intention to perform by the debtor might suffice, but in others it might be reasonable for the creditor to require evidence of ability to perform.<sup>21</sup>

3.23 An important difference from the first scenario is whereas in that case it has to be clear that the debtor is unwilling to receive performance,<sup>22</sup> in the second scenario the question is only one of the creditor's reasonable belief that the debtor will not perform.<sup>23</sup>

3.24 In our 1999 Report we decided against a need to legislate for this scenario in Scots law. This was on the basis that it was likely that the courts would recognise the possibility of anticipated breach in cases not necessarily involving outright express refusals of performance by the debtor. In any event, the Faculty of Advocates thought it "already the law that suspension of performance was possible in response to an anticipatory breach".<sup>24</sup> We consider below whether subsequent developments make reform of Scots law in this area desirable.

#### *Termination for anticipated non-performance*

3.25 The third scenario contemplated by the DCFR is that the creditor may terminate before performance of a non-monetary contractual obligation is due if the debtor has declared that there will be a non-performance of the obligation, or it is otherwise clear that there will be such a non-performance.<sup>25</sup> It is also a requirement that the non-performance would have been fundamental. In the absence of an express repudiation by the debtor, the DCFR commentary states that:

"[i]f the debtor's behaviour merely engenders doubt as to willingness or ability to perform, the creditor's remedy is to demand an assurance of performance".<sup>26</sup>

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<sup>19</sup> DCFR III.-3:401(2).

<sup>20</sup> DCFR III.-3:505. See also PECL art 8:105, PICC art 7.3.4. The McGregor Code (para 304) permits a party who reasonably believes that there may be a failure of performance on the other side to request an assurance of performance, meanwhile suspending its own; failure of the other party to provide a reasonable assurance within a reasonable time is a breach of contract.

<sup>21</sup> DCFR III.-3:505 Commentary D.

<sup>22</sup> As in *White & Carter* itself, where the debtor told the creditor unequivocally that he no longer wanted performance, stating: "Please cancel the contract."

<sup>23</sup> For example, because it acquires reliable information that the debtor is not performing other, similar contracts, or lacks the resources to do so.

<sup>24</sup> 1999 Report, paras 7.3, 7.15.

<sup>25</sup> DCFR III.-3:504.

<sup>26</sup> DCFR III 3.-504 Commentary D.

3.26 In effect, this is equivalent to the Scots law concept of termination after anticipatory repudiation of the contract by the debtor, but in the DCFR there is no need for the creditor to accept the repudiation before it can exercise its remedies.<sup>27</sup> The purpose of requiring acceptance in Scots law appears to be in making it clear that the creditor has terminated the contract and wishes to exercise its other available remedies, rather than performing the contract itself or compelling the debtor's performance. However, in the DCFR approach to termination the creditor is required to notify the debtor of its action.<sup>28</sup> This appears to us to serve the same function as acceptance does in Scots law, and so it does not appear that Scots law differs greatly from the DCFR in this scenario.

3.27 As a result, we do not think that any reform is required in relation to this aspect of the law on anticipated breach. If a general statutory restatement is pursued, however, the option would arise to adopt the DCFR approach and remove the requirement for acceptance of repudiation, with notification taking place as it would when any other contract is terminated. We ask accordingly:

**13. If a general statutory restatement is pursued, should it provide that the creditor may terminate before performance of a contractual obligation is due if:**

**(a) the debtor has declared that there will be a non-performance of the obligation, or it is otherwise clear that there will be such a non-performance; and**

**(b) that non-performance would have been fundamental?**

### **Potential reforms: anticipated breach of a monetary obligation**

#### *Basis for reform*

3.28 As we note above, *White & Carter* continues to be followed in Scots law.<sup>29</sup> This is despite trenchant criticism of the decision in England,<sup>30</sup> where it is the subject of two important qualifications. First, the creditor cannot compel the debtor to cooperate. As Lord Reid remarked in *White & Carter*:

“Of course, if it had been necessary for the debtor to do or accept anything before the contract could be completed by the creditors, the creditors could not and the court would not have compelled the debtor to act, the contract would not have been completed and the creditors' only remedy would have been damages.”<sup>31</sup>

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<sup>27</sup> For the present requirements of an acceptance of a repudiation see McBryde, *Contract*, para 20.33.

<sup>28</sup> See further para 4.19 below.

<sup>29</sup> *Salaried Staff London Loan Company Limited v Swears and Wells Limited* 1985 SC 189.

<sup>30</sup> See, for example, P M Nienaber, “The Effect of Anticipatory Repudiation: Principle and Policy” 19 62 CLJ 213; Liu, *Anticipatory Breach*, pp 193 to 217; M P Furmston, *Cheshire, Fifoot and Furmston's Law of Contract* (16<sup>th</sup> edn, 2012), pp 782 to 783.

<sup>31</sup> 1962 SC (HL) 1 at 13.

The effect is that the creditor will be compelled to accept the breach if it cannot continue with performance without the cooperation of the debtor.<sup>32</sup> The relatively limited availability of the specific performance remedy in English law may be particularly significant here; but, as we will discuss further below, specific implement has a wider ambit in Scots law.<sup>33</sup> This may mean that co-operation could be enforced in at least some cases in Scotland where it would not be in England.

3.29 The second qualification is also derived from the speech of Lord Reid when he stated:

“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.”<sup>34</sup>

3.30 Whilst Lord Reid’s view was not expressly shared by the other members of the majority (Lords Tucker and Hodson), this reasoning has been utilised in subsequent cases as a means of limiting the *White & Carter* principle when it has appeared that full performance of the contract is wasteful.<sup>35</sup>

3.31 *White & Carter* was followed in Scotland in *Salaried Staff London Loan Company v Swears and Wells Limited*.<sup>36</sup> In that case, the tenants repudiated a 35-year lease after 5 years. The landlord successfully sued for payment of one year’s rent and expenses, although the First Division did observe that different considerations might arise if the landlord continued to raise actions for payment.<sup>37</sup> The Lord President (Emslie) appeared to accept as a relevant control mechanism the “legitimate interest” test articulated by Lord Reid.<sup>38</sup>

3.32 In our 1999 Report, we articulated the following criticism of the existing law:

“There is nothing unreasonable in a general rule that contracts must be performed and that a party is entitled to perform and claim payment in accordance with the agreed terms. What is unreasonable is to push that general rule to absurd lengths. Most people, we believe, would consider it absurd to allow a party who has been clearly told that performance is unwanted, who has no special interest in tendering performance, and for whom damages would be an adequate remedy, to proceed to perform simply in order to increase the burden on the other party. And yet that appears to be the existing law, although it is true that the courts might yet be able to

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<sup>32</sup> *Hounslow London Borough Council v Twickenham Garden Developments Ltd* [1971] Ch 233; *Attica Sea Carriers Corp v Ferrostaal Poseidon Bulk Reederei GmbH (The Puerto Buitrago)* [1976] 1 Lloyd’s Rep 250; *Isabella Shipowner SA v Shagang Shipping Co Ltd* [2012] 2 All ER (Comm) 461, paras 37 to 41. But note that the decision of the majority in *Société Generale, London Branch v Geys* [2012] UKSC 63, [2013] 1 AC 523 is consistent with the decision in *White & Carter*. Lord Sumption’s powerful dissent is, however, based in part on Lord Reid’s co-operation qualification to the decision in *White & Carter*.

<sup>33</sup> See para 6.18 below.

<sup>34</sup> 1962 SC (HL) 1 at 14.

<sup>35</sup> See, for example, *Attica Sea Carriers Corp v Ferrostaal Poseidon Bulk Reederei GmbH* [1976] 1 Lloyd’s Rep 250; *Clea Shipping Corp v Bulk Oil International Ltd (The Alaskan Trader)* [1984] 1 ALL ER 129.

<sup>36</sup> 1985 SC 189.

<sup>37</sup> It seems from the opinion of Lord Ross that other litigation over the lease was, in any event, sisted behind this case.

<sup>38</sup> 1985 SC 189 at 194.

recognise exceptions to it. Almost all the consultees who responded on this issue considered that reform was desirable.”<sup>39</sup>

3.33 From a practical perspective, the concern was, and remains, that there is potential for abuse of the rule.

3.34 We noted two competing principles and assumptions: the first is that contracts should be performed; the second, that one party should not be permitted, by wasteful or unreasonable conduct, to increase the burden on the other party.<sup>40</sup> There was disagreement amongst judges and commentators about which should prevail.<sup>41</sup> The uncertainty created by this divergence of opinion and lack of clarity regarding the extent of the rule was the basis for our previous recommendation that:

“There should be legislation, designed to solve the problem revealed by *White & Carter (Councils) Ltd v McGregor*, to the effect that a party to a contract who has been told that performance under the contract is no longer wanted but who, being in a position to give performance without the co-operation of the other party, has proceeded to perform, is not entitled to recover payment for performance occurring after intimation that further performance is unwanted if (a) that party could have entered into a reasonable substitute transaction without unreasonable effort or expense or (b) it was unreasonable for that party to proceed with that performance.”<sup>42</sup>

3.35 That recommendation is based upon PECL, article 9:101(2), which is one of the predecessors of the DCFR. Indeed, had our recommendation been given effect then it appears to us that Scots law would be squarely aligned with the relevant DCFR provision on anticipated breach of a monetary obligation. As matters stand, we take the view that the continuing unmitigated application of the *White & Carter* principle is potentially anomalous, and may lead to absurd results. While these factors point towards the desirability of renewing our 1999 recommendation for reform, we think it would be appropriate first to review subsequent developments in Scots law before making any proposals on the matter.

#### *Subsequent developments in Scots law*

3.36 The leading case on anticipated breach in Scots law since 1999 is *AMA (New Town) Ltd v Law*.<sup>43</sup> In that case,<sup>44</sup> the purchasers had entered into missives to buy off-plan flats in a housing development being undertaken by AMA. The missives provided for a purchase price consisting of a deposit on reservation of the plot and a further deposit on conclusion of missives, with the balance payable at the date of entry. The missives provided a mechanism for determining the date of entry, and it was a matter of agreement that this clause triggered a date of entry at 23 September 2009. Entry and vacant possession were to be given and the keys released to the purchasers only on payment of the full purchase price (including any extras) and any interest due.

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<sup>39</sup> 1999 Report, para 2.6.

<sup>40</sup> 1999 DP, para 5.11.

<sup>41</sup> 1999 DP, para 5.11 fnn 21 and 22.

<sup>42</sup> 1999 Report, para 2.10 and recommendation 1.

<sup>43</sup> [2013] CSIH 61; 2013 SC 608; 2013 SLT 959.

<sup>44</sup> There were three appeals which were heard together. The defenders and respondents were respectively Mr Law, his wife and a company in which he had an interest. Mr Law’s case was treated as the primary case: see para 8.

3.37 At the date of entry, payment in terms of the missives was not made and the purchasers' agents advised AMA's agents that their clients were not in a position to proceed. A formal demand for payment was made but no payment was forthcoming. In these circumstances, AMA sued for payment of the balance of the purchase price, averring (which was admitted) that it was ready and willing to implement its obligations under the missives.

3.38 At first instance, the sheriff considered that AMA's arguments were well-founded, that the defences were irrelevant, and that AMA was entitled to decree *de plano*. However, he felt himself bound by a contrary decision of Sheriff Principal Bowen in *AMA (New Town) Ltd v McKenna*<sup>45</sup> and dismissed the action. On appeal to the Inner House, AMA was successful. An Extra Division held that the innocent party could accept the repudiation of the contract and seek damages, or refuse to accept it and seek implement—but the choice was that of the innocent party, and the party in default could not compel the innocent party to accept damages.<sup>46</sup>

3.39 Lady Dorrian, giving the leading judgment, indicated that the creditor's choice was not restricted except where circumstances rendered implement impossible or, in exceptional circumstances, wholly unjust.<sup>47</sup> Impossibility appears to encompass the notion of cooperation which is used to qualify the *White & Carter* principle in England:

“The exception recognised by Lord Reid was not based on any equitable considerations of not forcing a party to accept that which they no longer want. It was limited to the situation where the innocent party was unable to earn the contract price without the assent or co-operation of the other. That is echoed, in my view, by the Lord President in *Salaried Staff* when he said that an innocent party ‘cannot be compelled to resort to the alternative of an action of damages unless implement is shown to be impossible’.”<sup>48</sup>

3.40 However, the meaning of cooperation is not free from controversy, although its practical significance is evident: the debtor can prevent a claim for the contract price by simply withholding its cooperation, at least so far as it cannot be enforced by way of specific implement. So long as the debtor's cooperation is necessary for the creditor to perform in conformity with the terms of the contract, this is sufficient to prevent the creditor from affirming the contract and insisting upon performance.

3.41 In English law, the cooperation qualification has no application where the creditor's continuing performance is not a condition precedent to the payment of the contract price. As noted by Liu:

“[I]f the parties' performances are independent of each other, neither the victim's performance nor the contract-breaker's cooperation is necessary for the accrual of the obligation to pay the contract price.”<sup>49</sup>

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<sup>45</sup> *AMA (New Town) Ltd v McKenna* 2011 SLT (Sh Ct) 73.

<sup>46</sup> 2013 SC 608, para 46 per Lady Dorrian. See also para 1 per Lord Menzies.

<sup>47</sup> 2013 SC 608, para 48.

<sup>48</sup> 2013 SC 608, para 47.

<sup>49</sup> Liu, *Anticipatory Breach*, p 204.

3.42 A similar approach is also apparent in *AMA*. As Lady Dorrian observed, “[t]he terms of the contract are clear: payment was triggered by the date of entry and nothing else.”<sup>50</sup> The granting of a disposition providing a valid and marketable title was an independent obligation which was not conditional upon or contemporaneous with payment. While Scots law does not use the concept of conditions precedent (or subsequent), in *AMA*, the obligation to pay the final instalment was read as an independent obligation for which the debtor’s cooperation was not required. However, this would not always be the case. In *AMA*, the parties were contracting on builders’ missives. These do not accord with the usual practice in residential conveyancing<sup>51</sup> where the obligations would tend to be inter-dependent (i.e. to pay the price *in exchange for* a good and marketable title, a validly executed disposition and so on<sup>52</sup>). The direct impact of *AMA* may therefore principally be limited to contracts for the sale of new build properties, with inter-dependent obligations being more frequently encountered in practice elsewhere.<sup>53</sup>

3.43 Consideration of the law surrounding contracts for the sale of goods affords further illustration. Delivery by a seller generally requires cooperation by the buyer in accepting the goods. The obligation of the buyer to accept and pay the contract price of the goods is ordinarily a dependent obligation. The relevant contingency is the transfer of property in the goods to the buyer.<sup>54</sup> Accordingly, unless property has already passed,<sup>55</sup> or the price is payable on a certain day irrespective of delivery,<sup>56</sup> a refusal by the buyer to accept the goods will prevent recovery of the price by the seller.<sup>57</sup>

3.44 In summary, *AMA* has in our view adhered to the general *White & Carter* principle.<sup>58</sup> Its main advance is in setting out more clearly the extent to which Lord Reid’s cooperation qualification has a role in Scots law. While *AMA* has gone some way to clarify the circumstances in which a decree for payment for unwanted performance may be refused, the law in this area is still, in our view, unacceptably opaque.

#### *Options for reform*

3.45 The first option for reform would be to do nothing and allow the decision in *AMA* to bed in. The courts would be left to develop the law and possibly create further exceptions to the rule in favour of payment for unwanted performance. A potential disadvantage of this option is that there would remain a great deal of uncertainty in the interim, and there is no guarantee that the issue will be raised in the near future. Very few cases result in litigation,

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<sup>50</sup> 2013 SC 608, para 47. See also the English case of *Ministry of Sound (Ireland) Ltd v World Online Ltd* [2003] EWHC 2178 (Ch), paras 33 and 45.

<sup>51</sup> 2013 SC 608 at para 50 per Lady Dorrian “Usual practice” was the basis for the support given to the sheriff principal’s decision in *AMA (New Town) Ltd v McKenna* 2011 SLT (Sh Ct) 73 by W W McBryde and G L Gretton, “Sale of Heritable Property and Failure to Pay” 2012 SLT (News) 17.

<sup>52</sup> See the Scottish Standard Clauses (Edition 2), clause 18.1, available at <https://www.lawscot.org.uk/media/816883/Scottish-Standard-Clauses-Edition-2-.pdf>

<sup>53</sup> Although Professors Reid and Gretton had not had sight of the missives, they came to the conclusion that there was nothing to suggest that the missives were not in standard form. See K G C Reid and G L Gretton, *Conveyancing 2013* (2013), pp 124 to 131. However, we understand that the parties contracted using builders’ missives rather than the Combined Standard Clauses in force at the time.

<sup>54</sup> Sale of Goods Act 1979, s 49(1).

<sup>55</sup> Carter, *Breach of Contract*, paras 11.46 and 11.47.

<sup>56</sup> Sale of Goods Act 1979, s 49(2).

<sup>57</sup> See for example *Colley v Overseas Exporters* [1921] 3 KB 302.

<sup>58</sup> 2013 SC 608, paras 1 to 3 per Lord Menzies.

and many parties may be less inclined to pursue a claim if there is uncertainty about their chances of success.

3.46 Alternatively, we could reiterate our 1999 recommendation on this matter.<sup>59</sup> This would have the effect of aligning Scots law with the DCFR on the point. We think that there is merit in such an approach, and that the decision in *AMA* has not significantly altered the circumstances.

3.47 A number of other options were considered in our 1999 Discussion Paper, including the restoration of the law to the position it was in before *White & Carter*,<sup>60</sup> the adoption of the American model (where the creditor may continue to perform, subject to a duty to mitigate loss)<sup>61</sup> or the conferral on the court of a general discretion to refuse to grant a decree for payment for unwanted performance where it believes this would be unreasonable. For the reasons that we gave in 1999, we think that these options continue to be unattractive. We therefore ask:

- 14. Do consultees consider that there would be any merit in postponing reform on this point in the meantime to see how the decision in *AMA* is developed?**
- 15. Alternatively, do consultees consider that it would now be desirable to give effect to our 1999 recommendation and reform the law so that, where the creditor has not yet performed its obligation and it is clear that the debtor is unwilling to receive performance, the creditor may nonetheless proceed and recover payment unless:**
  - (a) the creditor could have made a reasonable substitute transaction without significant effort or expense; or**
  - (b) performance would be unreasonable in the circumstances?**

#### **Potential reforms: withholding performance**

3.48 In our 1999 Report, we considered that it was not necessary to legislate for withholding performance in response to anticipated breach, on the basis that the courts would likely recognise such a possibility should it arise.

3.49 We are not aware, however, of any decision of the Scottish courts on a creditor withholding its own performance in response to anticipated breach, and the possibility is not mentioned directly in McBryde's treatments of anticipatory breach, withholding performance or retention.<sup>62</sup> Nor is it mentioned in the account of retention in the Stair Memorial

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<sup>59</sup> See para 3.34 above.

<sup>60</sup> 1999 DP, para 5.14.

<sup>61</sup> 1999 DP, para 5.15. For a comparative discussion of US law preferring the approach in *White & Carter* provided that the creditor *must* show a legitimate interest in not accepting the debtor's repudiation, see M P Gergen, "The Right to Perform after Repudiation and Recover the Contract Price in Anglo-American Law", in L A DiMatteo and M Hogg (eds), *Comparative Contract Law: British and American Perspectives* (2015) ch 16. David Campbell provides a response to Gergen's analysis, questioning the result in *White & Carter* itself on the basis of the 'legitimate interest' test (at pp 338 to 341).

<sup>62</sup> See McBryde, *Contract*, ch 20, Parts 7 to 9. See however para 20.33 for a possible indirect reference.

Encyclopaedia.<sup>63</sup> Given the lack of such a decision in nearly 20 years since the 1999 Report was prepared, we now tend to think that legislative clarification could be useful here. It would be possible not only to recognise that a creditor may withhold its performance in response to anticipated breach, but to enable a creditor to seek clarification of the debtor's position where the creditor has reasonable doubts about the debtor's intention to perform.

3.50 In *GL Group plc v Ash Gupta Advertising Ltd*,<sup>64</sup> for example, AG became doubtful of GL's ability to pay for services rendered under a contract and sought immediate payment, also stating that if GL failed to make payment by a certain deadline, AG "would have no alternative but to resile from the contract".<sup>65</sup> The upshot of this was that AG was found to have wrongfully repudiated the contract and was held liable in damages. While we think the case correctly decided on its particular facts, it might have been helpful had the law provided a means of seeking or obtaining assurances of performance from GL while withholding AG's own performance. This would perhaps have been more effective anyway than demanding immediate payment of sums not yet due and threatening to resile if it was not made.

3.51 Enabling a creditor to act in the ways mentioned may also mean that the debtor can retract what might otherwise amount to anticipated breach. Termination will only be possible if the debtor fails to respond to a request for an assurance of performance. As McBryde remarks, making it possible for the debtor to retract "accords with the philosophy that whenever possible the law should encourage implementation of a contract".<sup>66</sup> We therefore ask:

- 16. Do consultees agree that the law should provide that a creditor may respond to indications of the debtor's unwillingness or inability to perform its obligations as and when they fall due under the contract by either:**
  - (a) notifying the debtor of its concerns and that it is going to withhold performance of its own obligations, while empowering the debtor to end the withholding by sending the creditor an adequate assurance that it will perform its obligation when the time comes; or**
  - (b) seeking an adequate assurance directly from the debtor, being thereby entitled to withhold its performance until such assurance is received, and becoming entitled to terminate the contract if one is not received within a reasonable time?**

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<sup>63</sup> *SME, Remedies* para 96.

<sup>64</sup> 1987 SCLR 149.

<sup>65</sup> 1987 SCLR 149 at 151.

<sup>66</sup> McBryde, *Contract*, para 20.35.

# Chapter 4 Termination

## Introduction

4.1 Rescission for material breach of contract is the second generally available self-help remedy for breach of contract in Scots law. Its DCFR equivalent is termination. In this Chapter, we begin with questions of terminology, before comparing the concepts of rescission and termination. We also look at the relationship between the use of ultimatums in Scots law and the provisions of the DCFR that allow a creditor to fix an additional period for performance. We are further aware of potential issues with restitution after a contract is terminated, and so we conclude by examining this area.

## Terminology

### *Rescission, resiling and termination*

4.2 In Scots law, “rescission” is a remedy used to bring a contract to an end. The concept involves a party declaring that it is no longer bound under a contract, so that it may lawfully refuse to carry out its obligations under the contract.<sup>1</sup>

4.3 The difficulty that arises in relation to this term is that it applies in more than one situation. The most commonly-encountered sense is that of a party wishing to rescind a contract due to a material breach on the part of another party to that contract.<sup>2</sup> However, another closely related remedy exists: rescission *ab initio*, which involves unwinding a contract as if it had never existed. That remedy may be used when a party wishes to escape a contract which is voidable because of its own error or misrepresentation by the other party.<sup>3</sup> If necessary, the remedy is obtained by raising an action of reduction, but *restitutio in integrum* must be possible before reduction is possible.<sup>4</sup> This remedy may also be refused on grounds such as the acquisition of relevant third party interests or delay by the party seeking the remedy.<sup>5</sup>

4.4 There is accordingly scope for confusion between the two forms of rescission. For example: is rescission for material breach of contract only available if *restitutio in integrum* is possible? May rescission for material breach be refused on equitable grounds? Is the effect of rescission for material breach the avoidance of the contract? The answer to all these questions seems to us to be no, but it needs some elaboration to say precisely why.

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<sup>1</sup> *SME, Remedies* para 94.

<sup>2</sup> *SME, Remedies* para 95.

<sup>3</sup> See e.g. *Macleod v Kerr* 1965 SC 253. This case involved the sale of a car to a person who misrepresented himself and was in fact an imposter. When the cheque used to pay for the car was dishonoured, the imposter had driven off in the car and the seller sought to rescind. It was held that contacting the police did not amount to rescission *ab initio*. Contrast the near contemporaneous English decision, *Car & Universal Finance Co v Caldwell* [1965] 1 QB 525, on which see also W A Wilson, “Dial 999 for Rescission”, (1964) 27 MLR 472.

<sup>4</sup> McBryde, *Contract*, para 20.05.

<sup>5</sup> *SME, Remedies* para 94.

4.5 In our view, it is not conducive to coherent and accessible law to have the same name for remedies operating in distinct contexts, as is the case here. In any event (as we noted above<sup>6</sup>), “rescission” is not a word which is in widespread use. Its meaning is likely to be obscure to lay persons.

4.6 Another word commonly used to denote parties bringing a contract to an end is “resile”. Again, this is not a word in widespread use except by Scots lawyers. It denotes withdrawal from an obligation which has been improperly constituted, or as a catch-all expression to signify lawful withdrawal from a contract which is not in response to breach or anticipated breach.<sup>7</sup> An example is where a contract provides that one party must obtain permission to do something by a certain date, and if it does not, either one or both parties may resile.<sup>8</sup> Such a failure to obtain permission cannot properly be characterised as a material breach which justifies rescission and damages.<sup>9</sup> However, confusion may arise if the term “resiling” is deployed when there is a material breach and subsequent rescission.<sup>10</sup>

4.7 It appears to us that it would be desirable to distinguish more clearly between contracts which are brought to an end as a result of a breach, and those which are brought to an end for other reasons. The current terminology for these distinct situations is outdated and potentially confusing, but we think that assistance may be derived from the DCFR, which uses separate terms to describe these situations.

4.8 In relation to contracts which are brought to an end as a result of a breach, we tentatively suggest that the term “termination”, as used in the DCFR, may be a suitable alternative. The DCFR says that:

“Termination’, in relation to an existing right, obligation or legal relationship, means bringing it to an end with prospective effect except in so far as otherwise provided.”<sup>11</sup>

Termination in the DCFR sense appears sufficiently broad to encompass rescission for material breach in Scots law. That said, it would appear to go significantly further and would also encompass situations where a contract was frustrated, where the obligations under a contract were brought to an end by prescription or, indeed, where parties agreed to end the contract.

4.9 Termination does not, however, strike us as being sufficiently broad a term to describe all of the ways in which a contract may be brought to an end. In particular, we note that obligations can be extinguished (indeed, this may be the most common way) as a result of the performance or payment required under the particular contract. In these circumstances, a more appropriate word may be “extinction”.

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<sup>6</sup> See paragraph 1.40 above.

<sup>7</sup> McBryde, *Contract*, para 20.04.

<sup>8</sup> McBryde, *Contract*, para 20.04.

<sup>9</sup> McBryde, *Contract*, para 20.04.

<sup>10</sup> McBryde, *Contract*, para 20.04.

<sup>11</sup> DCFR Annex, p 568.

4.10 When contracts are brought to an end as the result of failure of a condition to be fulfilled, the resulting end of the contract cannot adequately be described by termination. Traditionally, the term “resile” is used. This concept appears to correspond more closely to the term “withdraw”, which may be more appropriate and intelligible. In the DCFR:

“A right to ‘withdraw’ from a contract or other juridical act is a right, exercisable only within a limited period, to terminate the legal relationship arising from the contract or other juridical act, without having to give any reason for so doing and without incurring any liability for non-performance of the obligations arising from that contract or juridical act.”<sup>12</sup>

4.11 Accordingly, we think that there might be some utility in replacing the terms “rescission” and “resile”, with “termination” and “withdraw” respectively, alternatives which are (we think) more intelligible and more likely to be understood by the general public. It would of course be necessary to have a saving for those existing contracts in which the words “rescission” and “resile” have been used. That said, we ask:

**17. Do consultees consider that:**

- (a) “rescission” should be replaced with “termination”?
- (b) “resile” should be replaced with “withdraw”?

*Breach: material, fundamental or substantial?*

4.12 While contracting parties can of course provide expressly for when a contract may be terminated for breach (or indeed otherwise), the default position is that a breach must be “material” or non-performance “fundamental” before the remedies of rescission and termination are available. Both adjectives are intended to denote a situation in which the debtor’s activity (or inactivity) undermines the basic purpose of the contract to such an extent as to justify bringing the contract to an end. In *Wade v Waldon*,<sup>13</sup> the Lord President (Dunedin) saw the matter as more about the terms of the contract than about the breach:

“It is familiar law, and quite well settled by decision, that in any contract which contains multifarious stipulations there are some which go so to the root of the contract that a breach of those stipulations entitles the party pleading the breach to declare that the contract is at an end. There are others which do not go to the root of the contract, but which are part of the contract, and which would give rise, if broken, to an action of damages. I need not cite authority upon what is trite and very well settled law.”<sup>14</sup>

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<sup>12</sup> DCFR Annex, p 569. See also DCFR II.–5:101 to 5:105.  
<sup>13</sup> *Wade v Waldon* 1909 SC 571.  
<sup>14</sup> 1909 SC 571 at 576.

But McBryde points out:

“Scots law ... looks at the nature of the breach, and its concept of ‘material breach’ does not depend on a classification of the terms of the contract, even although it is common to ask whether a particular stipulation goes ‘to the root’ or not.”<sup>15</sup>

“The question is the nature of the breach rather than its consequences, although these may illustrate materiality. A material breach does not mean that there must be a material loss.”<sup>16</sup>

He goes on to comment:

“The nature of the breach should be judged objectively, rather than according to the intention of the party in breach. Good faith is not a defence to a claim for a breach of a mercantile contract”.<sup>17</sup>

However, McBryde also takes the view that “[t]he phrase ‘material breach’ is unfortunate, in that no breach of contract is immaterial.”<sup>18</sup> He thinks that the phrase has a meaning “nearer to substantial breach”,<sup>19</sup> although equally we wonder whether any breach of contract can be said to be insubstantial. Performance even one minute late could justify termination where time is of the essence.

4.13 The DCFR says that a non-performance is “fundamental” if:

“(a) it substantially deprives the creditor of what the creditor was entitled to expect under the contract, as applied to the whole or the relevant part of the performance, unless at the time of conclusion of the contract the debtor did not foresee and could not reasonably be expected to have foreseen that result; or

(b) it is intentional or reckless and gives the creditor reason to believe that the debtor’s future performance cannot be relied on.”<sup>20</sup>

4.14 It appears to us that the method for determining whether a breach is material in Scots law is similar to that of determining whether something falls under the heading of fundamental non-performance for (a) above in the DCFR. “Fundamental non-performance” and “substantial breach” are also arguably more meaningful descriptions than “material breach”. In particular, “fundamental” might be seen as a more useful term, especially when the former doctrine of fundamental breach in English law was long ago laid to rest by the House of Lords.<sup>21</sup> “Fundamental” fits neatly with Lord President Dunedin’s dictum about breach going to the root of the contract. Its deployment would also allow the use of “material” to describe the lesser kind of breach justifying retention but not rescission, should that be consultees’ preference on the question raised in Chapter 2.

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<sup>15</sup> McBryde, *Contract*, para 20.93.

<sup>16</sup> McBryde, *Contract*, para 20.94.

<sup>17</sup> *Ibid.*

<sup>18</sup> McBryde, *Contract*, para 20.91.

<sup>19</sup> McBryde, *Contract*, para 20.91.

<sup>20</sup> DCFR III.–3:502(2). Fundamental non-performance is defined in substantially similar terms in PECL art 8:103 and PICC art 7.3.1(2). The McGregor Code (para 306) allows termination for “substantial” breach, which is total non-performance or such other failure as to make unreasonable the innocent party’s continuation of performance.

<sup>21</sup> In *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827.

4.15 We acknowledge that whatever adjective is used the courts will most likely approach the question by asking whether or not the breach justifies termination. But language can be important in giving persons without legal advice guidance on exercise of the self-help remedy of termination. Accordingly, we ask:

- 18. Should the term “fundamental breach” or “substantial breach” be adopted in place of “material breach” as the term for the kind of breach which justifies termination of a contract?**

4.16 In our Advisory Group reference was made to the problem of “persistent non-material breaches”, none of which individually justifies rescission. While solutions to this problem are often the subject of express contractual provision allowing for termination, or provided by use of the ultimatum procedure discussed below,<sup>22</sup> it might be helpful to have some default rule on the subject. We therefore ask:

- 19. Should persistent non-material breaches be treated as a breach justifying termination?**

### **The DCFR and Scots law compared**

4.17 As we note above, under the DCFR termination is available as a remedy if the debtor’s non-performance is fundamental.<sup>23</sup> In Scots law, rescission for breach is possible only if the breach is material.

4.18 The DCFR further provides that where the debtor’s obligations under the contract are not divisible the creditor may only terminate the contractual relationship as a whole.<sup>24</sup> It also provides for partial termination where a contract is to be performed in several parts or is otherwise divisible. If there is fundamental non-performance in relation to a part to which the counter-performance can be apportioned, the aggrieved party can terminate in relation to that part. Termination of the whole contract can only follow if the creditor cannot reasonably be expected to accept performance of the other parts or there are grounds for termination in relation to the contract as a whole.<sup>25</sup> Scots law does not seem to have developed any rule equivalent to this partial termination of a divisible (or separable) contract, although we understand that this may occasionally be provided for by bespoke drafting in the contract. The issue of whether mutuality affects the whole of a contract or only specifically inter-dependent obligations may have a bearing on this point.<sup>26</sup>

- 20. If a general statutory restatement is pursued, should it provide for a right of partial termination where the obligations under a contract are separable?**

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<sup>22</sup> See paras 4.22 to 4.26 below.

<sup>23</sup> DCFR III.–3:502(1).

<sup>24</sup> DCFR III.–3:506(1).

<sup>25</sup> DCFR III.–3:506(2). See also PECL art 9:302.

<sup>26</sup> See paras 2.7 to 2.15 above.

4.19 Under the DCFR, the right to terminate must be exercised by notice to the other party.<sup>27</sup> No court action by the aggrieved party is required to terminate the contract, nor is there any period of grace. This is consistent with Scots law, of which McBryde remarks:

“[i]n principle, intimation of some kind is necessary for rescission and rescission cannot take effect until it is intimated.”<sup>28</sup>

4.20 Notice under the DCFR should be given within a reasonable time after a late tender of performance or a tender that otherwise does not conform to the contract of which the creditor has become, or could reasonably be expected to have become, aware; otherwise the creditor loses the right to terminate.<sup>29</sup> Likewise in Scots law a right to rescind which is not exercised within a reasonable time will be lost.<sup>30</sup>

**21. If a general statutory restatement is pursued, should it provide for a creditor to terminate the contract within a reasonable time after material (or substantial or fundamental) non-performance by the debtor?**

4.21 The DCFR provides that on termination the outstanding obligations or the relevant part of the outstanding obligations of the parties under the contract come to an end.<sup>31</sup> This is consistent with Scots law.<sup>32</sup> Termination does not, however, affect any provision of the contract for the settlement of disputes or other provision which is to operate even after termination; this is again consistent with Scots law.<sup>33</sup> Termination is thus basically prospective rather than retroactive.<sup>34</sup> The terminating creditor also retains existing rights to damages or stipulated payments for non-performance.<sup>35</sup> There seems nothing inconsistent with Scots law principles in these rules.

**22. We invite comment on:**

**(a) a requirement that the creditor notify termination to the debtor; and**

**(b) the need for the law to specify the prospective effects of termination.**

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<sup>27</sup> DCFR III.–3:507. For “notice” see para 11.23 to 11.25 below. See also PECL art 9:303; PICC art 7.3.2.

<sup>28</sup> McBryde, *Contract*, para 20.107.

<sup>29</sup> DCFR III.–3:508(1).

<sup>30</sup> McBryde, *Contract*, para 20.121 and cases cited in fn 418.

<sup>31</sup> DCFR III.–3:509(1); PECL art 9:305; PICC art 7.3.5.

<sup>32</sup> McBryde, *Contract*, para 20.109.

<sup>33</sup> McBryde, *Contract*, paras 20.108 (liquidate damages clauses), 20.110 to 20.115 (arbitration clauses). See also now Arbitration (Scotland) Act 2010 s 5.

<sup>34</sup> The DCFR avoids the unfortunate use of the word “avoidance” which obscures the nature of the remedy of termination under both ULIS and the CISG, at least in their English-language versions. It also leaves it unclear whether the consequence is automatic or requires the innocent party to take steps. The McGregor Code (para 307), in an echo of the 1960s doctrine of “fundamental breach” in English law, provides for automatic termination.

<sup>35</sup> McBryde, *Contract*, para 20.119. In addition under the DCFR III.–3:509(3) the creditor has the same right to damages or a stipulated payment (i.e. a penalty) for non-performance as it would have had if there had been non-performance of the debtor’s now extinguished obligations. With regard to these extinguished obligations the creditor is not to be regarded as having caused or contributed to the loss suffered merely by exercising the right to terminate. Commentary E to the article explains this provision, with hypothetical illustrative examples. The comparative notes do not point to any other system in which such rules are recognised, however, and our Advisory Group harboured doubts about them. We therefore do not consult upon them. The losses referred to in the provision might be recoverable as consequential upon the breach leading to termination. Any penalty clause would be subject to whatever system of rules applies to such clauses: see our Discussion Paper No 162.

## Potential reforms

### *Notice fixing additional period for performance*

4.22 As a balance to the debtor's right of cure (which we discuss in Chapter 5<sup>36</sup>), the DCFR allows the creditor to give notice to the non-performing debtor of an additional period of time for performance.<sup>37</sup> This is inspired by the German *Nachfrist* procedure. During the additional period notified by the creditor, the creditor may withhold performance of its reciprocal obligations and claim damages for any loss incurred, but may not resort to any other remedy. If the creditor is notified by the debtor that it will not perform during that period, or if upon expiry of the period due performance has not been made, the creditor may resort to any available remedy.<sup>38</sup>

4.23 In particular, a creditor may terminate in a case of delay in performance of a contractual obligation which is not in itself fundamental if the notice fixes an additional period of time of reasonable length and the debtor does not perform within that period.<sup>39</sup> If the period fixed is unreasonably short, however, the creditor may terminate only after a reasonable period from the time of the notice.<sup>40</sup> Where the notice provides for automatic termination if the debtor does not perform within the period fixed by the notice, termination takes effect after that period or a reasonable length of time from the giving of notice (whichever is longer) without further notice.<sup>41</sup> The procedure lets the issuer withhold performance and then, when there is still non-performance at the end of the ultimatum period, terminate.

4.24 Scots law recognises an ultimatum procedure by which a breach which initially does not justify termination may be made so by the expiry of a period of time notified to the debtor by the creditor.<sup>42</sup> The leading case is *Rodger Builders Ltd v Fawdry*,<sup>43</sup> in which the purchaser of heritable property did not pay the price on the due date of 11 November 1947. On 25 November the seller gave the purchaser three days within which to pay, intimating that if he did not pay the seller would regard the contract as void and himself as free to resell. On expiry of the three-day period, the seller resold. The purchaser sought reduction of the resale. It was held that unless time was made of the essence of the contract, failure to pay was not a material breach entitling the seller to rescind. But if payment was delayed, the seller could limit the time to pay to a reasonable period after which failure to pay would become a breach of a material condition entitling the seller to rescind.

4.25 The ultimatum procedure is in common use in conveyancing transactions with respect to failures to pay the price, and our Advisory Group told us that it is also usual for commercial contracts to make some provision on the matter. It has not been confined to

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<sup>36</sup> At paras 5.8 to 5.13 below.

<sup>37</sup> DCFR III.–3:103(1).

<sup>38</sup> DCFR III.–3:103(2). See also PICC art 7.1.5; PECL art 8:106. For antecedents see ULIS arts 27, 31, 44, 62; CISG arts 47, 63.

<sup>39</sup> DCFR III.–3:503(1).

<sup>40</sup> DCFR III.–3:503(2).

<sup>41</sup> DCFR III.–3:507(2).

<sup>42</sup> Where the breach is clearly material, no ultimatum need be used: see for example *Persimmon Homes v Bellway Homes* [2011] CSOH 149, [2012] CSOH 60, para 18 (Lord Drummond Young).

<sup>43</sup> *Rodger (Builders) Ltd v Fawdry* 1950 SC 483. Compare the Scottish Standard Clauses (which are used for the purchase and sale of residential property), cl 12 and 13.

breaches of payment obligations and is sometimes linked to giving the debtor an opportunity to remedy defective performance.<sup>44</sup> The ultimatum procedure is closely akin to the cure procedure, but in fact serves a different purpose. The ultimatum procedure converts a non-material breach into a material breach to justify rescission while the cure procedure prevents termination in response to a breach which may or may not be material.

4.26 An ultimatum procedure by which termination of the contract may be justified is obviously useful in practice. The DCFR adds some detail by comparison with Scots law at present. We ask accordingly:

- 23. If a general statutory restatement is pursued, should it provide for an ultimatum procedure by which a non-material breach of contract could lead to termination of the contract by the creditor who had previously notified the debtor of a reasonable period of time within which the latter must perform the obligation in question?**
  
- 24. If so, should it also provide that:**
  - (a) during the period of the notice the creditor is entitled to withhold its performance and may claim damages for the period of delay;**
  
  - (b) the notice may provide for automatic termination by non-performance at the end of the notified period; and**
  
  - (c) if the notice period is unreasonably short, termination (whether automatic or requiring further notice to the debtor) can take place only at the end of a reasonable period of time?**

#### *Restitution after termination*

4.27 Despite the basically prospective nature of termination, the DCFR also provides more generally for rights of restitution on termination of any benefit from the other party's performance of obligations under the terminated contract (or terminated part thereof).<sup>45</sup> Restitution is not required, however, to the extent that conforming performance by one party has been met by conforming performance by the other, or where the contract was gratuitous.<sup>46</sup> The remedy arises, therefore, only where at the point of termination for non-performance by the debtor, some performance has been rendered by one party but not met at all, or not fully met, by the reciprocal performance of the other party.<sup>47</sup> The remedy's aim is the redress of economic imbalances resulting from the termination.

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<sup>44</sup> See eg *McLennan v Warner & Co* 1996 SLT 1349; McBryde, *Contract*, paras 20.128 to 20.131.

<sup>45</sup> DCFR III.–3:510. The DCFR's restitution regime also applies to "excused non-performance" (i.e. frustration: see para 1.18 above) but we consider the matter here only in the context of termination for breach. For arguments that "there are, in principle, no fundamental differences between void, avoided, terminated and frustrated contracts regarding restitution, as long as the preliminary question that restitution should be granted is answered positively", and that "the way forward may be to separate restitution after failed contracts from the traditional categories of contract and unjustified enrichment in favour of an independent area of law", see S Meier, "Unwinding Failed Contracts: New European Developments" (2017) 21 Edin LR 1 (quotations at pp 28 and 29 respectively). We do not address such questions here.

<sup>46</sup> DCFR III.–3:511.

<sup>47</sup> For the concept of reciprocity of obligations within a contract in the DCFR, see para 2.7 above.

4.28 In such circumstances, restitution of an unreciprocated performance may be applied for by any party to the contract. Both the terminating creditor and the debtor may have rendered performances before the termination. The terminating party may elect to treat performance received as non-conforming if what was received is rendered of no, or of fundamentally reduced, value to that party by virtue of the non-performance by the other party giving rise to the termination.<sup>48</sup> This is however to view matters from the creditor's perspective only. There may still be something—money, property, the benefit of a service—in the hands of the creditor which the debtor would not have handed over unless it was to receive the creditor's full performance in return. Each party may therefore be required to make restitution. An illustration of the situation may be the sale of a faulty vehicle. The buyer is entitled to terminate and reclaim the price, but must also return the vehicle to the seller.

4.29 If the relevant performance was a payment of money, the amount received is to be returned. If a non-money benefit (such as the vehicle in the example just given) remains transferable, it is to be returned unless the transfer would cause unreasonable effort or expense, in which case its value is to be paid instead. If the benefit is non-transferable, its value is to be paid.<sup>49</sup> The obligation to return a benefit extends to its natural or legal fruits.

4.30 The initial recipient of the benefit is however obliged to pay a reasonable amount for any use made of it,<sup>50</sup> while also being entitled to payment of the value of any improvements made to the benefit which the other party can readily obtain by dealing with it.<sup>51</sup> The entitlement to payment for improvements flies off, however, if (a) the improvement was a non-performance of an obligation which the recipient owed to the other party; or (b) the recipient made the improvement knowing, or could reasonably be expected to know, that the benefit would have to be returned.

4.31 With regard to Scots law, our 1999 Report concluded that the redressing of economic imbalances caused by rescission of a partly performed contract should be left to the law on unjustified enrichment rather than be regulated by a general statute on remedies for breach of contract.<sup>52</sup> In 2007, however, McBryde noted that there had been a considerable amount of writing on the subject of unjustified enrichment and breach of contract and that “[t]here is not unanimity either as to what the law is, or as to what the law should be.”<sup>53</sup>

4.32 In the most recent judicial consideration of the question, Lord Tyre held that a party to a contract who has made payment in anticipation of a counterpart performance which never occurs has a remedy of restitution in Scots law. He also noted the absence of consensus amongst commentators as to the legal basis for this remedy, observing that in his

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<sup>48</sup> DCFR III.–3:511(2).

<sup>49</sup> For rules on valuing a benefit see DCFR III.–3:512. For liabilities arising after the time when return was due, see DCFR III.–3:514.

<sup>50</sup> DCFR III.–3:513(1). Cf the Consumer Rights Act 2015, s 24(8) to (11), which allows a limited deduction from refund of the price to take account of a consumer's use of rejected goods.

<sup>51</sup> DCFR III.–3:513(2).

<sup>52</sup> 1999 Report, para 7.23.

<sup>53</sup> McBryde, *Contract*, para 20.132. To the works he cites should be added S Miller, “Unjustified Enrichment and Failed Contracts”, in R Zimmermann, D Visser and K Reid (eds), *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (2004), ch 15; R Evans-Jones, *Unjustified Enrichment Volume 1: Enrichment by Deliberate Conferral: Condictio* (2003), paras 6.97 to 6.123.

view it did not depend upon the law of unjustified enrichment (in particular, upon the *condictio causa data causa non secuta*).<sup>54</sup>

4.33 We think it clear in principle that where parties have rendered performances under a contract but not received the reciprocal counter-performances, and the contract is then terminated, there should be restitution of the performances in question. This remedy is reciprocal, that is available if appropriate to both the creditor and the debtor in the other breach obligations. We do not propose to go over the various doctrinal arguments on this subject once again. Instead we ask:

- 25. Do consultees agree that where parties have rendered conforming performances under a contract but not received the reciprocal counter-performances, there should be reciprocal restitution of the uncompleted performances after termination for breach?**
- 26. If so, does the system of rules set out on this matter in the DCFR provide a satisfactory approach to the issue?**
- 27. Alternatively, do consultees consider that the law in this area should be left to develop, particularly as to the relationship between breach of contract and unjustified enrichment?**

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<sup>54</sup> *Stork Technical Services (RBG) Ltd v Ross's Executor* [2015] CSOH 10A, 2015 SLT 160, paras 33, 34.

# Chapter 5 Other self-help remedies

## Introduction

5.1 As we discuss in Chapter 2 and Chapter 4, Scots law has two generally available self-help remedies: retention, and rescission for material breach. It also recognises other self-help remedies, but only in limited contexts such as consumer contracts.

5.2 The DCFR also recognises other self-help remedies, though unlike Scots law it does not confine them to the consumer context. These are known as price reduction and cure. Cure exists in two different forms: the debtor's right to cure non-performance, and the creditor's right to have non-conforming performance remedied. In this Chapter, we consider the nature of the DCFR remedies, the extent to which they are recognised in Scots law, and potential reforms that might be considered.

## Price reduction

### *The DCFR and Scots law compared*

5.3 The DCFR allows a remedy of price reduction, and distinguishes it from damages.<sup>1</sup> A party who accepts a non-conforming performance may reduce the price by a sum proportionate to the decrease in value of the performance at the time of tender. If the contract price has been paid, the excess may be recovered from the other party. Use of the price reduction remedy precludes damages for reduction in value but not for any further loss which may have been suffered.

5.4 Scots law once knew a remedy of this kind in the law of sale, terming it the *actio quanti minoris*.<sup>2</sup> A purchaser who received defective property from the seller could, while retaining the goods, seek reduction of the price to the property's actual value as it stood rather than damages reflecting the difference in value. The likeliest reason for the rejection of the remedy in the nineteenth century<sup>3</sup> was because it was misunderstood as providing a remedy wherever property sold was said not to be worth the price paid or to be paid for it (*laesio enormis*).<sup>4</sup> Properly understood as a remedy where the property as sold was not conform to contract, the outcome might have been different, but the rule against the *actio quanti minoris* remained part of Scots contract law until it was abolished by section 3 of the Contract (Scotland) Act 1997. The difficulty, at least so far as self-help remedies are

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<sup>1</sup> DCFR III.–3:601. See also ULIS arts 41, 44 and 46; CISG art 50; PECL art 9:401.

<sup>2</sup> See generally SLC Discussion Paper No 97 *Contract Law: Extrinsic Evidence, Supersession, and the Actio Quanti Minoris* (1994), Part V; R Evans-Jones, "The History of the Actio Quanti Minoris in Scotland" 1991 JR 190; A L Stewart, "The Actio Quanti Minoris" (1966) 11 JLSS 124. Evans-Jones points out that Scots law embraced two distinct claims under the name *actio quanti minoris*: one the price reduction remedy discussed in the text, the other the right of the buyer of defective property to retain the object and claim damages for the defect. It was probably as a result of consequent confusion that in the nineteenth century the *actio* was rejected by the courts, thereby denying the purchaser both the price reduction remedy and damages unless the contract was rescinded. This "monstrous" rule was abolished by the Contract (Scotland) Act 1997 s 3, implementing our Report on Three Bad Rules in Contract Law (Scot Law Com No 152, 1996) Part IV.

<sup>3</sup> See *McCormick v Ritttyer* (1869) 7 M 854 at 848, per the Lord President (Inglis).

<sup>4</sup> Evans-Jones, "The History of the Actio Quanti Minoris in Scotland", 1991 JR 190 at 196 to 206.

concerned, is that section 3 appears only to relate to the application of the rule to judicial remedies, abolishing it so far as it prevents the purchaser obtaining damages for breach of contract.

5.5 Price reduction is, however, now a consumer remedy available under the Consumer Rights Act 2015 (the 2015 Act).<sup>5</sup> It was introduced in 2003, implementing an EU Directive.<sup>6</sup> As with the DCFR, it is available only if the goods, digital content or services (as the case may be) do not conform to the contract. The remedy is an alternative to the final right to reject. It arises only if (a) in the case of goods, the supplier has made one unsuccessful effort to cure the non-performance; or (b) the consumer cannot require cure; or (c) cure has not been effected within a reasonable time or without significant inconvenience to the consumer. The remedy may be effected by a reduction in what the consumer has to pay or a refund by the supplier, and the price may be taken down to nil. There seems to have been as yet no significant judicial discussion of the remedy in the United Kingdom or the Court of Justice of the European Union.

#### *Potential reform*

5.6 The main advantage which we can see in a price reduction remedy (distinct from damages) is the self-help possibility of deducting sums from payments due, a remedy often explicitly provided for in commercial contracts. It provides a practical alternative to suing when either there is no right to terminate because the non-performance is not fundamental, or when the right to terminate has been lost through lapse of time.<sup>7</sup>

5.7 The question for Scots law therefore is whether what is presently a consumer remedy should be extended to contracts in general and not restricted to ones for the supply of goods, digital content and services to consumers. It may be thought that there is as yet insufficient knowledge of how the consumer remedy operates in practice to justify its wider extension. Our Advisory Group thought that the remedy had not yet been often invoked. The consultation process may however enable us to gather further information on the use of the consumer remedy and to see whether there is any demand for or utility in anything similar in the non-consumer context. We accordingly ask:

- 28. Should a price reduction remedy along the lines of that provided in sections 24, 44 and 56 of the Consumer Rights Act 2015 also be provided for non-consumer contracts in general?**
- 29. Do consultees have any information or data about the use of this remedy in a consumer context?**

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<sup>5</sup> 2015 Act ss 24 (supply of goods), 44 (digital content), 56 (services). An earlier price reduction remedy can be found in Council Directive (EEC) 90/314 (as replaced by European Parliament and Council Directive 2015/2302), implemented in the UK by the Package Travel, Package Holidays and Package Tours Regulations (SI 1992/3288) reg 11 (implementing recital 34 and Article 14(1) of the Directive).

<sup>6</sup> See section 48C of the Sale of Goods Act 1979 (as inserted by the Sale and Supply of Goods to Consumers Regulations 2002). Section 48C implemented Article 3 of Directive 1999/44/EC of the European Parliament and of the Council of 25th May 1999 on certain aspects of the sale of consumer goods and associated guarantees (OJ No. L171 7.7.99, p 12).

<sup>7</sup> See para 4.20 above.

## Debtor's right to cure non-performance

### *The DCFR and Scots law compared*

5.8 Under the DCFR, a debtor may cure an initially non-conforming performance in certain circumstances.<sup>8</sup> The simplest form is (if it can be done within the time allowed for performance) for the debtor to make a new and conforming tender.<sup>9</sup> Alternatively, if it is not possible to make a new and conforming tender within the time allowed for performance, the debtor may offer to cure it within a reasonable time and at its own expense.<sup>10</sup> The offer must be made promptly after being notified of the lack of conformity. In the latter case, the creditor may not pursue any remedy for non-performance other than that of withholding its own performance without allowing the debtor a reasonable period within which to attempt the cure.<sup>11</sup> The creditor's right to use any remedy revives upon the debtor's failure to effect cure within the time allowed.<sup>12</sup> The right to terminate will be exercised by the creditor giving the debtor notice to that effect,<sup>13</sup> but will be lost if the notice is not given within a reasonable time from the date of expiry of the period for cure.<sup>14</sup>

5.9 Even if the cure is successful, the creditor retains the right to damages for any loss caused by the debtor's initial or subsequent non-performance or by the process of effecting cure.<sup>15</sup> Where the debtor effects cure by replacement of an item, it has a right and an obligation to take back the replaced item at its own expense.<sup>16</sup> Finally, the creditor is not obliged to pay for any use made of the replaced item in the period prior to the replacement.<sup>17</sup>

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<sup>8</sup> The right to cure has antecedents in ULIS (art 44) and the CISG (arts 46(3), 48). Both PECL (art 8:104) and PICC (art 7.1.4) recognise the possibility that a non-performing party may tender a cure, but have rather different versions of the right. The debtor cannot seek to cure a total non-performance.

<sup>9</sup> DCFR III.-3:202(1).

<sup>10</sup> In Chapter 4, we considered the corresponding ability of the creditor to fix an additional time for performance under the DCFR (see paras 4.22 and 4.23 above) and the ultimatum procedure found in Scots law (see paras 4.24 to 4.26 above).

<sup>11</sup> DCFR III.-3:202(2), III.-3:204(1).

<sup>12</sup> DCFR III.-3:204(2).

<sup>13</sup> DCFR III.-3:507(1). For "notice" see paras 11.23 to 11.25 below.

<sup>14</sup> DCFR III.-3:508(2).

<sup>15</sup> DCFR III.-3:204(3).

<sup>16</sup> DCFR III.-3:205(1).

<sup>17</sup> DCFR III.-3:205(2).

5.10 The creditor need not allow any attempt to cure outside the performance deadline if any of the following conditions are met:

“(a) the failure to perform a contractual obligation within the time allowed for performance amounts to a fundamental non-performance;

(b) the creditor has reason to believe that the debtor’s performance was made with knowledge of the non-conformity and was not in accordance with good faith and fair dealing;

(c) the creditor has reason to believe that the debtor will be unable to effect the cure within a reasonable time and without significant inconvenience to the creditor or other prejudice to the creditor’s legitimate interests; or

(d) cure would be inappropriate in the circumstances.”<sup>18</sup>

5.11 Scots law seems on the whole not to recognise a concept akin to a debtor’s right of cure, other than in relation to irritancy in leases<sup>19</sup> or to remediable defaults under a standard security.<sup>20</sup> There have been judicial suggestions at first instance that the creditor may not always be able to rescind without giving the debtor a second chance to perform.<sup>21</sup> In the most recent case, which concerned the defective installation of a kitchen in a restaurant, Sheriff Evans held that if a creditor fails to give the debtor an opportunity to rectify a breach that realistically is still remediable, the former may not terminate.<sup>22</sup> But this may simply be another way of saying that the breach in question is not material until the attempt at cure has also failed, or that the creditor has failed to mitigate its loss. In the context of sale of goods, it is further provided that the buyer does not lose the final right to reject defective goods merely by asking for, or agreeing to, their repair by the seller.<sup>23</sup> Indeed, the House of Lords has held in a commercial case that the buyer may still reject after full repair, if the seller does not respond to requests for information about the nature of the problem and how it was repaired.<sup>24</sup>

### *Potential reform*

5.12 In our 1999 Report we took the view that even the limited debtor’s right to proffer cure and forestall the creditor’s right to terminate (as now found in the DCFR) shifted the balance of power too much against the creditor.<sup>25</sup> This is because we placed a high value on the creditor’s right to reject, especially in consumer cases. That also informed our joint recommendations with the Law Commission for England and Wales in 2009 that consumers should have a short-term but immediate right to reject defective performances by suppliers

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<sup>18</sup> DCFR III.–3:203.

<sup>19</sup> A tenant may be able to purge a conventional irritancy in accordance with ss 4 or 5 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985, or to purge a legal irritancy at common law. On irritancy generally, see our (unimplemented) Report on Irritancy in Leases of Land (Scot Law Com No 191, 2003), Part 1.

<sup>20</sup> Conveyancing and Feudal Reform (Scotland) Act 1970, ss. 21 and 23.

<sup>21</sup> *Lindley Catering Investments v Hibernian FC* 1975 SLT (Notes) 56; *Strathclyde Regional Council v Border Engineering Contractors Ltd* 1998 SLT 175.

<sup>22</sup> *Magnet Ltd v John B Cape t/a Briggate Investments* (Cupar Sheriff Court, 19 July 2007), accessible at <http://www.scotcourts.gov.uk/search-judgments/judgment?id=8ff286a6-8980-69d2-b500-ff000d74aa7>.

<sup>23</sup> Sale of Goods Act 1979 s 35(6)(a).

<sup>24</sup> *J & H Ritchie Ltd v Lloyd Ltd* 2007 SC (HL) 89.

<sup>25</sup> 1999 Report, para 7.21.

of goods, which could be exercised regardless of the existence of repair and replacement remedies as well. This has now been implemented by sections 20 and 22 of the 2015 Act.

5.13 We remain inclined to think that in general the debtor should not be empowered to insist on attempting cure of a defective performance, although the creditor is of course entitled to accept a proffer of such cure should it be made. We note that under the DCFR it is only if the breach is non-fundamental that the debtor may so insist, while the creditor who has reason to believe that the debtor's previous non-performance was made knowingly, or that the proffered cure cannot be made within a reasonable time, or without substantial inconvenience or prejudice to the creditor, or is inappropriate in the circumstances, can refuse the debtor's offer. While these are substantial limitations upon the debtor's right, they still leave much ground for difficult disputes between the parties. We also note the possibility that, if high English authority in sale of goods law is followed, the debtor who has made an early but defective tender of performance which is rejected by the creditor does already have the power to try again within the time limit provided by the contract.<sup>26</sup> We ask accordingly:

- 30. Should the debtor have a right to carry out a cure (repair or replace or repeat performance) of a prior non-performance notified to it by the creditor if:
  - (a) performance is still possible within any relevant time limit imposed by the contract; or**
  - (b) the debtor offers a cure at its own expense, to be carried out within a reasonable time?****
- 31. Should this right exist only if the non-performance is not so fundamental as to entitle the creditor to terminate the contract?**
- 32. If consultees consider that debtors should have such a right, do they agree that while the cure is carried out the creditor may not terminate the contract, but that it may withhold its own performance and that it retains the right to claim damages for the initial non-performance if appropriate?**
- 33. Do consultees also agree that the debtor has the obligation to take back the replaced item at its own expense, while the creditor need not pay for any use made of that item?**
- 34. Do consultees further agree that if the cure is not carried out within a reasonable time the creditor may terminate the contract and exercise any other remedy available to it in respect of the breach of contract?**

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<sup>26</sup> *Borrowman Phillips & Co v Free and Hollis* (1878) 4 QBD 500 (CA); *Motor Oil Hellas (Corinth) Refineries SA v Shipping Corp of India (The Kanchenjunga)* [1990] 1 Lloyd's Rep 391 (HL). See also Benjamin's *Sale of Goods*, (9<sup>th</sup> edn, 2014), para 12.032; *Atiyah and Adams' Sale of Goods*, (13<sup>th</sup> edn, 2016) p 441; Goode, *Commercial Law* (5<sup>th</sup> edn, 2016), paras 12.19 to 12.27.

- 35. Do consultees finally agree the creditor should not be obliged to accept an offer of cure if:**
- (a) it has reason to believe that the debtor’s initial performance was made with knowledge of its non-conformity and was not in accordance with good faith and fair dealing;**
  - (b) it has reason to believe that the debtor will be unable to effect the cure within a reasonable time and without significant inconvenience to the creditor or other prejudice to the creditor’s legitimate interests; or**
  - (c) cure would be inappropriate in the circumstances?**

### **Creditor’s right to have non-conforming performance remedied**

#### *The DCFR and Scots law compared*

5.14 Specific performance under the DCFR includes the remedying free of charge of a performance not in conformity with the terms of the relevant obligation, i.e. repair or replacement of the non-conforming performance.<sup>27</sup> In Scots law, however, Professor McBryde writes that “[s]pecific implement seeks implement of the contract, not an undoing of what has been done in breach of contract for which the remedy is damages”.<sup>28</sup> It accordingly appears to us that in this respect the DCFR concept of specific performance of a non-monetary obligation is rather broader than specific implement.

5.15 However, such a creditor’s right does exist to a limited extent in Scots law, in the context of consumer contracts for the supply of goods, or digital content, or services. The consumer has the right under the 2015 Act to demand repair or replacement of defective supplies at the supplier’s expense and within a reasonable time.<sup>29</sup> The consumer who does this with regard to goods cannot exercise the short-term right to reject which it otherwise has until the supplier has had a reasonable opportunity to repair or replace; there are parallel provisions for digital content, but not for services.<sup>30</sup> The choice between repair or replacement is the consumer’s.<sup>31</sup>

5.16 The supplier’s only excuses are that repair or replacement are impossible or disproportionate given the value of the subject-matter, the significance of the lack of conformity, and whether any other remedy could be effected without significant inconvenience to the consumer.<sup>32</sup> These excuses bear some relation to the grounds on which specific implement may be refused by a court.<sup>33</sup>

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<sup>27</sup> DCFR III.–3.302(2).

<sup>28</sup> McBryde, *Contract*, para 23.14.

<sup>29</sup> 2015 Act ss 23, 43 and 55. For services the remedy is known as “repeat performance”.

<sup>30</sup> 2015 Act ss 23(6) and (7) (goods); 43(6) and (7) (digital content); 54(6) and (7)(f) (services).

<sup>31</sup> 2015 Act ss 23(2) (goods); 43(2) (digital content). There is no need to exercise choice of this kind with “repeat performance” of services.

<sup>32</sup> 2015 Act ss 23(3) to (8) (goods); 44(3) to (8) (digital content); 55(3) and (4) (services; repeat performance denied only if impossible).

<sup>33</sup> See further para 6.17 below.

5.17 There has been almost no case law in any of the United Kingdom jurisdictions about the consumer's repair or replacement remedy.<sup>34</sup> In *Douglas v Glenvarigill Co Ltd*<sup>35</sup> it was argued for a consumer buyer (in submissions that were apparently "not detailed"<sup>36</sup>) that he had a right to reject a defective car almost two years after purchase following failed attempts at repair. The judge noted that where repair or replacement were sought, rejection could follow where they were unsuccessful after a reasonable period of time. Given a history of failed attempts by the seller to repair the vehicle and offers to replace it refused by the consumer, there was clearly plenty of room for further discussion. Counsel for the consumer opted not to pursue the point, however, and the litigation ended in a finding that the consumer was not entitled to reject so long after the initial sale of the car. The Court of Justice of the European Union has however held that replacement in relation to goods installed in good faith by a buyer rather than by the seller (such as tiles put into a shower) extends to reinstallation of the goods in question, or meeting the costs of removal and reinstallation.<sup>37</sup>

#### *Potential reform*

5.18 The law of consumer protection is based on the idea of putting the consumer on a more equal footing with the seller, in order that the consumer has full autonomy at the time of contracting, in accordance with the classic principles of freedom of contract. For example, in a contract for sale of goods, the consumer is protected if the goods are not as they were originally described.<sup>38</sup> Why, then, should this remedy not extend to classic or commercial contract law? The one possible answer is that the 2015 Act exists to regulate consumer contracts and protect vulnerable groups, and that the traditional idea of commercial contracts involves parties who are (relatively) equal.

5.19 However, this is often not the case, especially where there is a service element to the contract. For example, A Ltd (an incorporated small business) contracts with B Ltd (another such small business) to build a fence which is required to be of a specific height and material. B Ltd builds the fence, but it is the wrong height, a different (but equally suitable) material is used, and the work is partially incomplete. A Ltd does not fall within the definition of "consumer" in section 2 of the 2015 Act and therefore cannot seek repair or replacement. Should A Ltd desire the fence to be replaced or improved rather than damages, A Ltd should seek a decree for specific implement. Both A Ltd and B Ltd are, theoretically, on an equal footing by virtue of being businesses. However, even when incorporated, small businesses are often in a vulnerable position, without the necessary funds for litigation, and the inherent difficulties in seeking a decree for specific implement mean that it can be a long and expensive process. A right to repair or replacement might better meet this case.

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<sup>34</sup> See *Lowe v W Machell Joinery Ltd* [2011] EWCA Civ 794, [2012] 1 All ER (Comm) 153; *Richford v Parks of Hamilton (Townhead Garage) Ltd* 2012 GWD 24-505 (Hamilton Sheriff Court, 10 January 2012).

<sup>35</sup> [2010] CSOH 14, 2010 SLT 634.

<sup>36</sup> *Ibid*, para 37 per Lord Drummond Young.

<sup>37</sup> Cases C-65/09 and C-87/09, *Wittmer v Gebr Weber GmbH; Putz v Medianess Electronics GmbH* [2011] 3 CMLR 27.

<sup>38</sup> 2015 Act, s 11.

5.20 We would be grateful for consultees' thoughts on the possibility of extending to all contracts a creditor's right to have non-compliant performance remedied by the debtor, and accordingly ask:

- 36. Should any creditor have a right to seek cure from the debtor in line with the specific remedy of repair or replacement (or repeat performance of a service) now afforded to consumers under the Consumer Rights Act 2015?**

# Chapter 6      Enforcing performance

## Introduction

6.1      The DCFR recognises two separate rights of the creditor to enforce performance: the creditor has a right to recover payment of money which is due,<sup>1</sup> and to enforce specific performance of an obligation other than one to pay money.<sup>2</sup> These correspond to the Scots remedies of the action for payment and specific implement respectively.

6.2      In this Chapter, we examine how the DCFR and Scots law approach rights to enforce performance, before going on to look at potential reforms of the latter. To an extent these focus on the mechanisms for enforcing a decree of specific implement in Scotland, which is properly speaking an aspect of the law of diligence, and hence is outwith the scope of the DCFR. However, it appears to us that the availability or otherwise of a remedy in Scots law only takes us so far: a question remains as to whether that remedy can be made effective. We also raise for discussion the possibility that reform might best be achieved by moving away from specific implement and creating a bespoke remedy to enforce performance of contract.

## Terminology

### *Specific implement and specific performance*

6.3      Scots law uses the remedy known as specific implement in order to compel performance by a contract debtor of its obligations *ad factum praestandum* (i.e. non-monetary obligations) under the contract. However, the term “specific performance” is encountered in other contexts.

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<sup>1</sup> DCFR III.–3:301.

<sup>2</sup> DCFR III.–3:302.

6.4 The *Stair Memorial Encyclopaedia* describes these remedies as being specific implement in non-contractual circumstances.<sup>3</sup> The principal such remedy is section 45 of the Court of Session Act 1988,<sup>4</sup> which states:

“Restoration of possession and specific performance

The Court may, on application by summary petition—

- (a) order the restoration of possession of any real or personal property of the possession of which the petitioner may have been violently or fraudulently deprived; and
- (b) order the specific performance of any statutory duty, under such conditions and penalties (including fine and imprisonment, where consistent with the enactment concerned) in the event of the order not being implemented, as to the Court seem proper.”

6.5 Section 45(b) may be used to require performance of any statutory duty. Similar powers are conferred by specific statutes.<sup>5</sup> While these remedies broadly parallel specific implement, it is notable that where Parliament has provided for a statutory form of specific implement that the legislation uses instead the term “specific performance”. It is also notable that section 45(b) carries with it its own power to fine and imprison, rather than relying upon the provisions of section 1 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1940 which apply to the enforcement of orders *ad factum praestandum*.

6.6 Other similar remedies proceed on a non-statutory basis. For example, the Court of Session may compel inferior courts, local authorities and public officers to perform their duties, and this is said to be in exercise of that court’s supereminent jurisdiction as the supreme civil court in Scotland (although it declined to determine whether this is an exercise of a high equitable jurisdiction, or the *nobile officium* proper).<sup>6</sup> Failure to comply renders the defaulter:

“...liable to imprisonment as upon a decree *ad factum praestandum*.”<sup>7</sup> [emphasis added]

It again appears that a parallel is being drawn, rather than the order of the court being *ad factum praestandum* in itself.

6.7 Our provisional view is that the term “specific implement”, in the strict sense, is at present applicable to contractual situations. Other orders for enforcement, although loosely termed orders for specific implement, are more correctly described as specific performance. It appears that practice has, to an extent, diverged from the position in law.

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<sup>3</sup> See generally *SME, Remedies*, para 11.

<sup>4</sup> See also section 46 which confers a broad power on the Court of Session to grant specific relief in interdict proceedings. Section 45 is derived from section 91 of the Court of Session Act 1868, the date of which may explain the use of typically English law terminology throughout the section (“real or personal property” as well as “specific performance”). Only in 1871 was there first appointed a “Parliamentary Draftsman for Scotland” (who however was required to submit his work to Parliamentary Counsel, all English lawyers): see D M Walker, *A Legal History of Scotland* vol 6 (2001) p 133.

<sup>5</sup> Local Government (Scotland) Act 1973, s 211(3) and (3A); Education (Scotland) Act 1980, s 70(1)(b).

<sup>6</sup> *Forbes v Underwood* (1886) 13 R 465 at 468, per the Lord President (Inglis).

<sup>7</sup> *Ibid*.

6.8 We observe that the term used in the DCFR is “specific performance”. Under the DCFR, it applies to both monetary and non-monetary obligations.<sup>8</sup> In Scots law, specific implement is not available to enforce monetary obligations, which require the separate remedy of the action for payment. The DCFR term also applies to obligations not to do something as it applies to obligations to perform. In Scots law the former may require the use of the distinct remedy of interdict. Specific performance in the DCFR context is accordingly far broader than specific performance or specific implement in Scots law

6.9 In all of the circumstances, we think that reform of the terminology in this area of the law is desirable. However, the DCFR terminology does not provide an easy solution, not least because in Scots law specific performance is already a term of art, and one with a significantly restricted meaning as compared to the DCFR concept. Specific performance may also be seen as carrying a certain amount of unwanted baggage given the significant substantive differences between Scots law and the English remedy of specific performance. We therefore think it might be appropriate to think about terminology on a more fundamental level, particularly if our reform proposals canvassed below attract the support of consultees.

6.10 At its most elementary, the common thread between all of these concepts appears to be that one party has to ask the court to make an order which tells the other party it must do (or not do) something. In the contractual situation, the intention is to compel performance by the debtor. We wonder whether it might therefore be appropriate to describe this as “compelled performance” or “enforced performance”. It is questionable whether the adjective adds anything of substance. Would it be attractive simply to call the remedy a “performance order”? This captures, we think, the essence of what the court is being asked to do. However, we would be particularly grateful for consultees’ views on this matter. Therefore we ask:

- 37. Do consultees agree that the terminology used to describe the remedy used to enforce performance of an obligation could usefully be clarified?**
- 38. If so, do consultees consider that it would be appropriate to call the remedy a “performance order”? Do consultees prefer an alternative formulation?**

## **The DCFR and Scots law compared**

### *Payment of money*

6.11 The DCFR provides simply that a creditor is entitled to recover money, payment of which is due.<sup>9</sup> This remedy can be distinguished from specific performance of non-monetary obligations for two main reasons. The first reason is that the DCFR rule on enforcement of monetary obligations<sup>10</sup> makes provision for the first anticipated breach scenario discussed in Chapter 3<sup>11</sup>, whereas there is no such rule in relation to enforcement of non-monetary

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<sup>8</sup> DCFR III.–3:301 and 3:302.

<sup>9</sup> See also PECL art 9:101; PICC art 7.2.1.

<sup>10</sup> DCFR III.–3:301(2).

<sup>11</sup> See paras 3.14 to 3.19 above.

obligations.<sup>12</sup> Secondly, unlike specific performance of a non-monetary obligation, there is no restriction of the remedy in certain circumstances.<sup>13</sup> Interest is however payable on delayed payments and damages can be claimed for any further loss.<sup>14</sup>

6.12 These reasons for distinguishing the two remedies are broadly to be found in Scots law too, although the restrictions on when specific implement are available are not exactly the same as the restrictions on specific performance under the DCFR.<sup>15</sup>

6.13 The other significant distinction between the remedies in Scots law lies in their enforcement. As we note above, the DCFR does not concern itself with how remedies are subsequently enforced. A creditor who obtains a decree for payment may, in general, use any competent diligence to enforce payment (or even, potentially, sequestrate or liquidate the debtor). By contrast, where the debtor does not obtemper a decree *ad factum praestandum* (which results where the court orders specific implement), the sanction (although it is rarely encountered) is ultimately civil imprisonment. Civil imprisonment for debt was largely abolished in 1880,<sup>16</sup> though it remains competent for alimentary debts. We review the sanction of civil imprisonment below.

6.14 Having reviewed the remedy of action for payment in light of the DCFR, it does not appear to us that there are any pressing issues that require reform.<sup>17</sup> The basis for its existence as a separate remedy appears rational and we do not think anything that is discussed in this paper would detract from it. However, if consultees are aware of any issues then we would be interested to hear of them.

### **39. Are consultees aware of any issues arising in relation to actions for payment that we should consider at this time?**

#### *Performance of non-monetary obligations*

6.15 The DCFR provides that the creditor is entitled to enforce specific performance of an obligation other than one to pay money.<sup>18</sup> However, specific performance cannot be enforced where:

- “(a) performance would be unlawful or impossible;
- (b) performance would be unreasonably burdensome or expensive; or
- (c) performance would be of such a personal character that it would be unreasonable to enforce it.”<sup>19</sup>

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<sup>12</sup> Compare DCFR III.–3:301 and 3:302.

<sup>13</sup> See para 6.15 ff.

<sup>14</sup> DCFR III.–3:708. See also DCFR III.–3:709 to 3:711 for further rules on interest. Note also PECL art 9:508; PICC art 7.4.9. This Discussion Paper does not seek to deal with the subject of interest.

<sup>15</sup> *SME, Remedies* paras 8 and 9.

<sup>16</sup> Debtors (Scotland) Act 1880 s 4.

<sup>17</sup> Other than the discussion of anticipated breach in Chapter 3.

<sup>18</sup> DCFR III.–3:302(1).

<sup>19</sup> DCFR III.–3:302(3).

6.16 These exceptions are explicitly not discretionary for the court.<sup>20</sup> Specific performance must also be requested within a reasonable time after the creditor has become, or could reasonably be expected to have become, aware of the non-performance.<sup>21</sup> Exclusion from a right to specific performance under these rules does not preclude a claim for damages.<sup>22</sup> But the creditor cannot recover damages for loss or a stipulated payment for non-performance to the extent that the creditor has increased the loss or the amount of the payment by insisting unreasonably on specific performance in circumstances where the creditor could have made a reasonable substitute transaction without significant effort or expense.<sup>23</sup>

6.17 In Scots law, an order for specific implement of a non-monetary obligation is likewise available to a creditor as a matter of right, except against the Crown.<sup>24</sup> There are a number of exceptions to the right, typically where compliance is impossible for the debtor, or the contract is one involving a highly personal relationship such as partnership or employment.<sup>25</sup> The court has a residual discretion to refuse the remedy, though only in exceptional circumstances where its grant would be inconvenient and unjust, or cause exceptional hardship.<sup>26</sup> In addition, the court will avoid granting a decree for specific implement if the decree would be for the supply of goods which would be readily available from another source.<sup>27</sup> If made, the order must be sufficiently precise as to what the debtor must do.<sup>28</sup> Non-compliance with the order may lead to the debtor's civil imprisonment but only if the failure is wilful.<sup>29</sup> If the failure is not wilful, the court may give the debtor a further chance to comply.<sup>30</sup>

6.18 The Scottish position is distinct from that in England,<sup>31</sup> where specific performance will only be granted where it is equitable to do so, and not if damages is an adequate remedy in the situation (as for example where an alternative source of supply is readily available on

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<sup>20</sup> DCFR III.–3:302 Commentary D.

<sup>21</sup> DCFR III.–3:302(4).

<sup>22</sup> DCFR III.–3:303.

<sup>23</sup> DCFR III.–3:302(5). See also PECL art 9:102(1); PICC art 7.2.2. The McGregor Code also favours an entitlement to specific enforcement (para 401), unlimited by the adequacy of damages as an alternative remedy (para 401(2)), but restricted by a number of rules on impossibility, hardship, difficulties of enforcement and personal relationships (paras 403 to 408). See too ULIS arts 25, 42 and CISG art 46.

<sup>24</sup> See generally McBryde, *Contract*, paras 23.08 and 23.09; 23.17. For the Crown see Crown Proceedings Act 1947 s 21(1). Coercive orders may, however, be made against the Crown in judicial review proceedings: *Davidson v Scottish Ministers* 2006 SC (HL) 41. It will be apparent that neither Scots law nor the DCFR adheres to any theory of "efficient breach", under which a contracting party always has a choice: to perform or to pay damages. The argument in support of this theory is that it means that the subject-matter of any contract eventually goes to the person who places the highest value upon it, thereby promoting economic efficiency.

<sup>25</sup> McBryde, *Contract*, paras 23.15 to 23.22; Gloag, *Contract*, p 657.

<sup>26</sup> *Highland and Universal Properties Ltd v Safeway Properties Ltd* 2000 SC 297 at 311 per Lord Kingarth. This contrasts with the position in England, where the burden of proof is on the claimant to show that specific performance ought to be granted as damages would be inadequate. See L J Macgregor, "Specific Implement in Scots Law" in J Smits, D Haas, G Heslen (eds) *Specific Performance in Contract Law: National and Other Perspectives* (2008) pp 67 to 93.

<sup>27</sup> *Ibid.*

<sup>28</sup> McBryde, *Contract*, paras 23.13 and 23.14.

<sup>29</sup> Law Reform (Miscellaneous Provisions) (Scotland) Act 1940 s 1. See also McBryde, *Contract*, paras 23.25 and 23.26 (which considers, among other things, the remedies competent against corporate bodies and those outwith the jurisdiction).

<sup>30</sup> See further McBryde, *Contract*, paras 23.24 to 23.27.

<sup>31</sup> The historical context is rehearsed in *Highland and Universal Properties Ltd v Safeway Properties Ltd* 2000 SC 297 at 298 ff per the Lord President (Rodger). See also D Hope (Lord Hope of Craighead), "Specific Implement and Specific Performance: Are They Really Much The Same?", in S Degeling, J Edelman and J Goudkamp (eds) *Contract in Commercial Law* (2016) ch 14 (where the answer given is "No".)

the market albeit at a higher price).<sup>32</sup> In Scotland, while it is normal practice in a crave or conclusion for specific implement to seek damages in the alternative, that is not necessary, and the adequacy of damages as a remedy in the circumstances is only one consideration for the court in determining the equities of granting implement.<sup>33</sup> It may indeed be that the difficulty of assessing damages is a factor leading creditors to seek instead an award of specific implement.<sup>34</sup> The fact that implement may be burdensome for the debtor will not stop a court awarding the remedy.<sup>35</sup> An order for specific implement may be made in relation to particular obligations in a contract despite the creditor also claiming and obtaining damages for breach of another obligation in the same contract.<sup>36</sup>

### *Negative enforcement: interdict*

6.19 The DCFR does not have a nominate remedy for the negative enforcement of contractual remedies but its commentary is clear that specific performance applies to obligations not to do an act.<sup>37</sup> A contractual obligation not to do something, or a threatened, or an ongoing continuing breach of contract may be remedied by way of interdict in Scotland rather than by specific implement.<sup>38</sup> A so-called “negative” interdict, which seeks to compel performance by prohibiting inaction, is incompetent: the correct remedy is specific implement.<sup>39</sup>

6.20 In Scots law, interdict is often thought of as the converse remedy to specific implement and it shares certain characteristics, including its non-availability against the Crown in civil proceedings.<sup>40</sup> But, at least so far as concerns breach of contract, the law of interdict does not quite align with the law of specific implement.<sup>41</sup> For example, the exclusion of specific implement in contracts involving close personal relationships is not precisely paralleled in the law of interdict.<sup>42</sup> Interdict is commonly used to enforce restrictive covenants in employment and also partnership contracts.<sup>43</sup> Interdict is also available on an interim basis, subject to the creditor showing a *prima facie* case and on an assessment of the

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<sup>32</sup> See Chitty, paras 27.005 to 27.022.

<sup>33</sup> McBryde, *Contract*, paras 23.10 to 23.12; 23.21.

<sup>34</sup> See for example the commercial lease case of *Douglas Shelf Seven Ltd v Co-operative Wholesale Society Ltd* [2007] CSOH 53 (Lord Reed), in which the proof of loss flowing from a tenant’s breach of the lease occupied 63 court days, with 29 witnesses (including four expert witnesses). Before interest, the damages awarded were just under £600,000. As has been observed, “it would be useful to know what relationship that figure bore to the defender’s and the third party’s costs” (D Campbell and R Halson, “The Irrelevance of the Performance Interest: A Comparative Analysis of ‘Keep-Open’ Covenants in Scotland and England”, in L A DiMatteo, Q Zhou, S Saintier and K Rowley (eds), *Commercial Contract Law: Transatlantic Perspectives* (2013), p 481).

<sup>35</sup> See *Retail Park Investments Ltd v Royal Bank of Scotland plc (No 2)* 1996 SC 227 and *Highland and Universal Properties Ltd v Safeway Properties Ltd* 2000 SC 297. Contrast the decision in the English case *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1998] AC 1, and see discussion in MacQueen and Thomson, *Contract*, paras 6.9 to 6.11. The English approach is vigorously defended in Campbell and Halson, “Irrelevance of the Performance Interest”.

<sup>36</sup> *Douglas Shelf Seven Ltd v Co-operative Wholesale Society Ltd (No 2)* [2009] CSOH 3 (Lord Menzies).

<sup>37</sup> DCFR III.–3:302 Commentary A.

<sup>38</sup> See in particular *Church Commissioners for England v Abbey National plc* 1994 SC 651. Other cases are discussed in MacQueen and Thomson, *Contract*, para 6.13.

<sup>39</sup> *SME, Remedies* para 21.

<sup>40</sup> Again, *Davidson v Scottish Ministers* makes it clear that interdict, as a coercive order, is competent against the Crown in judicial review proceedings: see fn 24 above.

<sup>41</sup> For the law in general see McBryde, *Contract*, paras 23.28 to 23.35. Para 23.31 discusses the position of the Crown.

<sup>42</sup> See e.g. *Anderson v Pringle of Scotland* 1998 SLT 754; *Peace v City of Edinburgh Council* 1999 SLT 712. The cases are discussed in H L MacQueen and L J Macgregor, “Specific Implement, Interdict and Contractual Performance” (1999) 3 Edin LR 239.

<sup>43</sup> McBryde, *Contract*, para 23.28 fn 88 (which refers to paras 19.112 to 19.127).

balance of convenience between the parties. By contrast, the existence of a power to make an interim order *ad factum praestandum* was only recently put beyond doubt, by the Courts Reform (Scotland) Act 2014.<sup>44</sup> At first sight, it is not clear to us why the law of interdict and that of specific implement should operate differently in these respects. In our Advisory Group, it was suggested that compelling someone to do something is more intrusive than compelling inaction, and that this explains why considerations leading to specific implement being refused are inapplicable (or have less force) in interdict cases. We would be grateful for consultees' views.

### *Creditor's right to have non-conforming performance remedied*

6.21 Specific performance under the DCFR includes the remedying free of charge of a performance not in conformity with the terms of the relevant obligation, that is, repair or replacement of the non-conforming performance.<sup>45</sup> For Scots law, however, McBryde writes that "[s]pecific implement seeks implement of the contract, not an undoing of what has been done in breach of contract for which the remedy is damages".<sup>46</sup> It accordingly appears to us that in this respect the DCFR concept of specific performance of a non-monetary obligation is rather broader than specific implement.

6.22 However, such a creditor's right does exist in Scots law, in the context of consumer contracts for the supply of goods, or digital content, or services. The consumer has the right under the Consumer Rights Act 2015 to demand repair or replacement of defective supplies at the supplier's expense and within a reasonable time.<sup>47</sup> We discuss this matter further in Chapter 5.<sup>48</sup>

### **Enforcement of performance of non-monetary obligations**

6.23 In our 1999 Report, we noted that consultees had suggested a need for further work in relation to civil imprisonment as it applies to a decree for specific implement. We took the view that further research and consultation would be required on the subject and so made no recommendations at that time. It appears to us that it would now be desirable to revisit this topic, particularly as interest has been aroused by a recently-reported sheriff court judgment about the use of civil imprisonment to enforce decrees *ad factum praestandum*.<sup>49</sup>

6.24 As we note above, civil imprisonment for debt was largely abolished by the Debtors (Scotland) Act 1880.<sup>50</sup> However, that Act took care to ensure that it did not affect the continued existence of imprisonment under a decree *ad factum praestandum*. Reform in relation to imprisonment for failure to comply with such a decree had to wait until the passage of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1940 (the 1940 Act).

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<sup>44</sup> Sections 88 (sheriff court) and 90 (inserting section 47(2A) of the Court of Session Act 1988). This gave effect to a recommendation made by the Scottish Law Commission in its 1999 Report (see paras 5.1 to 5.6). These concerns were taken up by the Scottish Civil Courts Review (see paras 143 and 144 of Chapter 4 of its [Report](#)) and subsequently addressed by the Courts Reform (Scotland) Act 2014 (see paras 122 and 132 of the [Explanatory Notes to the Bill](#)). There are some earlier examples of interim orders *ad factum praestandum* in the Court of Session: see eg *Whyte & Mackay Ltd v Capstone International* 2011 SC 221.

<sup>45</sup> DCFR III.-3:302(2).

<sup>46</sup> McBryde, *Contract*, para 23.14.

<sup>47</sup> Consumer Rights Act 2015 ss 23, 43 and 55. For services the remedy is known as "repeat performance".

<sup>48</sup> See paras 5.14 to 5.20 above.

<sup>49</sup> *Moneybarn No. 1 Ltd v Bell* 2016 SLT (Sh Ct) 419.

<sup>50</sup> See para 6.13 above.

6.25 Prior to the passage of that Act, it was possible to obtain a decree *ad factum praestandum* and then proceed to imprison the non-compliant debtor without further formality. This appears to have arisen frequently when individuals were ordered to return goods purchased on hire purchase. Although the Hire Purchase Act 1932 reduced the effects of this problem significantly, there were still a number of cases which were not covered by the protection of that Act.<sup>51</sup> In order to address this, section 1 of the 1940 Act provides that civil imprisonment for failure to fulfil the requirements of a decree *ad factum praestandum* would no longer be possible without the express authorisation of the court which would be granted only where the court was satisfied that the person against whom decree had been pronounced was wilfully failing to comply. It also limits the maximum period of imprisonment to 6 months, and gives the court power to make an alternative order (such as a decree for payment or for delivery) where a warrant to imprison is sought.

#### *Compatibility with the European Convention on Human Rights*

6.26 Civil imprisonment for wilful refusal to comply with a court order to fulfil a contractual obligation appears to be permitted by Article 5(1)(b) of the European Convention on Human Rights, which provides that:

“No one shall be deprived of his liberty save in the following cases and in accordance with a procedure prescribed by law: ...

(b) the lawful arrest or detention of a person for non-compliance with the lawful order of a court or in order to secure the fulfilment of any obligation prescribed by law.”

6.27 By contrast, Article 1 of Protocol 4 to the European Convention on Human Rights states that:

“No-one shall be deprived of his liberty merely on the ground of inability to fulfil a contractual obligation.”

6.28 This Protocol does not include cases where there has been an additional element of bad faith such as fraud or negligence.<sup>52</sup> Whether this includes *wilful* failure to perform a contractual obligation *ad factum praestandum* is perhaps uncertain.<sup>53</sup> Protocol 4 has not been ratified by the United Kingdom and it is not incorporated into domestic law under the Human Rights Act 1998.<sup>54</sup> We are not aware of its ever having been considered by the European Court of Human Rights. Nevertheless, its existence does suggest that reflection on our own laws on civil imprisonment is appropriate.

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<sup>51</sup> Law Reform (Miscellaneous Provisions) (Scotland) Bill [Lords]. *Hansard*, HC, Vol 362, cols 1195 to 1204 (10 July 1940).

<sup>52</sup> <http://www.coe.int/en/web/echr-toolkit/protocole-4>.

<sup>53</sup> *Ibid.*

<sup>54</sup> MacQueen and Thomson, *Contract*, para 6.8 fn 2.

### Use of civil imprisonment

6.29 According to the Scottish Government,<sup>55</sup> there have been several civil prisoners every year from 2004 to 2014. However, the Scottish Government Justice Analytical Services advises that none of those civilly imprisoned between April 2011 and April 2015 were imprisoned as a result of wilful failure to comply with a decree *ad factum praestandum* and has provided us with the following tabular analysis:

Reason for civil imprisonment	2011–12	2012–13	2013–14	2014–15
Wilful failure to comply with decree <i>ad factum praestandum</i>	0	0	0	0
Non-payment of aliment	1	2	1	0
Section 40A of the Child Support Act 1991	6	10	5	3
Lawburrows	0	0	0	0
Other	0	2	3	0

6.30 These statistics are striking in that they appear to show that the primary remedy for wilful failure to comply with an order *ad factum praestandum* is not being put into effect. We cannot say from this data that warrants to imprison are never sought or indeed granted;<sup>56</sup> but can it still be considered a valid sanction if never made effective? The historic trend since the 1880s has seen a move away from imprisonment for failure to meet obligations as an unduly harsh response to the problem, and it may now therefore seem appropriate further to restrict the availability of civil imprisonment.

6.31 Some members of our Advisory Group, however, pointed out how the *threat* of civil imprisonment is in practice an effective means of encouraging compliance with court orders for the performance of contractual obligations. Its value lies in the fact that very few people are willing to defy an order *ad factum praestandum* when the consequence may be imprisonment. This is a difficult proposition to assess, given that it is, by its very nature, subjective, but Advisory Group members testified to its reality.

6.32 It is also important to note that section 1 of the 1940 Act is not the only route to civil imprisonment. It is available for breach of interdict as a species of contempt of court, in which context it was used by Lord Doherty in 2015.<sup>57</sup> In our Advisory Group reference was made to a statement of principle in *Wilson v McKellar*: civil imprisonment is "... an invocation of the power inherent in every civil court to ordain performance of acts within its jurisdiction,

<sup>55</sup> Scottish Government Justice Analytical Services, "Prison statistics and population projections Scotland: 2013-14" (2015), p 32 Table A.8.

<sup>56</sup> The 2011-12 figures in this table do not tally with published Table A.8 (12 civil prisoners, not 7). Nor do the 2012-13 figures (13, not 14). As the Table A.8 figures are for prison *receptions*, it presumably is not the case that the discrepancies can be explained by some of the sentences running through more than one year. There are also five unexplained civil imprisonment cases in the table; we cannot say that they (or some of them) are not a result of orders *ad factum praestandum*.

<sup>57</sup> *Mackenzie Hall Ltd and PRA UK Holding Pty Ltd v Mackenzie*, 8 January 2015 (accessible at <http://www.scotland-judiciary.org.uk/8/1356/MACKENZIE-HALL-LTD-And-PRA-UK-HOLDING-PTY-LIMITED-v-PAUL-MACKENZIE>). The sentence imposed was of 10 months' duration.

and in default to commit the defaulter to prison”.<sup>58</sup> But it is possibly anomalous that the 1940 Act limits the period of imprisonment to a maximum of six months, while the maximum imprisonment for breach of interdict is for three months in the sheriff court and two years in the Court of Session.<sup>59</sup>

## Potential reforms

### *Abolition of civil imprisonment*

6.33 Perhaps the most noticeable difficulty with civil imprisonment is that it may be unlikely to be in the interests of either party. For example, if A obtains a decree under section 1 of the 1940 Act which requires B to carry out works to A’s roof which had been previously contractually agreed, and B wilfully refuses to complete the works, what benefit can A derive from B’s imprisonment? The roof is still in need of repair, and A may have gone to significant expense in order to obtain the warrant for B’s imprisonment. This may perhaps explain at least in part why the sanction is rarely sought.

6.34 In *Moneybarn No. 1 Limited v Bell*<sup>60</sup> the creditors sought warrant to imprison the debtor for failure to return a car purchased under a conditional sale agreement. The purchase price was £18,244, of which £9,389 was on credit. The debtor failed to make several payments and a default notice was served in October 2014. In November 2014 the creditors terminated the agreement and sought payment of £11,109, that being the outstanding balance payable under the agreement, together with return of the car. Alternatively, they sought the value of the car on the date of termination. Decree was granted and after several failed attempts to recover the car, the creditors sought warrant for the debtor’s imprisonment under section 1 of the 1940 Act. The sheriff refused this application on the grounds that the creditors already had a warrant to search for and take possession of the car, and further elaborated:

“...solely because the agreement encompasses the possibility of obtaining an order *ad factum praestandum*, which does retain the possibility of imprisonment, would not generally in my view warrant the imprisonment of one of the parties to it at the behest of the other...The arguments which led to the abolition of imprisonment for non-payment of civil debt in the nineteenth century are likely to be equally valid and apt today in relation to a conditional sale agreement. A number of such applications are increasingly beginning to emerge...However, while many customers might relish the opportunity to acquire a new car, few would expect that experience to lead to their imprisonment on the application of the finance company.”<sup>61</sup>

6.35 While this is only a single decision, it may be indicative of a certain general reluctance on the part of the judiciary to make orders under section 1 of the 1940 Act. The sheriff stated that the instances in which such an order will be granted “are likely to be rare”,<sup>62</sup> but did not offer any assessment as to when it might be appropriate to do so. But our

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<sup>58</sup> *Wilson v McKellar* (1896) 24 R 254 at 256 per the Lord Justice-Clerk (Macdonald).

<sup>59</sup> Contempt of Court Act 1981 s 15(2).

<sup>60</sup> 2016 SLT (Sh Ct) 419.

<sup>61</sup> 2016 SLT (Sh Ct) 419 at para 5.

<sup>62</sup> *Ibid.*

Judicial Advisory Group thought imprisonment “a valuable last resort”, pointing out Lord Doherty’s already-mentioned use of the sanction in a breach of interdict case in 2015.<sup>63</sup>

6.36 One of the reasons commonly put forward for not choosing specific implement as a remedy is the impossibility of enforcing it by imprisoning a corporate body or an individual who is outwith the jurisdiction.<sup>64</sup> This was, however, addressed by Sheriff Principal Gimson in *Ford v Bell Chandler*.<sup>65</sup> He explained that as the 1940 Act allows alternatives to imprisonment, specific implement is a perfectly competent remedy to seek against a company or a debtor based abroad.<sup>66</sup> Nevertheless, it may be that because the possibility for the court to order more creative solutions under the 1940 Act is not as widely known as the ultimate sanction of civil imprisonment, this may remain a factor in deterring parties from seeking the remedy against corporate debtors or parties outside the jurisdiction.<sup>67</sup>

6.37 In seeming to suggest that imprisonment is the primary sanction against non-compliance with a specific implement decree, the present law does not lend itself well to the needs of modern business or economic efficiency. But abolition altogether of the possibility of civil imprisonment for non-compliance with an order *ad factum praestandum* may be to go too far, in the light of its availability in other remedial contexts for the enforcement of contracts (notably interdict), and its utility in upholding the authority of court orders and motivating defaulters to comply with them.

6.38 It may also be that by clarifying the courts’ powers to make alternative orders to enforce a decree of specific implement (possibly from the outset rather than waiting for a wilful refusal to comply with a decree for actual performance), it could become a more useful and more often used remedy. In particular, this might involve setting out specific examples of things other than simple performance that might be ordered by the court to ensure that the decree is given effect. For example, the court might order the party against whom decree has been granted to pay for a third party to carry out the obligation rather than compel the debtor to complete it personally.

6.39 PICC provides that when a court orders a party to perform it may also direct that this party pay a penalty if it does not comply with the order.<sup>68</sup> This seems to stem from the French institution of *astreinte*, a criminal sanction which is not paralleled in legal systems outwith that tradition. The McGregor Code, by contrast, prohibits criminal penalties for failure to carry out an order for specific enforcement, the commentary making special reference to imprisonment, although it allows the order to be made “upon such terms and conditions as to mode of performance and otherwise as it considers reasonable”,<sup>69</sup> which might include the creditor or a third party performing at the debtor’s expense.

6.40 Scots law may already be able to move some way towards judicial penalties under section 1 of the 1940 Act, by which the court has discretion to grant orders in lieu of

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<sup>63</sup> *Mackenzie Hall Ltd and PRA UK Holding Pty Ltd v Mackenzie*, 8 January 2015.

<sup>64</sup> McBryde, *Contract*, para 23.26.

<sup>65</sup> 1977 SLT (Sh Ct) 90.

<sup>66</sup> McBryde, *Contract*, para 23.26.

<sup>67</sup> See also McBryde, *Contract*, para 23.27, citing *Retail Parks Investments v Royal Bank of Scotland Plc (No. 2)*, 1996 SC 227 at 240 per Lord McCluskey.

<sup>68</sup> PICC art 7.2.4.

<sup>69</sup> McGregor Code, para 402.

imprisonment such as ordering payment of a specified sum to the creditor. McBryde contemplates that:

“[u]nder this section the court could fine a debtor. This might appear to be an appropriate remedy in some circumstances, particularly if the debtor is a company or trade union.”<sup>70</sup>

It does not, by itself, achieve performance of the contract or compensation for the creditor; but neither does imprisonment. In our Advisory Group it was suggested that the measure of the fine might be determined by the court taking account of the creditor’s legitimate interests in the same way as these are now deployed to uphold penalty clauses.<sup>71</sup> This would certainly be relevant if the penalty was to be payable to the creditor,<sup>72</sup> but perhaps not if it was payable to the state, as with the French *astreinte*.<sup>73</sup> We would welcome consultees’ views on all these matters. We therefore ask:

- 40. Should civil imprisonment be retained as the ultimate sanction for wilful refusal to comply with a decree *ad factum praestandum*?**
- 41. If so, should the periods for which civil imprisonment may be ordered for wilful refusal to comply with a decree *ad factum praestandum* and for breach of interdict be aligned in length?**
- 42. As a means of enforcing a decree *ad factum praestandum*, should the courts be empowered to make such orders as may be just and equitable in all the circumstances as an alternative to civil imprisonment?**
- 43. If so, should it be possible for a court to make such orders together with the initial decree?**
- 44. Should it be open to the court to specify a penalty which is to be paid if a party fails to comply with a decree *ad factum praestandum*?**
- 45. If so, should the penalty be payable to the creditor or the state? If the former, should the amount of the penalty be determined having regard to the creditor’s “legitimate interests” as defined in the general law on penalty clauses?**

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<sup>70</sup> McBryde, *Contract*, para 23.25. By contrast, it is clear that such a fine is contemplated under section 45(b) of the Court of Session Act 1988 for failure to comply with an order for specific performance of a statutory duty: see para. 6.5 above.

<sup>71</sup> See *Cavendish Square v Makdessi* [2016] AC 1172. The suggested approach would remain possible if the law was reformed as suggested in our Discussion Paper No 162 on Penalty Clauses (2016).

<sup>72</sup> For a rare example of this in Scots law, see the Tenancy Deposit Schemes (Scotland) Regulations 2011, regs 9 and 10, discussed in *Fraser v Meehan* 2013 SLT (Sh Ct) 119 at para 13, per Sheriff K E C Mackie, and in K G C Reid and G L Gretton, *Conveyancing 2013* (2014), pp 118 and 119.

<sup>73</sup> A further suggestion made in our Advisory Group was that the court might be empowered to deprive a defaulting business debtor of any licence which it needed to trade. There is already statutory provision for this kind of thing in consumer protection legislation, and there has been at least one case of the kind in the Court of Session; but it usually requires public rather than private enforcement. See *Office of Fair Trading v MB Designs (Scotland) Ltd* 2005 SLT 691.

### *A unified remedy for performance of non-monetary obligations?*

6.41 As we comment above, the DCFR recognises a single remedy for enforcement of non-monetary obligations, termed specific performance. In Scots law, it is necessary to look both to specific implement and to interdict as well as (in the consumer context) the creditor's right to repair or replacement to cover the same ground. We also highlighted some of the inconsistencies as to when implement and interdict are available.<sup>74</sup> This in turn reminded us that in the mid-1990s some discussion arose about the extent to which specific implement and interdict do (or do not) dovetail.<sup>75</sup> The scope of interdict is, of course, significantly wider than its use in relation to breach of contract, and this discussion concerns only the use of interdict in relation to contract. That is another distinction—if our analysis above<sup>76</sup> is correct, then specific implement in the strict sense is a remedy to compel performance of contracts, whereas interdict is of rather broader application.

6.42 By contrast, the single DCFR remedy is apt to cover both the enforcement of an obligation to do something and an obligation not to do something. In *Church Commissioners*, much was made of the fact that interdict as a remedy is preventive, and therefore is not a suitable remedy for completed breach, even if that breach is ongoing. On one view, this division between positive and negative acts and obligations might be thought to obscure the basic point: in general, Scots law and the DCFR both favour performance of the contract. A remedy which allows parties to enforce performance underpins that general policy, and it is perhaps questionable whether the availability of a remedy to enforce should be dependent on how the obligations are characterised. Cases have turned on whether the correct remedy is being sought, and that is to some extent driven by the different criteria for obtaining the respective remedies, and what may be done to enforce them.

6.43 Rather than try to reconcile the differences that exist among the current remedies, it appears to us that reform of the law on remedies for breach of contract might provide some scope for a rather more radical approach. As we note, Scots law and the DCFR tend to favour performance of the contract. Specific implement and interdict are both judicial remedies. The first step is for the matter to be submitted to the court for a decision on whether the creditor is entitled to enforce performance of an obligation. If the court considers that the creditor is so entitled, then we suggest that the second step should be for the court to make an order which is intended to secure the enforcement of the contract. We have already canvassed above the possibility of orders other than for simple performance.<sup>77</sup> Parties could, of course, make submissions about what they considered to be the most appropriate means of enforcement. The court could have discretion as to the most appropriate means of enforcement, albeit giving due attention to the wishes of the creditor. Or discretion could be avoided by setting out certain criteria to determine the most appropriate means of enforcement from which the creditor could choose and which the court could determine to have employed. As already mentioned, we think it would be important to give examples of the sort of order that might be made: for instance, imposing a fine on a non-compliant debtor (although it might here be necessary to specify whether the fine was

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<sup>74</sup> See para 6.20 above.

<sup>75</sup> See eg *Church Commissioners for England v Abbey National plc* 1994 SC 651.

<sup>76</sup> See paras 6.3 to 6.10 above.

<sup>77</sup> See para 6.38 above.

payable to the debtor or the state).<sup>78</sup> Other remedies (such as repair and replacement, which the DCFR treats as an aspect of specific performance) could also be given as examples of things that the court might do under the new remedy. This would follow in the footsteps of section 1(2) of the 1940 Act, which gives a number of examples of the sort of order that a court might make if it is minded to refuse to grant warrant to imprison.

6.44 If consultees were attracted to a new remedy of this nature, then we think it would (if anything) bolster the case for terminological reform set out at the start of this Chapter.<sup>79</sup> We therefore ask:

- 46. Do consultees consider that there would be merit in replacing the current methods of enforcing non-monetary obligations with a single bespoke remedy, encompassing both positive and negative obligations?**
- 47. If so, do consultees support our suggestion that the courts should be given a broad power to make an order which is intended to secure performance of the obligation?**
- 48. Would consultees prefer to confer a general discretion on the courts to select an appropriate order, or to have rules to be applied by the court in order to determine the most appropriate order?**
- 49. Do consultees consider that it would be beneficial to give examples of the sort of order that might be made, particularly for more unusual possibilities such as fines or an extended right to repair and replacement?**

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<sup>78</sup> As it can do under section 45(b) of the Court of Session Act 1988 for failure to comply with an order for specific performance of a statutory duty. See para. 6.40 above.

<sup>79</sup> See paras 6.3 to 6.10 above.

# Chapter 7 Damages

## Introduction

7.1 In this Chapter, we examine how the DCFR and Scots law approach damages as a remedy, before going on to look at potential reforms, focusing on whether the position on non-patrimonial losses could be put on a more stable footing in Scots law, as recommended in our 1999 Report.<sup>1</sup>

## The DCFR and Scots law compared

7.2 Under the DCFR there is a general entitlement to damages for loss caused by the other party's unexcused non-performance, without any reference to a requirement of fault.<sup>2</sup> Loss for these purposes includes non-pecuniary loss such as distress or physical suffering, and future loss which is reasonably likely (or reasonably certain) to occur.<sup>3</sup> The DCFR distinguishes between “economic” and “non-economic” loss, the former including loss of income or profit, burdens incurred, and reductions in the value of property, while the latter embraces pain and suffering and impairment of the quality of life.<sup>4</sup> The PICC specifies loss of a chance in its list of recoverable losses.<sup>5</sup>

7.3 Scots law likewise treats damages as a means to recover loss or harm caused by breach, without imposing any requirement of fault on the part of the contract-breaker.<sup>6</sup> In our 1999 Report we observed that the recovery of loss would be an important principle to make clear in any statutory restatement of the law. In general, it is also important to be clear as to what losses, or kinds of loss, the creditor is entitled to be compensated for.<sup>7</sup> Since the Report the courts have also made clear that in the absence of loss breach of contract does not give an automatic entitlement to nominal damages.<sup>8</sup> Loss has generally been seen as primarily an economic concept,<sup>9</sup> but has also included the “trouble and inconvenience” suffered by the creditor as a result of the breach,<sup>10</sup> as well as physical personal injury (with accompanying *solatium*) and, in a relatively small number of cases, injury to a person's feelings and personal distress.<sup>11</sup>

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<sup>1</sup> 1999 Report, Part 3 and recommendation 2.

<sup>2</sup> DCFR III.–3:701(1). See also PECL art 9:501(1); PICC art 7.4.1.

<sup>3</sup> DCFR III.–3:701(2). See also PECL art 9:501(2); PICC art 7.4.2.

<sup>4</sup> DCFR III.–3:701(3).

<sup>5</sup> PICC art 7.4.3.

<sup>6</sup> On causation see McBryde, *Contract*, paras 22.16 to 22.25.

<sup>7</sup> *South Australia Asset Management Corp v York Montague Ltd* [1997] AC 191 at 211 ff per Lord Hoffmann.

<sup>8</sup> *Wilkie v Brown* 2003 SC 573.

<sup>9</sup> See McBryde, *Contract*, paras 22.76 to 22.90 (considered in the context of remoteness of liability).

<sup>10</sup> McBryde, *Contract*, paras 22.98 to 22.100 suggests that the term “nominal” is perhaps misleading and that these damages, where awarded, are for the pursuer's trouble and inconvenience.

<sup>11</sup> See McBryde, *Contract*, paras 22.101 to 22.105.

#### 7.4 The general measure of damages under the DCFR is:

“such sum as will put the creditor as nearly as possible into the position in which the creditor would have been if the obligation had been duly performed. Such damages cover loss which the creditor has suffered and gain of which the creditor has been deprived.”<sup>12</sup>

7.5 McBryde quotes several judicial dicta showing that this is also Scots law’s basic approach.<sup>13</sup> The approach has been characterised as protecting the creditor’s expectation (or performance) interest.<sup>14</sup> The McGregor Code is broadly similar, but it also explicitly recognises the reliance interest (the recovery of the creditor’s abortive or wasted expenditure under the contract, putting the creditor back in the position as if the contract had not been made) as an alternative to expectation damages. This is however limited by the principle that the creditor could not thereby escape the consequences of a bad bargain, that is where the expectation was of loss, not gain.<sup>15</sup> It is therefore most commonly encountered where the expectation is too uncertain to be measurable, as for example the profits that might have been earned (or not) by a film that was never made, or the market value of salvaging a ship supposed to be wrecked which in fact never existed.<sup>16</sup>

7.6 Such reliance-based recovery has been granted by the English courts in a number of cases, and there are also some Scottish examples.<sup>17</sup> But expectation and reliance measures cannot usually be combined in a single claim, since expenditure will have to be incurred to achieve the expectation.<sup>18</sup> Out-of-pocket expenses (expenditure made necessary by the breach of contract) are however recoverable as part of the loss that would not have arisen had there been no breach.<sup>19</sup> In our 1999 Report we indicated that we did not recommend any specific rule introducing reliance as an alternative measure of damages, available at the creditor’s option.<sup>20</sup> The general principle that losses caused by the breach of contract are recoverable is likely to be sufficient to allow reliance-based recovery in appropriate cases. A useful dictum was provided by the first Lord President Clyde in 1926:

“[T]he measures employed to estimate the money value of anything (including the damage flowing from a breach of contract) are not to be confounded with the value which it is sought to estimate, and the true value may only be found after employing more measures than one—in themselves all legitimate, but none of them necessarily

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<sup>12</sup> DCFR III.–3:702. See also PECL art 9:502; PICC art 7.4.2(1).

<sup>13</sup> McBryde, *Contract*, para 22.91.

<sup>14</sup> See the classic US article: L Fuller and W Perdue, “The Reliance Interest in Contract Damages”, (1936) 46 Yale LJ 52, 373 (two parts). See also *McGregor on Damages*, paras 2.003 and 4.036 to 4.042; D Friedmann, “The Performance Interest in Contract Damages”, (1995) 111 LQR 628 (stressing performance (or expectation) over reliance).

<sup>15</sup> McGregor Code, para 435. See for an example *C & P Haulage v Middleton* [1983] 1 WLR 1461 where a licensee incurred expenditure before the licence was wrongfully terminated early; but even if the licence had not been terminated, the licensee would not have recouped the expenditure, and so no damages were recoverable.

<sup>16</sup> The examples come from *Anglia TV v Reed* [1972] 1 QB 60 and *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377.

<sup>17</sup> See McBryde, *Contract*, paras 22.96 and 22.97. L J Macgregor, “The Expectation, Reliance and Restitution Interests in Contract Damages”, 1996 JR 227, suggests that such claims have been rare in Scotland.

<sup>18</sup> *Cullinane v British “Rema” Manufacturing Co* [1954] 1 QB 292, but see *TC Industrial Plant Pty Ltd v Robert’s Queensland Property Ltd* (1964) 37 ALJR 289 (High Court of Australia).

<sup>19</sup> McBryde, *Contract*, para 22.106.

<sup>20</sup> 1999 Report, para 7.33.

conclusive by itself—and checking one result with another. As Lord Stair puts it... ‘It is rather in the arbitrament of the Judge to ponder all circumstances.’”<sup>21</sup>

7.7 There has been academic debate, largely in the common law world, about the principle that damages compensate for the creditor’s loss attributable to the debtor’s breach. Cases in which damages have been based rather on the debtor’s gain from the breach, or the debtor has been made liable for a third party’s loss caused by the breach (albeit paying the damages to the creditor) are argued to show that a distinction exists between damages awards that provide a substitute for the performance not rendered and those that make good certain detrimental factual consequences for the creditor which flow from the breach.<sup>22</sup> A slightly different way of putting this is that some forms of award vindicate the creditor’s right to performance even where no loss arises, while others are intended to compensate for loss.<sup>23</sup> We do not enter into these debates, but instead deal with the problems of gain-based awards for breach of contract in Chapter 8 and transferred loss claims in Chapter 9.

7.8 The DCFR makes particular provision for damages recovery following termination of contract. Damages may be assessed on the basis of what is termed a “cover” or “replacement” or “substitute” transaction following termination. That is, the loss is measured by the cost of procuring a substitute performance, as well as damages for any further loss.<sup>24</sup> Alternatively, where there has been termination but no cover transaction, the difference between the contract price and the current price of the contract performance at the time of termination may be recovered as damages, as well as any further loss.<sup>25</sup> In essence this amounts to allowing damages on either a “cost of cure” or “difference in value” basis.<sup>26</sup> In our 1999 Report, we took the view that legislative provision of this kind was unnecessary, given the general principle that damages are for the recovery of losses, and that we proposed making clear that this included non-patrimonial loss. McBryde notes that, “the tendency of the courts has been to contrast the contract price with the market price” but that where that is “impossible or unrealistic ... replacement value has been used as a factor in the assessment.”<sup>27</sup> Again, leaving this question for the judges to determine under a general inquiry as to the creditor’s recoverable losses on the particular facts of individual cases may be the most sensible course.

7.9 Liability under the DCFR is limited by reasonable foreseeability of the loss as “a likely result of the non-performance” at the time of conclusion of the contract; but this restriction does not apply if the non-performance was intentional, reckless, or grossly negligent.<sup>28</sup> In our 1999 Report we observed that “hardly any consultees” thought that there should be an exception of the latter kind to the general rule of remoteness.<sup>29</sup> There was support, however, although not universal, for the proposition that the remoteness rule should be stated in terms of foreseeability. Since the Report, the courts have continued to apply the “two-limb”

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<sup>21</sup> *Duke of Portland v Wood’s Trustees* 1926 SC 640, 651. The reference for Stair’s *Institutions* is I, xvii, 16.

<sup>22</sup> This position is most fully argued in D Winterton, *Money Awards in Contract Law* (2015).

<sup>23</sup> R Stevens, “Damages and the Right to Performance: A *Golden Victory* or Not?”, in J W Neyers, R Bronaugh and S G A Pitel (eds), *Exploring Contract Law* (2009) 171.

<sup>24</sup> DCFR III.–3:706. See also PECL art 9:506; PICC art 7.4.5.

<sup>25</sup> DCFR III.–3:707. See also PECL art 9:507; PICC art 7.4.6.

<sup>26</sup> See S Rowan, “Cost of cure damages and the relevance of the injured promisee’s intention to cure”, [2017] CLJ, forthcoming November 2017.

<sup>27</sup> McBryde, *Contract*, para 22.107.

<sup>28</sup> DCFR III.–3:703. See also PECL art 9:503; PICC art 7.4.4.

<sup>29</sup> 1999 Report, para 7.32.

approach formulated in *Hadley v Baxendale*: recoverable loss is either that arising naturally and in the ordinary course of things or that unusual loss which was nonetheless in the parties' reasonable contemplation as the probable result of the breach at the time of contracting. The judges have often glossed this as a single test of foreseeability, while also stressing that what must be foreseeable is the type of loss rather than the amount.<sup>30</sup>

7.10 The DCFR does not appear to have any express equivalent to the possibility found in English law that, while in general loss is assessed as at the date of breach, account may exceptionally be taken of events occurring after that date. The general rule in England is explained by the understanding that normally the creditor responding to breach will immediately go to an alternative source of supply in the market, and then recover the extra cost thereby imposed by way of damages from the debtor. The exception takes into account that this understanding is not invariably what happens after breach.<sup>31</sup> It also extends to cases where a post-breach event would inevitably have reduced the damages payable, such as a declaration of war that would have frustrated the contract or entitled the debtor lawfully to terminate it.<sup>32</sup>

7.11 Damages may be reduced under the DCFR if the creditor is guilty of failure to take reasonable steps in mitigation of its loss, or contributory negligence.<sup>33</sup> The principle of mitigation or minimisation is well-recognised in Scots law,<sup>34</sup> and the DCFR formulation appears consistent with that position. We discuss contributory negligence in Chapter 10.

7.12 Under the DCFR damages are to be measured by the currency most appropriately reflecting the aggrieved party's loss,<sup>35</sup> upholding the principle established for Scots law in *Commerzbank Aktiengesellschaft v Large*.<sup>36</sup> The PICC refines the rule in stating that damages are to be assessed either in the currency in which the monetary obligation was expressed or in the currency in which the harm was suffered, whichever is more appropriate.<sup>37</sup>

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<sup>30</sup> See MacQueen and Thomson, *Contract*, paras 6.33 to 6.39, updating McBryde, *Contract*, paras 22.56 to 22.90. We have not thought it necessary in this Discussion Paper to canvass views on Lord Hoffmann's alternative approach to remoteness enunciated in *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] UKHL 48; [2009] 1 AC 61, which we see as a gloss on the *Hadley v Baxendale* principle. It may be useful in some (but not all) cases, and it is therefore best left with the courts rather than in legislation. See further *McGregor on Damages*, paras 8.165 to 8.178 and A Burrows, "Lord Hoffmann and Remoteness in Contract", in P S Davies and J Pila (eds), *The Jurisprudence of Lord Hoffmann: A Festschrift in Honour of Lord Leonard Hoffmann* (2015) ch 14 (arguing against Lord Hoffmann that remoteness is policy-based, not agreement-centred).

<sup>31</sup> See *Radford v De Froberville* [1977] 1 WLR 1262; *Dodd Properties (Kent) Ltd v Canterbury City Council* [1980] 1 WLR 433; and *Ageas (UK) Ltd v Kwik-Fit (GB) Ltd* [2014] EWHC 2178 (QB). In Scotland see *Douglas Shelf Seven Ltd v Co-operative Wholesale Soc Ltd* [2007] CSOH 53 at para 603 per Lord Reed.

<sup>32</sup> See *Golden Strait Corporation v Nippon Yusen Kubishka Kaisha (The Golden Victory)* [2007] 2 AC 353 (3 to 2 majority), criticised by A Dyson and A Kramer, "There is No 'Breach Date' Rule: Mitigation, Difference in Value and Date of Assessment" (2014) 130 LQR 259. See also M Bridge, "Market and Damages in Sale of Goods Cases" (2016) 132 LQR 405. The decision is further explained as applicable to one-off sales as well as instalment deliveries in *Bunge SA v Nidera BV* [2015] UKSC 43, [2015] 3 All ER 1082.

<sup>33</sup> DCFR III.–3:704 and 3:705. See also PECL arts 9:504 and 9:505; PICC arts 7.4.7 and 7.4.8.

<sup>34</sup> McBryde, *Contract*, paras 22.37 to 22.55.

<sup>35</sup> DCFR III.–3:713.

<sup>36</sup> 1977 SC 375.

<sup>37</sup> PICC art 7.4.12. The McGregor Code, here a little overtaken by developments in the case law since the 1960s, states that damages are generally awarded in sterling (para 431(2)), but in his commentary McGregor stressed that "generally" means that there can be exceptions.

7.13 Whilst the rules of the DCFR and Scots law appear to be broadly similar with regard to damages, it may nonetheless be helpful to clarify the law in this area by including it in any general statutory restatement. We therefore ask:

- 50. If a general statutory restatement is pursued, should it provide that:**
- (a) damages are primarily compensation for any recoverable loss caused to the creditor by the debtor's breach of contract;**
  - (b) the guiding principle in assessing damages is to put the creditor in the position that it would have been in had the contract been fully performed;**
  - (c) losses which are not reasonably foreseeable to the parties at the time of contracting are irrecoverable;**
  - (d) damages may be reduced to the extent that the creditor unreasonably fails to minimise its loss;**
  - (e) damages are to be measured by the currency most appropriately reflecting the creditor's loss?**
- 51. If a general statutory restatement is pursued, should it provide that:**
- (a) in general, loss is assessed as at the date of breach; but**
  - (b) exceptions to this general rule may be allowed?**
- 52. If so, what exceptions should be allowed?**

## **Potential reforms: damages for non-patrimonial loss**

### *Introduction*

7.14 As we have already seen, Scots law favours an approach which sees an award of damages for breach of contract as compensation for the aggrieved party. The aim is to make good the loss suffered by that party. There are a number of qualifications<sup>38</sup> and exceptions. We aim to examine the circumstances in which damages for non-patrimonial loss are recoverable and whether they ought to be available more widely.

7.15 Non-patrimonial loss is the loss of something other than money or property. For example, suppose that a customer orders an outfit which is to be ready for a specified date but the tailor fails to deliver it on time. The customer is upset as a result, but that distress does not generally<sup>39</sup> sound in damages for breach of contract. The decision of the House of

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<sup>38</sup> *Hadley v Baxendale* (1854) 9 Ex 341.

<sup>39</sup> There are exceptions. For example, if the dress is a wedding dress then the position may well be different: *Diesen v Samson* 1971 SLT (Sh Ct) 49.

Lords in *Addis v Gramophone Co Ltd* is often given as the longstanding authority for this proposition.<sup>40</sup> Gloag cites that decision as a authority for the proposition that:

“... it is conceived that injury to the feelings of the party whose contract has been broken, either from the fact or the manner of the breach, are not elements to be taken into account in estimating damages.”<sup>41</sup>

7.16 Not all non-patrimonial claims are disallowed: Scots law recognises damages for non-patrimonial loss in certain situations.<sup>42</sup> It has long been the case, for example, that damages are available when breach of contract leads to physical injury or illness,<sup>43</sup> or trouble and inconvenience.<sup>44</sup> The position in respect of a breach which leads to psychiatric illness is somewhat less clear, though Lord Reed observed in *Ward v Scotrail Railways Ltd*:

“Whatever room for argument there may be in cases where only mental distress is averred, the present case is one in which actual injury (in the form of a psychiatric illness) is alleged; and there is no rule that damages for such injury are irrecoverable in contract.”<sup>45</sup>

7.17 In employment contract cases, however, it has been held at the highest judicial level that psychiatric damage caused to an employee by a dismissal in breach of contract is not a recoverable loss (in part at least because otherwise the statutory regulation of unfair dismissal, which does not compensate such harm, might be undermined).<sup>46</sup> But if the employee suffers a psychiatric injury as a result of the employer’s wrongful behaviour before wrongful dismissal, damages are recoverable for that harm.<sup>47</sup>

7.18 Compensation for mental distress or injured feelings (*solatium*) gives rise to some fine distinctions which are neither always clear in the reported cases nor, in our view, readily justifiable on policy grounds. When we consulted on this topic in 1999 the Faculty of Advocates argued that the courts should be left to develop the law incrementally.<sup>48</sup> Our view at that time was that, whilst court reform was an option, it was both more rapid and more reliable to effect change by legislation. Since we consulted, it appears that the law has become more complex rather than clearer.

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<sup>40</sup> [1909] AC 488. The case concerned the wrongful dismissal of an employee in breach of his contract. A claim for compensation for matters such as the manner of the dismissal, injured feelings, and the fact that the dismissal might make it harder to find new employment was unsuccessful.

<sup>41</sup> Gloag, *Contract*, p 686.

<sup>42</sup> See MacQueen and Thomson, *Contract*, paras 6.28 to 6.29. See also 1999 Report, paras 3.3 and 3.4. The exceptions to the general rule are also considered briefly in a series of *obiter* remarks by Lord Tyre in *Clark v Turnbull* [2017] CSOH 4 at paras 32 and 33. For English Law see *McGregor on Damages*, paras 5.015 to 5.035.

<sup>43</sup> *Cameron v Young* 1907 SC 475 (damages awarded to tenants whose factor negligently failed to investigate and cure drainage problems which led to the tenants contracting typhoid fever).

<sup>44</sup> In the sense of nominal damages, discussed at para 7.3 and fn 8 above. See *Webster & Co v Cramond Iron Co* (1875) 2 R 752 (damages of £10 payable for trouble and inconvenience where an iron company failed to supply pipes to a cotton mill on time, in circumstances where the mill owner suffered no specific pecuniary damage).

<sup>45</sup> 1999 SC 255 at 264. See also Lord Reed’s decision in *Logan v Falkirk and District Royal Infirmary NHS Trust* 1999 GWD 30-1431.

<sup>46</sup> *Johnson v Unisys Ltd* [2003] 1 AC 518. See also *Bliss v SE Thames RHA* [1987] ICR 700; *Edwards v Chesterfield Royal Hospital NHS Foundation Trust* [2011] UKSC 58; [2012] 2 AC 22. In what is strictly an *obiter* part of his judgment in *Logan v Falkirk and District Royal Infirmary NHS Trust* 1999 GWD 30-1431, Lord Reed explored the “obvious” anomalies which would be thrown up if the delictual damages available for psychiatric illness were not also available following breach of contract.

<sup>47</sup> *Eastwood v Magnox Electric plc; McCabe v Cornwall CC* [2005] 1 AC 503.

<sup>48</sup> 1999 Report, para 3.7.

7.19 The basic position is that physical loss or harm caused by a breach of contract will attract damages but other types of loss or harm, such as mental distress, will not.<sup>49</sup> But some non-physical loss or harm has become recoverable as a free-standing claim in damages, as a result of a series of cases from the 1970s onward, though the class of contract to which this applies is narrowly confined.

7.20 Examples include holiday arrangements which have not turned out as intended,<sup>50</sup> a contract for a domestic swimming pool which was not built to the agreed specifications,<sup>51</sup> and a failure by a solicitor to obtain an injunction against molestation of a client.<sup>52</sup> In these cases the sole or main aim of the contract was to provide “pleasure, relaxation, peace of mind or freedom from molestation”. This doctrine has been applied in Scotland when a photographer was in breach of his agreement with the bride to attend her wedding to take photographs,<sup>53</sup> and when caravan owners complained that the owner of a caravan park had not provided the agreed amenities.<sup>54</sup>

7.21 The current law on the recoverability of loss following breach of contract is summarised diagrammatically in Appendix B.<sup>55</sup> In our view, the diagram illustrates the significance of the exceptions to the principle that non-patrimonial loss is irrecoverable.

#### *Recent developments: surveyors' contracts*

7.22 A further area in which damages have been sought as *solatium* is in respect of negligent surveyors who have been in breach of contract. An unsuccessful claim of this nature was made in *Watts v Morrow*.<sup>56</sup> Mr and Mrs Watts bought a holiday home on the strength of a surveyor's report stating that any defects could be dealt with as part of ordinary maintenance. It rapidly emerged that urgent and radical works were needed, eventually costing almost as much as the purchase price. The Watts sued for damages, both for the cost of the unexpected repairs and for the resulting distress, worry, vexation and inconvenience. At first instance, damages were awarded under both heads. The surveyor successfully appealed, though it is only the damages for distress which are relevant for present purposes. Although Ralph Gibson LJ gave the leading judgment, Bingham LJ's concurring one is more succinct. Under the heading “damages for distress and inconvenience”, he stated:

“A contract-breaker is not in general liable for any distress, frustration, anxiety, displeasure, vexation, tension or aggravation which his breach of contract may cause to the innocent party. This rule is not, I think, founded on the assumption that such

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<sup>49</sup> The simplicity of this distinction may turn out to be more apparent than real. In *Farley v Skinner* [2001] 4 All ER 801, Lord Scott essays, at para 85, an explanation of what is meant by “physical inconvenience and discomfort” (and what the substitution of “non-physical” would produce). The critical factor is said to lie in the *cause* of the inconvenience or discomfort: only if the cause is “a sensory (sight, touch, hearing, smell, etc) experience” are damages recoverable (provided that the remoteness test is met). Whilst this shifts the focus from the physicality of the discomfort or inconvenience to its cause, it is not clear that it will always produce an incontrovertible result.

<sup>50</sup> *Jarvis v Swans Tours Ltd* [1973] QB 233; *Jackson v Horizon Holidays Ltd* [1975] 3 All ER 92; *Milner v Carnival plc (t/a Cunard)* [2010] EWCA Civ 389, [2010] 2 All ER (Comm) 397, [2010] 3 All ER 701.

<sup>51</sup> *Ruxley Electronics Ltd v Forsyth* [1996] AC 344.

<sup>52</sup> *Heywood v Wellers* [1976] QB 446.

<sup>53</sup> *Diesen v Samson* 1971 SLT (Sh Ct) 49.

<sup>54</sup> *Colston v Marshall* 1993 SLT (Sh Ct) 40.

<sup>55</sup> No account is taken for these purposes of the tests of foreseeability and remoteness.

<sup>56</sup> [1991] 4 All ER 937, [1991] 1 WLR 1421.

reactions are not foreseeable, which they surely are or may be, but on considerations of policy.

But the rule is not absolute. Where the very object of a contract is to provide pleasure, relaxation, peace of mind or freedom from molestation, damages will be awarded if the fruit of the contract is not provided or if the contrary result is procured instead. If the law did not cater for this exceptional category of case it would be defective. A contract to survey the condition of a house for a prospective purchaser does not, however, fall within this exceptional category.

In cases not falling within this exceptional category, damages are in my view recoverable for physical inconvenience and discomfort caused by the breach and mental suffering directly related to that inconvenience and discomfort. If those effects are foreseeably suffered during a period when defects are repaired I am prepared to accept that they sound in damages even though the cost of the repairs is not recoverable as such. But I also agree that awards should be restrained, and that the awards in this case far exceeded a reasonable award for the injury shown to have been suffered.<sup>57</sup> [emphasis added]

7.23 Two important points emerge from this. First, the boundary between what is recoverable and what is not is very far from clear. Physical harm, if reasonably foreseeable, sounds in damages, as does mental harm which is directly related to it. Ascertaining this is an exercise of considerable subtlety. Secondly, the justification for denying damages for distress or displeasure following breach of contract is set out in the underlined sentence above. It is a question of policy, as becomes clear on examining a number of cases where it has been considered. An unsurprising consequence is that the court's view of that policy has varied over time.

7.24 For example, in *Addis v Gramophone Co Ltd*, Lord Atkinson considered it highly desirable that the heads of damage for breach of contract should remain distinct from those available under tort or delict.<sup>58</sup> Furthermore, the exception which Bingham LJ recognised in *Watts*, that it be confined to contracts whose "very object" was peace of mind, was also based on policy.<sup>59</sup> The policy further developed in 2001 when the House of Lords held in *Farley v Skinner* that the exception is now available where it is merely "a major or important" (as distinct from the sole) object of the contract to give pleasure, relaxation or peace of mind.<sup>60</sup>

7.25 *Farley v Skinner* is another surveyor case. In some ways the facts are rather similar to those in *Watts*, but in this case the defect could not be cured. Mr Farley wanted to buy a property but its proximity to Gatwick Airport caused him some concern. He instructed his surveyor to report on aircraft noise. Reassured by the surveyor's report, he went ahead with the purchase and spent a large sum of money on modernising and refurbishing the property before moving in. After moving in, it became apparent that the property was affected by aircraft noise.<sup>61</sup>

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<sup>57</sup> [1991] 1 WLR 1421 at 1445 E-H.

<sup>58</sup> [1909] AC 488 at 495.

<sup>59</sup> The origins of the exception, which is a product of judicial development in the 1970s, are explained in *Farley v Skinner* [2001] UKHL 49; [2001] 4 All ER 801 at para [19] by Lord Steyn.

<sup>60</sup> [2001] UKHL 49 at para [24] per Lord Steyn.

<sup>61</sup> [2001] UKHL 49 at para [6].

7.26 The damages claim was in two parts, one for diminution of value of the property due to the aircraft noise and one for impairment of use and enjoyment. It appears that the first part of the claim was refused and the second upheld, with damages of £10,000 awarded. This brief summary should not obscure a number of latent difficulties. One feature is that there are four separate and detailed speeches, each giving subtly differing reasons for the result.<sup>62</sup> Another is that some of the judges deal with the “impairment of use” issue by means of two alternative analyses, each leading to the same outcome. On one analysis the matter is one of a contractual loss—the prospective purchaser had instructed the surveyor to report on aircraft noise, amongst other things, and the surveyor had failed to do so. The other analysis focuses on the physical inconvenience of living under the aircraft flight path and the consequent distress.<sup>63</sup>

7.27 There are, however, some common points which emerge from the four speeches:

- if “a major or important object of the contract is to give pleasure, relaxation or peace of mind” there is no bar to the recovery of damages for non-physical loss, and surveying contracts are capable of falling into this category;<sup>64</sup>
- if the contract does not fall into that category, non-physical loss may still be recoverable if it is consequential on physical loss, such as inconvenience or physical discomfort;
- any award for non-physical loss should be modest.<sup>65</sup>

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<sup>62</sup> The fifth, Lord Browne-Wilkinson, agrees with two of the others. An example of the difficulties to which this gives rise is that the test tentatively set out at para [54] for use in future cases is contained in Lord Hutton’s speech, but he is not one of those whom Lord Browne-Wilkinson mentions. It has been said that “[a] close examination of all four speeches in *Farley* can make your head spin”: A Bowen, “*Watts v Morrow* and the consumer surplus”, 2003 SLT (News) 1 at 6.

<sup>63</sup> In Lord Scott’s speech these analyses follow, respectively, the decisions in *Ruxley Electronics Ltd v Forsyth* [1996] AC 344 and *Watts v Morrow*: see paras [105] to [110].

<sup>64</sup> [2001] UKHL 49 at para [24] per Lord Steyn. See also para [41] per Lord Clyde, and para [52] per Lord Hutton.

<sup>65</sup> See para [28] per Lord Steyn and para [110] per Lord Scott.

### *Preliminary conclusions*

7.28 It may be helpful to summarise our preliminary conclusions about the availability of damages for non-patrimonial loss before turning to consider how it is to be quantified. In our view:

- the law is unclear;<sup>66</sup>
- it is developing, but in a piecemeal and patchwork fashion;
- there is some anecdotal evidence that the lower courts are currently awarding damages in suitable cases for non-patrimonial loss;<sup>67</sup>
- this means that decisions about awards of damages are dependent not simply on the exercise of what is, in essence, judicial discretion but also on the judge's understanding of what the proper test is, which leads not to legitimate variation of outcome but to inherent injustice;
- accordingly, there would be value in a principled reform embodied in a clear and universally applicable statutory rule.<sup>68</sup>

### *Quantification of non-patrimonial loss*

7.29 Financial loss is made good by an award whose effect is to compensate the injured party for their loss, that is to put them into the position they would have been in but for the breach.<sup>69</sup> In theory, this is a straightforward exercise whereby the loss is measured in economic units and an equivalent sum is awarded by way of damages.<sup>70</sup> Compensation for losses such as mental distress is much harder to quantify: not only does it involve an exercise of judicial discretion but it may also depend on the subjective sensibilities of the injured party. However, as we have already seen in the context of *Farley*,<sup>71</sup> there is a clear and, it appears, settled view amongst the judiciary that financial awards, if made, are to be modest. What counts as modest is, of course, a matter of subjective judgement and is

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<sup>66</sup> This remains the case despite the outcome of the *Farley* case, where Lord Scott at para [74] said: "It is highly desirable that your Lordships should resolve the present angst on this subject [the recoverability of non-patrimonial losses] and avoid the need in the future for relatively simple claims, such as Mr Farley's, to have to travel to the appellate courts for a ruling". The angst is arguably still present.

<sup>67</sup> See, eg, Lord Steyn's comment in *Farley v Skinner* [2001] UKHL 49 at para [20]: "I am satisfied that in the real life of our lower courts non-pecuniary damages are regularly awarded on the basis that the defendant's breach of contract deprived the plaintiff of the very object of the contract, viz pleasure, relaxation, and peace of mind." This is quoted in a Scottish context without demur: A Bowen, "*Watts v Morrow* and the consumer surplus", 2003 SLT (News) 1, at 5 and 6.

<sup>68</sup> There have been calls from the bench to this effect. Staughton LJ said in a case decided in 1988: "For my part I would have wished for a rather more elaborate argument than we received on this point [damages for distress], before deciding it, since the law seems to be in some doubt. But I would be most reluctant to impose on Mr and Mrs Hayes, on top of their other misfortunes, two or three days of scholarly argument as to whether and in what circumstances damages can be awarded for mental distress consequent upon breach of contract in a business transaction [...]. If, as I think, the law needs clarification, it is to be hoped that a case can be found where that will be provided by the House of Lords. Or it may be that the Law Commission can supply it." *Hayes v James & Charles Dodd (A Firm)* [1990] 2 All ER 815 at 822.

<sup>69</sup> See para 7.3 above.

<sup>70</sup> Of course, that is not always the case in practice: see, eg, MacQueen and Thomson at paras 6.20 to 6.27 and, for a recent example, Lord Hodge's computations in *McCrindle v Maclay Murray & Spens* [2013] CSOH 72 at paras [141] onwards.

<sup>71</sup> See para 7.27 and fn 65 above.

dependent on the facts.<sup>72</sup> Nonetheless, what is indisputable is that the compensatory nature of the award is not to be forgotten. Thus, damages for distress which are in effect punitive,<sup>73</sup> or which represent exemplary or aggravated damages, are liable to be struck down on appeal. Awards for patrimonial loss are compensatory, and so too are any non-patrimonial awards.<sup>74</sup> For compensation for distress as a result of building works to domestic properties, the English courts appear to have accepted the modest annual level of award set out by the High Court in *AXA Insurance UK Plc v Cunningham Lindsey United Kingdom*,<sup>75</sup> which is described in a recent decision of the Court of Appeal as the “well-accepted maximum.”<sup>76</sup>

### *Proposals for reform*

7.30 We criticised the current law in our 1999 Report and recommended that all forms of loss or harm should be recoverable, whether or not patrimonial in nature, subject only to the normal rule as to remoteness.<sup>77</sup> Almost all consultees supported this, and the one dissenting view was to the effect that the common law should be allowed to continue to evolve and develop incrementally. Leaving aside any question of what substantive developments the courts might make, such a view is open to the objection that too few cases are brought before the Scottish courts to justify them being given the task of keeping the law under review. Of course, even where courts have a plentiful supply of certain types of case this does not mean that they are necessarily in a better position than a body such as a Law Commission to effect change. Where the quantity of cases is only a trickle rather than a flood the argument is, in our view, all the harder to make.<sup>78</sup>

7.31 We are therefore interested to hear consultees’ views on statutory reform. The aim would be to state clearly that awards of damages as compensation for non-patrimonial loss or harm are competent. We set out a specific proposal below, but before doing so it is worth recognising that there are principled arguments in support of a contrary view.

7.32 First, the floodgates argument. Whilst we acknowledge that the suggested reform might lead to some claims being made when they would not at present be raised, we are not persuaded that this is likely to happen on an industrial scale. Nor does the current evidence suggest that the courts will make awards which would encourage any widespread claim culture. Indeed, as we have seen, domestic courts carefully police the hurdles to be satisfied before a valid claim can be made, and downplay any expectations of significant awards for non-patrimonial loss. It should also be noted that in certain areas, such as package travel,

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<sup>72</sup> See *Milner v Carnival plc (t/a Cunard)* [2010] EWCA Civ 389, [2010] 3 All ER 701 for recent authority on the need for restraint.

<sup>73</sup> There are indications that the *Addis* decision, which is usually cited as the reason why non-patrimonial loss is not recoverable following breach of contract, was in part motivated by a fear that such loss would be seen more as punishment for the wrong-doer rather than compensation for the injured party. If that fear is removed or at least allayed then there is less of a principled or practical objection to non-patrimonial loss being recoverable.

<sup>74</sup> Compare the recommended approach in the joint Report by this Commission and the Law Commission on Consumer Redress for Misleading and Aggressive Practices (LC No 332, SLC No 226; 2012) at paras 8.149 to 8.164. Its recommendation 44 calls for statutory provision that damages for distress and inconvenience should be “restrained and modest”.

<sup>75</sup> [2007] EWHC 3023 (TCC), at paras 274 and 275: £2,000 per person per year at 2001 prices; allowing for inflation to the end of 2007, Akenhead J thought damages would not generally exceed £2,500 per person per year.

<sup>76</sup> *West v Ian Finlay & Associates* [2014] EWCA Civ 316 at paras 83 to 86.

<sup>77</sup> 1999 Report, paras 3.5 to 3.8.

<sup>78</sup> Indeed, the Court of Appeal of England and Wales has called for the Law Commission to intervene: see fn 68 above.

claims are already competent for non-patrimonial losses, and so we would be developing that practice rather than creating an entirely new one.<sup>79</sup> Also, two important safeguards would remain firmly in place: first, the measure of damages would continue to be compensatory, and secondly it would still be for the party asserting an injury to establish the existence of any loss or harm, whether patrimonial or not. In addition, the test of remoteness applies, so that the loss or harm must be reasonably foreseeable. The court will also take into account any countervailing factors such as steps taken (or not taken) to mitigate the loss, and any relevant contributory negligence.

7.33 The other criticism is that contractual and delictual damages for non-patrimonial loss will become assimilated without good reason. Although this Paper is not the place to consider the point in great detail, it is a relevant argument and merits consideration. Is there a policy reason why a person may claim contractual damages for patrimonial loss but may have to raise an action in delict for non-patrimonial loss or harm? Up until the early twentieth century it was not hard to find such reasons: for instance, contracts were essentially tools of business, and companies generally only suffer patrimonial losses; and the law of delict, certainly before *Donoghue v Stevenson*,<sup>80</sup> was both unrecognisably more restrictive than it is now and has, by and large, developed independently of developments in the law of contract. But, whatever justification there may have been in the past, policy considerations now tend to point in a rather different direction.

7.34 We have seen a positive willingness both domestically<sup>81</sup> and internationally<sup>82</sup> to break down what are increasingly seen as artificial barriers to granting compensation in contract for some non-patrimonial loss or harm. The scope of such loss which remains irrecoverable in contract is diminishing.<sup>83</sup> A policy which seeks to screen out a steadily reducing set of claims, and whose boundaries have been successfully challenged in various recent appellate proceedings, is a policy whose existence needs to be positively and persuasively justified.

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<sup>79</sup> See Council Directive (EEC) 90/314 (as replaced by European Parliament and Council Directive 2015/2302), implemented in the UK by the Package Travel, Package Holidays and Package Tours Regulations (SI 1992/3288) reg 15 (implementing recital 34 and Article 14(2) of the Directive).

<sup>80</sup> [1932] AC 562; 1932 SC (HL) 31; 1932 SLT 317.

<sup>81</sup> Eg the comments of Lord Reed noted at para 7.16 above, and especially the *Logan* decision cited in fn 46.

<sup>82</sup> See fn 78 above.

<sup>83</sup> See for example the acceptance in *Farley v Skinner* that surveyors' contracts are a proper basis for a claim following breach, contrary to comments in earlier cases.

7.35 Furthermore, it is a feature of Scots law that, in seeking to right wrongs, the primary focus is on identifying the relevant remedy rather than on a formalistic insistence on identifying the correct form of action. This is an aspect of the equitable doctrine *ubi jus ibi remedium*. Other legal systems require a claimant to bring their claim within a particular action before any consideration of remedy can be given. With that in mind, for Scots law to deny compensation to a claimant who brings an action for non-patrimonial loss under contract rather than delict could be seen as being contrary to principle. Accordingly, we ask:

- 53. Subject to the normal remoteness and other rules, should damages recoverable for breach of contract include non-patrimonial loss or harm of any kind?**
- 54. In particular, should loss of the satisfaction of obtaining a contractual benefit, and harm in the form of pain, suffering or mental distress be included?**

# Chapter 8 Gain-based damages

## Introduction

8.1 Gain-based damages are best described as awards that reflect the gain made by the debtor from its breach of contract, rather than compensating the creditor for the loss it has suffered. Such damages have received little attention in Scotland as a potential remedy for breach of contract, perhaps in light of House of Lords authority that they are not available.<sup>1</sup>

8.2 The concept of gain-based damages has been developed in recent years in England and Wales, where the courts have made a number of awards of damages which can best be characterised in this way. The concept has also spread to other common law jurisdictions, although its reception has not been uniform.

8.3 In this Chapter, we begin by considering the extent to which the DCFR and Scots law recognise the existence of gain-based damages. We then review the development of the concept in England and Wales, and other common law jurisdictions, before discussing whether the non-recognition of this type of award in Scots law should be revisited.

## The DCFR and Scots law compared

### *The DCFR*

8.4 Under the DCFR, it is clear that damages are recoverable only in respect of the creditor's loss, not any gain made by the debtor in consequence of its non-performance.<sup>2</sup> The creditor's right to damages is explained in terms of loss caused by the debtor's unexcused non-performance, and the definition of loss does not contemplate that any benefit to the debtor should be taken into account.<sup>3</sup> The commentary confirms what is apparent from the text:

"A few of the laws [i.e. national laws] permit the creditor in particular circumstances to recover the gains made by the debtor through the non-performance, even if these exceed the loss to the creditor. The situations are so limited that this approach has not been adopted in these rules."<sup>4</sup>

8.5 It has been argued that under the DCFR the creditor may have delictual and unjustified enrichment claims against the gain-making debtor.<sup>5</sup> However, this Discussion Paper is concerned only with contractual remedies. The compilers of the DCFR appear to have seen no need to develop any general provision on the matter in contract law, perhaps because of the limited recognition of the concept in the legal systems that were considered. The text provides no guidance on the limited situations in which such an award might be

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<sup>1</sup> See para 8.6 below.

<sup>2</sup> See para 7.4 above.

<sup>3</sup> DCFR, III.–3:701(1) and (3).

<sup>4</sup> DCFR III.–3:701 Commentary B, para 2.

<sup>5</sup> See H L MacQueen, "The Common Frame of Reference in Europe", (2010) 25 *Tulane European and Civil Law Forum* 177, at 182 to 192.

made in the legal systems which do recognise the concept, and so we are unable to consider whether those limited situations might find a place in Scots law.

### *Scots law*

8.6 In Scots law, damages for breach of contract are purely compensatory: if the debtor makes a profit in breaching the contract, that is regarded as irrelevant to any calculation of the creditor's damages.<sup>6</sup> *Teacher v Calder* is the most commonly cited authority for this rule.<sup>7</sup> In that case, the creditor lent the debtor (a timber merchant) sums of money to be invested in his business, in exchange for interest and a share of the profits. The debtor, in breach of a provision of the contract forbidding it, withdrew capital from the business and invested it in a distillery. The debtor made large profits from the distillery business.

8.7 While the judgments of the Inner House and the House of Lords were primarily concerned with other terms of the contract, the question of the appropriate measure of damages was briefly considered. In both courts, the notion that the debtor should be made to account for the profits that he had made with the diverted funds was rejected. It was held (without much discussion) that the correct measure of damages was the difference between what the timber business would have made with the additional investment, and what it had in fact made.

8.8 That said, Scots law recognises that a debtor may be called to account for its profits in certain circumstances. It appears, however, that this arises only where there has been a breach of fiduciary obligations (such as those between trustees and trust beneficiaries, partners in a partnership, agent and principal, and directors and their company). The underlying policy is to deter parties in fiduciary positions from committing breach of duty.

8.9 Not all of these fiduciary relationships involve a contract, although partnership and agency typically do.<sup>8</sup> Indeed, it appears that *Teacher v Calder* was argued before the Inner House principally as a question of breach of trust, or breach of partnership, so that the breach would be treated as a breach of a fiduciary obligation, opening up the prospect of an accounting. Those arguments were rejected, as was the secondary argument that the measure of damages should be the profits made with the diverted funds, leaving the creditor to claim damages in the ordinary way instead.<sup>9</sup>

## **Development of the concept of gain-based damages**

### *Gain-based remedies in English law*

8.10 England and Wales is probably the jurisdiction in which gain-based remedies for breach of contract are most developed. However, the origin of gain-based remedies in English law is not to be found in the field of contract. Gain-based remedies have long been familiar in areas of English law such as tort: for example, interferences with rights to land,<sup>10</sup>

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<sup>6</sup> McBryde, *Contract*, para 22.94.

<sup>7</sup> (1898) 25 R 661 (Inner House); (1899) 1 F (HL) 39 (House of Lords).

<sup>8</sup> See further L J Macgregor, *The Law of Agency in Scotland* (2013) ch 6.

<sup>9</sup> *Teacher v Calder* (1898) 25 R 661 at 672 per the Lord President (Robertson).

<sup>10</sup> *Wrotham Park Estate Co Ltd v Parkside Homes Ltd* [1974] 1 WLR 798.

property torts such as conversion,<sup>11</sup> and breach of confidence cases.<sup>12</sup> In *Attorney General v Blake*, however, it was held that they also applied to breaches of contract.<sup>13</sup>

8.11 According to Edelman, gain-based remedies for breach of contract fall into two distinct categories: accounts of profits (or disgorgement awards), and reasonable fee awards.<sup>14</sup> That view is not universal: Rowan suggests that reasonable fee awards achieve, in effect, partial disgorgement and that there is a “sliding scale” of damages with an account of all profits representing total disgorgement.<sup>15</sup> In this Discussion Paper, we discuss the development of English law by reference to the two distinct categories, in line with the most recent decisions of the Court of Appeal which highlight the different tests to be applied.<sup>16</sup>

8.12 Disgorgement awards are intended to represent the totality of the debtor’s profits from committing the breach of contract. The rationale underpinning this award is generally understood to be deterrence of breach: in depriving the debtor of the benefits of breaching the contract, any incentive to do so is removed.<sup>17</sup> The concept is known elsewhere in English law, most notably in relation to fiduciary obligations.<sup>18</sup>

8.13 By contrast, reasonable fee awards do not deprive the debtor of the entirety of the profits made in committing the breach, but require the debtor to pay the creditor a hypothetical “reasonable fee” for the waiver of the contractual right in question. The rationale behind such an award is controversial. While such an award may be considered restitutionary or gain-based because it is the amount the debtor has saved in not having to pay such a fee to the creditor,<sup>19</sup> others consider it to be compensatory and based on the creditor’s lost opportunity to bargain with the debtor.<sup>20</sup>

### Reasonable fee awards

8.14 Reasonable fee awards are sometimes called *Wrotham Park* damages after the case in which they were first granted.<sup>21</sup> They are based on a hypothetical “reasonable fee” which the court considers it would have been reasonable for the debtor to pay to the creditor in

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<sup>11</sup> *Strand Electric & Engineering Co v Brisford Entertainments Ltd* [1952] 2 QB 246.

<sup>12</sup> *Vercoe v Rutland Fund Management* [2010] EWHC 424 (Ch).

<sup>13</sup> [2001] 1 AC 268 at 284 per Lord Nicholls of Birkenhead.

<sup>14</sup> Edelman, *Gain-Based Damages* Ch 3.

<sup>15</sup> Rowan, *Remedies for Breach of Contract*, p 160 and fn 343.

<sup>16</sup> *Morris-Garner v One Step (Support) Ltd* [2016] EWCA Civ 180, [2017] QB 1, para 126 per Christopher Clarke LJ.

<sup>17</sup> Rowan, *Remedies for Breach of Contract*, p 155 and fn 314; K Barnett, “Deterrence and Disgorging Profits for Breach of Contract,” (2009) 17 RLR 79.

<sup>18</sup> *Boardman v Phipps* [1967] 2 AC 46. See also P Birks, “The Content of Fiduciary Obligation” [2000] Israeli LR 3; I Samet, “Guarding the Fiduciary’s Conscience – a Justification of a Stringent Profit-Stripping Rule” (2008) 28 OJLS 763.

<sup>19</sup> Edelman, *Gain-Based Damages* Ch 3; *Experience Hendrix LLC v PPX Enterprises Inc* [2003] EWCA Civ 323, [2003] EMLR 25. See further A Burrows, “Are ‘Damages on the *Wrotham Park* Basis’ Compensatory, Restitutionary or Neither?” in D Saidov and R Cunnington, *Contract Damages: Domestic and International Perspectives* (2008), p 165; R Cunnington, “The Measure and Availability of Gain-Based Damages for Breach of Contract”, *ibid*, p 207; C Rotherham, “‘*Wrotham Park* Damages’ and Accounts of Profits: Compensation or Restitution?” [2008] LMCLQ 25; R Cunnington, “The Assessment of Gain-Based Damages for Breach of Contract” (2008) 71 MLR 559.

<sup>20</sup> *WWF World Wide Fund for Nature (formerly World Wildlife Fund) v World Wrestling Federation Entertainment Inc* [2007] EWCA Civ 286, [2008] 1 WLR 445; *Pell Frischmann Engineering Ltd v Bow Valley Iran Ltd* [2009] UKPC 45, [2011] 1 WLR 2370.

<sup>21</sup> *Wrotham Park Estate Co Ltd v Parkside Homes Ltd* [1974] 1 WLR 798.

exchange for breaching the obligation in question.<sup>22</sup> In other words, they are calculated by reference to what the creditor could have obtained from the debtor in exchange for waiving its right.<sup>23</sup>

8.15 *Wrotham Park* itself provides a good illustration. The defendants breached a restrictive covenant not to develop land without approval. When the claimants sought a mandatory injunction for the demolition of the additional buildings, the court refused to grant it, awarding damages instead. It held that the correct measure of damages was the sum that the claimants might reasonably have demanded from the defendants in exchange for relaxation of the covenant.

8.16 It was once thought, based on the context of *Wrotham Park*, that reasonable fee damages were only awardable as part of the court's jurisdiction to award damages in lieu of an injunction.<sup>24</sup> However, it is now clear that the possibility of, or the fact that the creditor has sought, an injunction is not a requirement for reasonable fee damages.<sup>25</sup> It is also now clear that reasonable fee awards can be awarded for breach of any contractual right,<sup>26</sup> not just rights of a proprietary character as was previously thought to be the case.<sup>27</sup>

8.17 In *Morris-Garner v One Step (Support) Ltd*, the Court of Appeal held that the only question the court should ask itself when considering whether to grant a reasonable fee award is "what remedy is required to avoid injustice in the particular case."<sup>28</sup> It also stated that *Wrotham Park* damages may be awarded where it is very difficult for the creditor to establish ordinary compensatory damages.<sup>29</sup> Chitty also suggests that a reasonable fee award may be made where traditional damages would leave the creditor undercompensated.<sup>30</sup> It appears that this criterion is key when considering whether to grant a reasonable fee award. The essential comparison in judging under-compensation is whether the debtor's gain exceeds the creditor's loss by a significant amount.

8.18 Once the court decides to make a reasonable fee award, it is necessary to consider how it assesses what a reasonable fee is. It has been established that this is a hypothetical exercise carried out on the basis that the creditor would have been prepared to sell its contractual right, even if this was not the case.<sup>31</sup> The negotiation is imagined to be between a willing buyer (the debtor) and a willing seller (the creditor), and the subject-matter is the

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<sup>22</sup> *WWF World Wide Fund for Nature (formerly World Wildlife Fund) v World Wrestling Federation Entertainment Inc* [2007] EWCA Civ 286, para 53 per Chadwick LJ.

<sup>23</sup> *Chitty on Contracts*, para 26.051.

<sup>24</sup> Originally under Lord Cairns' Act (the Chancery Amendment Act 1858), now under s 50 of the Senior Courts Act 1981.

<sup>25</sup> See *Morris-Garner v One Step (Support) Ltd* [2016] EWCA Civ 180, [2017] QB 1, para 89 per Christopher Clarke LJ; *Giedo van de Garde BV v Force India Formula One Team Ltd* [2010] EWHC 2373, para 526 per Stadlen J; *Prell v Frischmann Engineering Ltd v Bow Valley Iran Ltd* [2009] UKPC 45, [2011] 1 WLR 2370, paras 46 and 47 per Lord Walker of Gestingthorpe.

<sup>26</sup> *Giedo van de Garde BV v Force India Formula One Team Ltd* [2010] EWHC 2373; *Morris-Garner v One Step (Support) Ltd* [2016] EWCA Civ 180, [2017] QB 1.

<sup>27</sup> *Prell v Frischmann Engineering Ltd v Bow Valley Iran Ltd* [2009] UKPC 45, [2011] 1 WLR 2370, para 48 per Lord Walker of Gestingthorpe.

<sup>28</sup> *Morris-Garner v One Step (Support) Ltd* [2016] EWCA Civ 180, para 120 per Christopher Clarke LJ. It disapproved the suggestion in *Abbar v (SEDCO) Real Estate Ltd* [2013] EWHC 1414 that the creditor must be unable to establish any financial loss assessed on the usual basis.

<sup>29</sup> *Morris-Garner v One Step (Support) Ltd* [2016] EWCA Civ 180, [2017] QB 1, para 117 per Christopher Clarke LJ.

<sup>30</sup> *Chitty*, para 26.053.

<sup>31</sup> *Giedo van de Garde BV v Force India Formula One Team Ltd* [2010] EWHC 2373, para 540 per Stadlen J.

release of the relevant contractual obligation.<sup>32</sup> Sales J in *Vercoe v Rutland Fund Management*<sup>33</sup> provided a list of factors to be taken into account. These were:

- “(i) the likely parameters given by ordinary commercial considerations bearing on each of the parties [...];
- (ii) any additional factors particularly affecting the just balance to be struck between the competing interests of the parties [...];
- (iii) the court’s overriding obligation to ensure that an award of damages for breach of contract [...] does not provide relief out of proportion to the real extent of the creditor’s interest in proper performance judged on an objective basis by reference to the situation which presents itself to the court.”<sup>34</sup>

8.19 In line with the general rule discussed above,<sup>35</sup> the court will normally assess a reasonable fee award at the date of the breach, but may depart from this rule where justice requires it to do so.<sup>36</sup>

### Accounts of profits

8.20 The House of Lords first awarded an account of profits as a remedy for a breach of contract in *Attorney General v Blake*. Blake was a former member of the Secret Intelligence Service. During his service, he disclosed secret information to the USSR. He pleaded guilty in 1961 to offences under the Official Secrets Act 1911. He was subsequently imprisoned, escaped, and then fled to the USSR. In 1990, he published his memoirs which related in part to his activities as a secret intelligence officer, receiving a substantial advance from his English publishers as a result.

8.21 The Attorney General commenced proceedings in 1991 with the intention that Blake should not profit further from the publication of his memoirs. The Attorney General’s case was differently formulated at each stage of the proceedings: at first instance, he argued that Blake was in breach of fiduciary duties that he owed the Crown; on appeal he was permitted to advance a public law claim where he invoked the assistance of the civil law in aid of the criminal law to ensure that Blake did not profit from his crimes. Before the House of Lords, the Attorney General’s argument further evolved to add a new private law claim, namely that Blake had breached a contractually binding obligation constituted in 1944 when he signed a declaration relating to the Official Secrets Act 1911.

8.22 The Attorney General was ultimately successful before the House of Lords on the last of these arguments. It declared that the Attorney General was entitled to be paid a sum equal to the amount due to Blake from his publisher: in effect, Blake had to account for the profits arising from his breach of the 1944 declaration.

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<sup>32</sup> *Prell v Frischmann Engineering Ltd v Bow Valley Iran Ltd* [2009] UKPC 45, [2011] 1 WLR 2370, para 49 per Lord Walker of Gestingthorpe. There are some similarities with the usual approach in Scotland under rent review clauses.

<sup>33</sup> [2010] EWHC 424.

<sup>34</sup> [2010] EWHC 424, para 292 per Sales J.

<sup>35</sup> See para 7.10 above.

<sup>36</sup> *Morris-Garner v One Step (Support) Ltd* [2016] EWCA Civ 180, [2017] QB 1, para 132 per Christopher Clarke LJ.

8.23 Giving the leading speech, Lord Nicholls of Birkenhead examined the origin of various remedies and concluded that:

“it would be only a modest step for the law to recognise openly that, exceptionally, an account of profits may be the most appropriate remedy for breach of contract. It is not as though this step would contradict some recognised principle applied consistently throughout the law to the grant or withholding of the remedy of an account of profits. No such principle is discernible.”<sup>37</sup>

8.24 Lord Nicholls went on to emphasise that an account of profits would only be available in such cases in exceptional circumstances, and that the court would have regard to all the circumstances of the case in assessing exceptionality. He added that:

“[a] useful general guide [...] is whether the [creditor] had a legitimate interest in preventing the [debtor’s] profit-making activity and, hence, in depriving him of his profit.

It would be difficult, and unwise, to attempt to be more specific.”<sup>38</sup>

8.25 In essence, it appears that Lord Nicholls thought that the availability of an account of profits would be fact-sensitive. For example, he also considered that Blake’s obligation, though not fiduciary, was “closely akin to a fiduciary obligation”, where an account of profits would have been the standard remedy.<sup>39</sup> He suggested that, in the special circumstances of the intelligence services, it would be just to order an account of profits even though the information in question was no longer confidential.<sup>40</sup> In short, it appears that the fact that the creditor could have obtained specific performance or an injunction, but could no longer do so due to the actions of the debtor, might have been enough to bring the case within the exceptionality criterion.

8.26 *Blake* was not received uncritically. Campbell proposed that restitutionary remedies were inappropriate in commercial cases, partially because of the extent to which these interfere with the theory of efficient breach.<sup>41</sup> Campbell also criticised *Blake* on the basis that it completely failed to address *Teacher v Calder*. The argument was however challenged by Black, who argued for the commercial utility of the new approach in responding to breach of restrictive covenants in particular, so long as the remedy otherwise remained exceptional in nature.<sup>42</sup> However, it has also been doubted whether any contract at all existed between Blake and the Crown. The House of Lords looked to the declaration relating to the Official Secrets Act 1911 as being the source of the contractual obligation, rather than any purported contract of employment. Simpson’s analysis of the declaration casts doubt on its contractual status, however.<sup>43</sup>

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<sup>37</sup> [2001] 1 AC 268 at 285 per Lord Nicholls of Birkenhead.

<sup>38</sup> *Ibid.*

<sup>39</sup> [2001] 1 AC 268 at 287 per Lord Nicholls of Birkenhead.

<sup>40</sup> *Ibid.*

<sup>41</sup> D Campbell, “The Treatment of *Teacher v Calder* in *AG v Blake*” (2002) 65 MLR 256. See also D Campbell and P Wylie, “Ain’t No Telling (Which Circumstances are Exceptional)” [2003] CLJ 605.

<sup>42</sup> Black, “New Experience”.

<sup>43</sup> A W B Simpson, “A decision per incuriam?” (2009) 125 LQR 433.

8.27 The second case in which the court granted an account of profits for breach of contract was *Esso Petroleum Ltd v Niad*.<sup>44</sup> In this case, the debtor (Niad) had a five-year solus agreement with the creditor (Esso) to sell its fuel. The creditor introduced a marketing scheme by which every day it would undercut the prices being charged by its competitors. The debtor signed a document agreeing to implement the recommended daily prices under the scheme. It was the debtor's breach of this agreement (charging more than the agreed price) which led to the creditor raising proceedings.

8.28 In holding that the creditor was entitled to an account of profits, Sir Andrew Morritt VC listed a number of relevant factors. First, contractual damages would be inadequate as it would be "almost impossible" to attribute lost sales to a breach by one out of several hundred dealers. Secondly, the obligation in question was "fundamental" to the operation of the scheme, and failure to comply with it undermined the entire marketing campaign. Thirdly, the creditor had complained four times, with the debtor appearing to comply on each occasion, but the breaches turned out to be more extensive than the creditor apprehended. Finally, Esso as creditor "undoubtedly [had] a legitimate interest in preventing Niad from profiting from its breach of obligation."<sup>45</sup>

8.29 The decision has been criticised by some for applying the remedy in a purely commercial context, and on the basis that the impossibility of quantifying conventional damages should not be a reason for awarding an account of profits.<sup>46</sup> Others have argued that the remedy in this case is a useful commercial tool as it offers a stronger means of incentivising performance than damages alone.<sup>47</sup>

8.30 Although an account of profits has not been awarded for a breach of contract in any other case, it has been discussed in a small number of subsequent cases, all of which stress the requirement of exceptionality as a pre-requisite. In *Experience Hendrix LLC v PPX Enterprises Inc*, Mance LJ stated that he did not "regard the case as exceptional to the point where the court should order a full account of profits."<sup>48</sup> In *Morris-Garner v One Step (Support) Ltd*, Christopher Clarke LJ stated that exceptionality was not the test for reasonable fee awards, but that the position was different in relation to an account of profits which "is, truly, an exceptional remedy".<sup>49</sup> An account was refused in *AB Corporation v CD Company (The "Sine Nomine")*,<sup>50</sup> where arbitrators held that "there should not be an award of profits where both parties are dealing with a marketable commodity ... for which a substitute can be found in the market place."<sup>51</sup>

8.31 A great deal of the academic commentary in England supports the proposition that the purpose of an account of profits, at common law or in equity, is to deter the debtor from breaching its obligations.<sup>52</sup> This is generally agreed to be necessary in fiduciary

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<sup>44</sup> [2001] EWHC Ch 458.

<sup>45</sup> *Ibid*, para 63.

<sup>46</sup> E McKendrick, "Breach of Contract, Restitution for Wrongs, and Punishment", in A Burrows and E Peel (eds) *Commercial Remedies* (2003), p 110; A Gray, "Disgorgement Damages", [2013] *Journal of Business Law* 657.

<sup>47</sup> See Black, "New Experience".

<sup>48</sup> [2003] EWCA Civ 323, para 44, [2003] EMLR 25.

<sup>49</sup> [2016] EWCA Civ 180, para 126, [2017] QB 1.

<sup>50</sup> [2002] 1 Lloyds Rep 805.

<sup>51</sup> [2002] 1 Lloyds Rep 805 at para 10.

<sup>52</sup> M Conaglen, "The Nature and Function of Fiduciary Loyalty" (2005) 121 LQR 452; J Edelman, *Gain-Based Damages*, Ch 3; Barnett, "Deterrence and Disgorging Profits for Breach of Contract", (2009) 17 RLR 79.

relationships, as the fiduciary is uniquely placed to take advantage of the person to whom the obligations are owed. However this can also happen in the contractual context. For example, if, as in *Blake* and *Esso*, a party has contracted not to do something and the other party has no practical power to supervise them and prevent them from doing that thing, then the latter is in a reliant and vulnerable position. In such situations, it can be argued that an account of profits is a suitably deterrent remedy.

#### Accounts of profits: other jurisdictions

8.32 The availability of an account of profits for breach of contract, stemming from *Blake* and *Esso* in English law, may be compared with the position in other jurisdictions. As we discuss below, approaches to this remedy are mixed: we have identified jurisdictions where the position appears similar, where the remedy is more readily available, where the possibility of the remedy is accepted but has never been applied, and where the remedy has been rejected.

8.33 **Canada.** Most similar to *Blake* is the Canadian case, *Nunavut Tunngavik Inc v Canada (Attorney General)*.<sup>53</sup> Notably, however, the amount awarded here was the amount saved by the defendants, rather than profits made. The debtor was the (Canadian) Crown, which had entered a land agreement (the Nunavut Land Claims Agreement) with the Inuit people (represented by the creditor Nunavut Tunngavik Inc). Under the agreement, the Crown should have created and funded an environment and monitoring plan by 2003. But this did not commence until 2010. The loss to the creditor was the lack of a monitoring plan, which it saw as essential to making better decisions about environmental protection and land use. The cost of implementing the plan was estimated to be \$11 million. The debtor's gain was calculated by the court as the amount saved by the Crown in not expending the \$11 million when it ought to have done so.

8.34 It was contended that the Crown owed a fiduciary relationship to the Inuit people. However, Johnson J held that a gain-based remedy could be granted for breach of contract alone: "in some circumstances an appropriate remedy for breach of contract is to require the defendant to disgorge the benefit obtained through the breach."<sup>54</sup> One such circumstance is when the debtor is under an obligation "akin to a fiduciary duty".<sup>55</sup> Johnson J considered that the case had the "something more" envisaged in *Blake* as required to order an account of profits even if the Crown did not have a fiduciary duty.

8.35 Clear parallels can be drawn between the reasoning of Johnson J in *Nunavut Tunngavik* and Lord Nicholls in *Blake*. Firstly, in both cases, one of the reasons for awarding an account of profits was that the debtor was in a position "akin to a fiduciary". Secondly, we also see the creditor having a "legitimate interest" in preventing the breach, though without a great deal of guidance as to the content of the interest in question. Thirdly, both cases involved some element of public policy: the confidentiality of the secret services in *Blake*, and the maintenance of relations between the Crown and the aboriginal Canadian people in *Nunavut Tunngavik*. Fourthly, in both cases specific performance was unavailable: in *Blake*

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<sup>53</sup> 2012 NUCJ 11 (Nunavut Ct. Jus).

<sup>54</sup> 2012 NUCJ 11 (Nunavut Ct. Jus), para 287 per Johnson J.

<sup>55</sup> Johnson J states that the Crown's duty to act honourably in the implementation of land claims agreements is "akin to a fiduciary obligation".

because the information had already been published, and in *Nunavut Tunngavik* because the court had no jurisdiction to grant specific performance against the Crown. Finally, in both cases, loss was impossible to quantify, and nominal damages were considered an unacceptable measure of recovery.

8.36 **Israel.** The most far-reaching application of an account of profits for breach of contract is to be found in an Israeli case. In *Adras Building Material Ltd v Harlow and Jones GmbH*,<sup>56</sup> the debtor was a German company which was due to supply iron to the appellant, an Israeli company. Most of the iron had been dispatched to Israel, but due to a surge in the iron market some of the remaining iron in Germany was sold to a third party at a higher price. The creditor sued for breach of contract and unjust enrichment, claiming the additional profits realised by the debtor as a result of its breach.

8.37 The Israeli Supreme Court held by a majority that the creditor could recover the profits made by the debtor from its breach of contract. For the majority Barak J held that a contractual right was “part of a person’s property”; as unjust enrichment could arise from harm to a proprietary right, so it could also arise from “harm to a contractual right”.<sup>57</sup> Further, specific performance in Israel (which includes prohibition of breach as well as enforcement of performance) is not a secondary remedy to be granted at the court’s discretion, but rather provides “the first and foremost remedies according to our basic principles”.<sup>58</sup> The right to restitution would “strengthen the contractual relationship and ... increase the likelihood of the contract’s being performed.”<sup>59</sup>

8.38 For the minority, Ben-Porath VP found that the creditor was not entitled to claim the debtor’s profits. To do so, the creditor would have had to have brought an action for specific performance. This, in the Vice President’s view, was prohibited by the fact that its damages claim had brought the contract to an end.<sup>60</sup> Both lines of reasoning are interesting because they each demonstrate a linkage between disgorgement of profits for breach of contract and the availability of specific performance (including in its prohibitory form).

8.39 **Ireland.** An Irish decision some 20 years before *Blake* recognised the possibility of gain-based awards for breach of contract, although there has been no subsequent decision applying the idea.<sup>61</sup> In *Hickey & Co Ltd v Roches Stores (Dublin) Ltd (No 1)*,<sup>62</sup> the debtor breached a contract which allowed the creditor to sell fabric in the former’s store, having concluded that even after paying damages it would still profit by itself selling the fabric instead. Finlay P stated obiter that though the general rule of damages was to put the injured party in the same position as if the contract had been performed, where the debtor has “calculated and intended by his wrongdoing to achieve a gain or profit, which he could not otherwise achieve and in that way acted *mala fide*”, then “irrespective” of whether the act

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<sup>56</sup> (1988) 42(1) PD 221 (fully translated in (1995) 3 RLR 235).

<sup>57</sup> *Ibid*, 270 (para 25).

<sup>58</sup> *Ibid*, 271 (para 26).

<sup>59</sup> *Ibid*, 271 (para 27).

<sup>60</sup> *Ibid*, 248 and 249 (para 1).

<sup>61</sup> R Clark, *Contract Law in Ireland* (8<sup>th</sup> edn, 2016), para 19.19.

<sup>62</sup> [1980] ILRM 107; (1993) RLR 196.

was a tort or a breach of contract, the court should “look not only at the loss suffered by the injured party but also to the profit or gain unjustly or wrongly obtained by the wrongdoer.”<sup>63</sup>

8.40 **Australia.** By contrast, the Federal Court in Australia rejected the concept of a disgorgement award in the secondary ticketing case of *Hospitality Group Pty Ltd v Australian Rugby Union Ltd*.<sup>64</sup> It concerned the conditions on which the Australian Rugby Union (ARU) sold its tickets, which prohibited on-selling for profit. ARU, having discovered that Hospitality Group had bought on-sold tickets, and on-sold them again as part of a “hospitality package”, brought a claim for an account of profits. Hill and Finkelstein JJ held that it would be “inconsistent” with Australian contract law to “confer a windfall on a plaintiff under the guise of damages for breach of contract.”<sup>65</sup> The court considered *Blake*, but held that the general rule was to place the plaintiff in the position it would have been in had the breach not been committed. As such, the remedy sought was unavailable to the creditor. Effectively, this denied the creditor any means of regulating the on-selling of its tickets, as even if it were to have brought a claim against the original purchaser, it would not have been able to establish any loss.<sup>66</sup> The fundamental principle in Australian law remains that damages are exclusively compensatory, and only the legislature or the High Court of Australia can change that.<sup>67</sup>

### Potential reforms

8.41 We now consider whether Scots law would benefit from the introduction of gain-based remedies for breach of contract. As the present view appears to be that a reasonable fee award and an account of profits are remedies of a very different nature, they are considered separately. We begin with reasonable fee awards<sup>68</sup> before considering accounts of profits.

#### *Reasonable fee awards*

8.42 It is currently unclear whether reasonable fee awards are available under the Scots law of contract, although the underlying idea is not unfamiliar in unjustified enrichment cases.<sup>69</sup> An option is to leave the law as it stands, perhaps placing some reliance on the first Lord President Clyde’s dictum in *Duke of Portland v Wood’s Trustees*<sup>70</sup> quoted above.<sup>71</sup> However, this would involve waiting for a case to come before the courts before the question could be decided. This may not happen for several years, if it happens at all, until which time the state of the law will be unclear, creating uncertainty.

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<sup>63</sup> [1980] ILRM 107; (1993) RLR 196 at 208.

<sup>64</sup> [2001] FCA 1040, (2001) 110 FCR 157.

<sup>65</sup> *Ibid*, para 159.

<sup>66</sup> We note that in recent years (at least in the United Kingdom), practical steps have been taken to address this issue, such as printing the name of the ticket-holder on the ticket and requiring the production of photographic identification as a condition of admission.

<sup>67</sup> Carter, *Contract Law in Australia*, (6<sup>th</sup> edn 2013), para 35.03. It may be worth noting that the author of Edelman, *Gain-Based Damages*, was appointed to the High Court of Australia in 2016. See also J Edelman and E Bant, *Unjust Enrichment* (2<sup>nd</sup> edn, 2016) pp 34 and 35.

<sup>68</sup> See paras 8.14 to 8.19 above.

<sup>69</sup> See for example *Glen v Roy* (1882) 10 R 239; *Shetland Islands Council v BP Petroleum Development Ltd* 1990 SLT 82; *Rochester Poster Services Ltd v AG Barr plc* 1994 SLT (Sh Ct) 2; *GTW Holdings Ltd v Toet* 1994 SLT (Sh Ct) 16. See also A J M Steven, “Recompense for interference in Scots law” 1996 JR 51; R Evans-Jones, *Unjustified Enrichment*, vol 2 (2013), Ch 4.

<sup>70</sup> 1926 SC 840.

<sup>71</sup> See para 7.6 above.

8.43 The other option would be to legislate on the issue and set out statutory criteria under which reasonable fee awards would be available for breaches of contract. Although there is some divergence in the English cases, the circumstances under which a reasonable fee award will be granted, and how it ought to be calculated, are reasonably clear. However, it may be beneficial to exclude the test from *Morris-Garner v One Step (Support)*, based on whether the remedy is required to avoid injustice in the particular case, as too nebulous and thus too uncertain. We accordingly ask:

**55. Do consultees consider that reasonable fee awards of damages for breach of contract should be introduced?**

**56. If so:**

**(a) in what circumstances should such an award of damages be available; and**

**(b) how should the courts calculate a reasonable fee?**

#### *Accounts of profits*

8.44 As it stands, Scots law does not allow a creditor to require a debtor to disgorge profits made as a result of a breach of contract.<sup>72</sup> If a case like *Blake* were to reach the Scottish courts, the consequence might be that the debtor could profit from flagrant breaches of contract and the creditor would not have an effective remedy. That difficulty could be avoided if the concept of a disgorgement award as a remedy for breach of contract were introduced.

8.45 If the law is to be reformed to introduce accounts of profits as a remedy for breach of contract, it would be necessary to specify when the remedy was to be available. As we note above,<sup>73</sup> approaches vary in different jurisdictions, and each appears to have advantages and disadvantages.

8.46 Perhaps the most developed model is that found in England and Wales, where the availability of the remedy rests on exceptionality and legitimate interest. However, the key deficiency in the English case law is thought to be the uncertainty surrounding the question of when the remedy is available, with a number of different approaches apparent in judgments over the years.

8.47 Alternatively, Scotland could adopt the approach that Israel has taken, and provide that an account of profits should be available in any scenario in which a debtor has profited as a result of its breach. This would certainly combat the problem of any uncertainty as to when the remedy was available but it would create much greater uncertainty about the possible externalities of such a rule.

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<sup>72</sup> Leaving aside the interaction between the law of contract and fiduciary obligations mentioned in paras 8.8 and 8.9 above.

<sup>73</sup> See para 8.32 above.

8.48 The Law Reform Commission of Ireland broadly adopted this approach, however, in its Report on Aggravated, Exemplary and Restitutionary Damages, published in 2000.<sup>74</sup> The Report distinguished restitutionary damages from exemplary damages, concluding that restitutionary damages should not necessarily be regarded as an “exceptional remedy”.<sup>75</sup> The Report went on to state that they should, in principle, be available for:

“all torts and for breach of contract, in cases where the defendant has derived a profit from the commission of the tortious or contractual wrong against the plaintiff.”<sup>76</sup>

8.49 However, the Law Reform Commission of Ireland considered that legislation to this effect would be premature, as the law was still in a state of development, and that the courts should be left to flesh out the principles governing such awards.<sup>77</sup> The Report also recommended that, contrary to Finlay P’s obiter statements in *Hickey & Co Ltd v Roches Stores (Dublin) Ltd (No 1)*,<sup>78</sup> there should be no additional requirement of bad faith.<sup>79</sup>

8.50 Thomson has argued for an alternative basis for introducing gain-based damages in Scots law. It proceeds on the basis that a creditor in Scotland is entitled to specific implement, and so the essence of contract is to oblige parties to perform what they have undertaken to do. A creditor should therefore “be entitled to the debtor’s ‘gains’ from breach, always provided they are not disproportionate to the debtor’s breach.”<sup>80</sup> Whether the limits on the availability of specific implement would meaningfully apply to control claims for gain-based damages must, however be doubtful. There would be considerable uncertainty about the scope of a remedy along the lines envisaged by Thomson. A significant period of time could well elapse before the courts had determined sufficient cases to clarify its scope and application.

8.51 A further option would be to introduce an account of profits into Scots law as a contractual remedy available only in exceptional circumstances, but to define these circumstances more closely than the English case law currently does. In identifying these circumstances, it is useful to look at the common features shared by the cases in which an account has been granted. Broadly speaking, these are that:

- specific performance would have been granted before the breach took place;
- the debtor’s position was “akin to a fiduciary”;
- damages would be an inadequate remedy;
- to use Barnett’s classification,<sup>81</sup> the performance of the contract in question was “non-substitutable”;

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<sup>74</sup> LRC 60-2000.

<sup>75</sup> *Ibid*, para 6.02.

<sup>76</sup> *Ibid*, para 6.48.

<sup>77</sup> *Ibid*, para 6.46.

<sup>78</sup> See para 8.39 above.

<sup>79</sup> LRC 60-2000, paras 6.42 and 6.43.

<sup>80</sup> J Thomson, “Restitutionary and Performance Damages” 2001 SLT (News) 71.

<sup>81</sup> K Barnett, “Deterrence and Disgorging Profits for Breach of Contract” [2009] RLR 79. However, this term is in need of further clarification. An analogy might be drawn with the concept of “available market” in s 50(3) of the Sale of Goods Act 1979.

- to adopt the language of Johnson J in *Nunavut Tunngavik Inc.*,<sup>82</sup> the breach was a “zero sum outcome” rather than an “efficient breach”.

8.52 We would add a further factor based on our own observations: due to the significance of its contractual interest, no reasonable creditor would have consented to the breach in exchange for a reasonable fee, making a reasonable fee award inappropriate.

8.53 We comment on each of these in turn. The fact that specific performance would have been granted seems to be a common thread in all cases, and, in our view, must be a pre-requisite to an account of profits remedy. Both remedies exist to protect the creditor’s performance interest, either by directly enforcing it or deterring the debtor from breaching the contract.

8.54 The requirement that the relationship be “akin to a fiduciary” is unhelpful unless better defined. As a test, without further definition it may suffer from the same indeterminacy as whether the creditor had a “legitimate interest”.

8.55 It seems self-evident that an account of profits must only be awarded if conventional damages would be inadequate in that the debtor’s gain from the breach would be out of proportion to the creditor’s loss. We tentatively suggest that this should also be a pre-requisite for the award of any equivalent to an account of profits.

8.56 The fact that performance was “non-substitutable” and not replaceable on the open market at first seems useful in that it does seem to apply to all the scenarios in which an account of profits has been granted. However, in our view, it is perhaps too wide, as it covers any case involving interests in property, and would have applied to *Wrotham Park* itself, where the court thought it only appropriate to grant reasonable fee damages.<sup>83</sup>

8.57 In our view, rather than substitutability, it may be preferable for the courts to focus on whether any reasonable person *in the creditor’s position* would have consented to the breach in exchange for a reasonable fee. This is narrower than the concept of substitutability, and has the dual advantages of maintaining a clear divide between disgorgement and reasonable fee awards, and ensuring that disgorgement awards remain exceptional in breach of contract claims. We therefore ask:

- 57. Do consultees consider that the courts should be empowered to order a debtor to account to a creditor for profits arising from the debtor’s breach of contract?**
- 58. If so, do consultees consider that such an order should be available:**
  - (a) in response to any breach of contract; or**
  - (b) only where specified conditions are met?**

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<sup>82</sup> 2012 NUCJ 11 (Nunavut Ct. Jus.) at para 291.

<sup>83</sup> [1974] 1 WLR 798.

- 59. If consultees consider that such an order should only be available where specified conditions are met, they are asked for their views on the appropriateness of the following conditions:**
- (a) that specific implement or interdict would have been available to the creditor before the breach occurred;**
  - (b) the breach having occurred, that ordinary damages would be inadequate as they would leave the creditor undercompensated as the debtor's gain from the breach would be out of proportion to the creditor's loss; and**
  - (c) that no reasonable creditor would have consented to the breach in exchange for a reasonable fee.**
- 60. Consultees are also asked whether they think that any other conditions would be appropriate in addition to, or in substitution for, those conditions.**

# Chapter 9 Transferred loss claims

## Introduction

9.1 In this Chapter, we consider the problem of transferred loss.<sup>1</sup> It is applicable, in general terms, in the scenario where a breach of contract occurs and loss results, but that loss is sustained by a person who is not party to the contract.

9.2 Throughout this Chapter, we continue to use the terminology for the parties mentioned in Chapter 1:<sup>2</sup> the contract-breaker is the debtor (D) and the other contracting party is the creditor (C). We also refer to the person who suffers the loss as the third party (T).

9.3 The scenario outlined is problematic when a conventional analysis is applied. The outcome is that T suffers a loss but is not a party to the contract and so does not have title to sue for breach of contract. C, by contrast, has title to sue but has suffered no loss. Given the compensatory nature of damages in Scots law,<sup>3</sup> C is not entitled to damages. D has broken the contract but does not incur liability to anyone for doing so.<sup>4</sup>

9.4 The concept of transferred loss appears to be encountered most frequently in relation to building contracts, although its origins are to be found in shipping and carriage of goods. An example may help to illustrate: C contracts with D, a roofer, to repair the roof of C's office building. Shortly after the works are complete, C sells the building to T. Some time later, it becomes apparent that the works were defective and T incurs substantial costs in putting them right. T cannot sue D for damages because T is not a party to the contract. While C is a party, it has suffered no loss and so is not entitled to recover any damages. In effect, the losses fall on the innocent T, rather than D whose breach of contract caused them.

9.5 The contracting parties may, of course, identify the potential for a transferred loss situation to arise, and make express provision to protect T's position. For example, they might include a term in their contract that gives T a right to sue under it for its loss. A further possibility is for D to provide T with an independent undertaking of liability for any loss, such as the collateral warranties familiar in the construction context.<sup>5</sup> The Contract (Third Party Rights) (Scotland) Bill, when enacted and brought into force, ought to make the first option

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<sup>1</sup> Also known as the damages "black hole": see *GUS Property Management Ltd v Littlewoods Mail Order Stores Ltd* 1982 SLT 50 at 54, per Lord Stewart; 1982 SC (HL) 157 at 177, per Lord Keith of Kinkell; *McLaren Murdoch & Hamilton Ltd v Abercromby Motor Group Ltd* 2003 SCLR 323 at para 33, per Lord Drummond Young. Reservations about this terminology were expressed in *Marquess of Aberdeen and Tremair v Turcan Connell* [2008] CSOH 183 at para 45, per Lady Smith.

<sup>2</sup> See para 1.19 above.

<sup>3</sup> See para 7.3 above.

<sup>4</sup> For the difficulties that arise in trying to plead a relevant case in these circumstances, see McBryde, *Contract*, para 22.30.

<sup>5</sup> See Review of Contract Law – Report on Third Party Rights (Scot Law Com No 245 (2016)), paras 1.26 to 1.30.

easier to achieve, and nothing in the Bill would prevent use of the second option. It may also be possible for C to assign its claim against D to T.<sup>6</sup>

9.6 This Chapter is concerned, however, with the situation that arises where parties have not made any express arrangements to deal with a transferred loss situation. We begin with a brief consideration of the extent to which the concept is recognised in the DCFR, then trace its development in Scots and English law in order to summarise the current state of the law. We go on to set out possible options for reform in this area.

## The DCFR and Scots law compared

### *The DCFR*

9.7 Although the DCFR provides for third-party rights in contract,<sup>7</sup> it does so by recognising their existence where parties have created them in the contract itself, rather than providing for their existence as a matter of law if certain requirements are fulfilled. Their nature and content is accordingly determined by the contract.<sup>8</sup> The DCFR does not appear to contain any provisions which explicitly address the issue of transferred loss. The general position under the DCFR is that C is entitled to damages for its loss caused by D's non-performance of an obligation,<sup>9</sup> but nothing is said about situations where the loss has been suffered by a third party. Unless the parties have expressly provided in their contract to protect T's position in the event of a transferred loss situation,<sup>10</sup> the DCFR does not appear to offer a solution.

9.8 This is despite the problem being known in other European legal systems, notably Germany. There, the issue is labelled as *Drittschadensliquidation* ("recovery of a third party's loss"). The law enables the creditor in exceptional circumstances to recover the losses of a third party.<sup>11</sup>

9.9 As a result, the DCFR does not offer a yardstick against which Scots law can be compared in relation to transferred loss. We turn instead to consider how transferred loss has developed in Scots and English law.

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<sup>6</sup> See *Darlington Borough Council v Wiltshier Northern Ltd* [1995] 1 WLR 68. The case differs from other transferred loss decisions in that C never had any proprietary interest in the property upon which D's defective work was carried out; it always belonged to T. There is also a question about what if any loss was suffered by C in the circumstances, and thus what the content of the assigned claim should have been. In the complex case of *L/M International Construction Inc (now Bovis International Inc) v The Circle Ltd Partnership* (1995) 49 Con LR 12 the court used a number of exceptions to allow the assignee T to sue, when applying *Darlington* might have sufficed. This could have been because it was not argued or because the court disapproved of *Darlington*. Assignment may also be problematic if C becomes insolvent: see para 9.51 below.

<sup>7</sup> DCFR II.–9:301 to 9:303.

<sup>8</sup> DCFR II.–9:301(1).

<sup>9</sup> DCFR III.–3:701(1).

<sup>10</sup> See para 9.5 above.

<sup>11</sup> The rules are not found in the BGB but in the case law: see further H Unberath, *Transferred Loss: Claiming Third Party Loss in Contract Law* (2003), Ch 3.

## Scots and English law

### Overview

9.10 Although its roots lie much deeper, the concept of transferred loss as an aspect of general contract law has come to prominence in several reported cases in the United Kingdom over the last twenty years. The courts have generally been sympathetic to the view that D should be liable in a transferred loss situation, although a definitive approach to achieve that result has never entirely been settled on. In Scotland, all of the cases have been decided at first instance, and none of them has turned on a question of transferred loss. In England, despite a number of cases reaching the highest levels of the court system, there is still no settled view.

9.11 In general terms, the answer given has been to make D liable to C for T's loss, but only in limited circumstances. C's claim is based upon its contractual relationship with D: the remedy arises as a matter of the law of contract. It has not been made clear, however, how C may be made accountable to T for what C recovers from D.

9.12 In some circumstances, it is also possible that T may have a direct claim against D under another branch of the law, such as delict or unjustified enrichment. This Discussion Paper does not examine this possibility in detail, but it is relevant in general terms to the discussion that follows.

### Origins of transferred loss claims

9.13 The English and Scots courts have attempted to remedy the issue of transferred loss and impose liability on D since at least the nineteenth century, but only in limited circumstances. This was achieved by exceptions to the general rule that C might not recover damages because it had not suffered the loss. The principal exception was thought to apply only in relation to shipping law until the 1990s. Its origins are to be found in *Dunlop v Lambert*,<sup>12</sup> a Scottish appeal to the House of Lords. In that case, C sold goods to T and then entered into a contract of carriage with D to deliver the goods to T. In the course of carriage, the goods were destroyed. It appeared that ownership of the goods had passed to T before they were destroyed.<sup>13</sup>

9.14 The House of Lords observed that, in general, where goods were consigned to a carrier for delivery to a consignee, it was for the consignee to bring an action against the carrier if the goods should be lost. However, it held that a consignor who entered a contract with a carrier to deliver goods to any particular person at a particular place could sue for damages on that contract in respect of damage to the goods even if the consignor had

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<sup>12</sup> (1839) 7 ER 824; (1839) 6 CI & F 600.

<sup>13</sup> The ownership of the goods was never established. At first instance, the Lord President directed the jury in terms that ownership had passed to T ((1837) 15 S 884). The pursuers excepted to the Lord President's direction and the bill of exceptions was disallowed by the First Division ((1837) 15 S 1232). The House of Lords reversed that interlocutor and remitted for a new trial. Before a new trial was ordered, the defenders paid the pursuers the sum concluded for. The pursuers were subsequently awarded their expenses ((1840) 2 D 339). See further see E M Clive, "*Jus quaesitum tertio* and the carriage of goods by sea" in D L Carey Miller and D W Myers (eds), *Comparative and Historical Essays in Scots Law* (1992), pp 47 to 56.

suffered no loss (for example, if the goods had meantime become the property of the consignee).<sup>14</sup> The basis for the decision of the House of Lords is unclear.

9.15 That rule fell to be reconsidered in 1977 by the House of Lords in *The Albazero*,<sup>15</sup> another shipping case about a contract of carriage. Lord Diplock gave the leading judgment, in which he characterised the reasoning in *Dunlop v Lambert* as “baffling”.<sup>16</sup> He observed, however, that it had been treated as authoritative by textbook writers and that it appeared to have been regarded as “...undoubted law by [...] eminent judges...”.<sup>17</sup> In attempting to rationalise the rule, he offered the following reformulation:

“[I]n a commercial contract concerning goods where it is in the contemplation of the parties that the proprietary interests in the goods may be transferred from one owner to another after the contract has been entered into and before the breach which causes loss or damage to the goods, an original party to the contract, if such be the intention of them both, is to be treated in law as having entered into the contract for the benefit of all persons who have or may acquire an interest in the goods before they are lost or damaged, and is entitled to recover by way of damages for breach of contract the actual loss sustained by those for whose benefit the contract is entered into.”<sup>18</sup>

9.16 As reformulated, it appeared that the *Albazero* exception:

- is based on the intention of the parties rather than any freestanding legal principle;
- only applies to contracts concerning goods;
- entitles C to recover by way of damages rather than T.

Lord Diplock’s reformulation would, however, go on to be revisited in subsequent cases.<sup>19</sup>

#### Development and expansion of transferred loss

9.17 In *Linden Gardens v Lenesta Sludge Disposals Ltd*,<sup>20</sup> the House of Lords expanded the *Albazero* exception from carriage of goods cases to contracts generally.<sup>21</sup> Here, C contracted with D, a building company, to develop a site. The building contract purported to prevent C from assigning its rights under the contract. Despite this, C assigned its rights to T. Defects were subsequently discovered after the site had been transferred to T. The House of Lords held that the assignment had been ineffective and so C still had the benefit of the contract, but T had the interest in the land. It went on to hold that C could sue D and recover damages on T’s behalf.

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<sup>14</sup> (1839) 7 ER 824 at 834, per the Lord Chancellor (Cottenham).

<sup>15</sup> [1977] AC 774. A useful analysis of the subsequent development of English law is M Furmston and G J Tolhurst, *Privity of Contract* (2015) paras 6.39 to 6.159.

<sup>16</sup> [1977] AC 774 at 843, per Lord Diplock.

<sup>17</sup> *Ibid.*

<sup>18</sup> [1977] AC 774 at 847, per Lord Diplock.

<sup>19</sup> It should also be noted that the facts in *The Albazero* did not satisfy the requirements of the exception, and so the exception was not applied in the case which gives it its name.

<sup>20</sup> [1994] 1 AC 85.

<sup>21</sup> *Chitty*, para 18.057.

9.18 However, the House of Lords reached that conclusion on two distinct grounds: the “narrower ground” put forward by Lord Browne-Wilkinson, with whom Lords Keith of Kinkel, Bridge of Harwich and Ackner agreed, and the “broader ground” favoured by Lord Griffiths.

9.19 The basis of the narrower ground is that C can recover T’s loss arising from breach of a contract dealing with property where it was contemplated that the property would be transferred to, or the loss would otherwise be suffered by, T, and if T could not acquire a right to hold D liable for the breach.<sup>22</sup> It shares features with the *Albazero* exception from which it derives, not least the need for a property-related link among the parties and the fact that it is C, rather than T, who has the right of action.

9.20 On the broader ground, by contrast, C could recover because the loss was suffered by C who “did not receive the bargain for which he had contracted,”<sup>23</sup> and the measure of damage should be the cost of curing the damage caused by the breach.<sup>24</sup> This approach of course leaves open the question of whether or not there is any obligation on C to pay the damages recovered to T.

9.21 The proponents of the narrower ground did not, however, reject the broader ground approach favoured by Lord Griffiths.<sup>25</sup> The preferred approach has been much debated in the subsequent cases, which accounts in part for the diversity of judicial views referred to above.<sup>26</sup>

9.22 The House of Lords returned to the issue in *Alfred McAlpine Construction Ltd v Panatown Ltd*.<sup>27</sup> C entered into a contract with D to construct an office block on land owned by T, a company owned by C’s parent company. The works were defective and C sought to recover the loss suffered by T as a consequence of the defects. The majority (Lords Clyde, Jauncey of Tullichettle and Browne-Wilkinson) held that the existence of a separate agreement between D and T which gave T a direct right of action against D barred C from recovering in respect of T’s loss: neither the *Albazero* exception nor the narrower ground in *Linden Gardens* applied.<sup>28</sup>

9.23 The case is notable, not so much for its outcome or for any extension of the principle, as for the detailed examination of transferred loss undertaken by each of the judges. Lord Clyde in particular analysed the derivation of the rule in *Dunlop v Lambert* and its subsequent development in *The Albazero*.<sup>29</sup> In addition, he rejected the contention that the operation of the *Albazero* principle hinged upon the intention of the contracting parties:

“In my view it is preferable to regard it as a solution imposed by the law and not as arising from the supposed intention of the parties, who may in reality not have applied their minds to the point.”<sup>30</sup>

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<sup>22</sup> [1994] 1 AC 85 at 115, per Lord Browne-Wilkinson.

<sup>23</sup> [1994] 1 AC 85 at 97, per Lord Griffiths.

<sup>24</sup> Further on the measure of damages in transferred loss cases see S Rowan “Cost of Cure Damages and the Relevance of the Injured Promisee’s Intention to Cure”, [2017] CLJ, forthcoming.

<sup>25</sup> [1994] 1 AC 85 at 95, per Lord Keith of Kinkel; at 96, per Lord Bridge of Harwich.

<sup>26</sup> See para 9.10 above.

<sup>27</sup> [2001] 1 AC 518.

<sup>28</sup> [2001] 1 AC 518 at 531, per Lord Clyde. See also *Chitty*, para 18.060.

<sup>29</sup> [2001] 1 AC 518 at 522 to 531, per Lord Clyde.

<sup>30</sup> [2001] 1 AC 518 at 530, per Lord Clyde.

9.24 By contrast, the minority (Lords Goff and Millett) would have applied Lord Griffiths' broader ground from *Linden Gardens*. They were willing to hold that, in cases such as the present, C ought to be able to recover for the loss as its own loss. As Lord Goff stated:

"Indeed, if the law should in such circumstances deny the creditor a remedy in damages, it can be said with force that his performance or expectation interest is insufficiently protected in law. Historically this may have been the position; but, if so, it appears that this defect in the law has, in recent years, been addressed and remedied in cases which the point has arisen for decision and furthermore that those decisions have been generally welcomed by the academic legal community."<sup>31</sup>

9.25 Lord Clyde considered that, if the broader ground approach were to be followed, it would leave open the possibility of C recovering damages without any obligation to account to T who had suffered the actual loss. He pointed out that an effective solution would require the addition of an obligation to account to the person who had suffered the loss, and that if such an obligation were added then the approach began to approximate to the *Albazero* exception.<sup>32</sup>

9.26 The status of the broader ground after *Panatown* was not entirely clear due to the judgment of Lord Browne-Wilkinson. He decided *Panatown* on the basis of the narrower ground, holding that T's direct right of action against D was fatal to C's claim. He recalled, however, that in *Linden Gardens* he had expressed sympathy with the broader ground.<sup>33</sup> He was prepared to assume that the broader ground was sound in law and that C might be able to recover damages on that basis where T had no direct right of action against D. As T did have such a right in this case, however, even the broader ground would not permit C to recover damages.<sup>34</sup> Accordingly, *Panatown* cannot be seen as clear authority for rejecting the broader ground.<sup>35</sup>

9.27 The UK Supreme Court has recently considered issues of transferred loss in *Lowick Rose LLP (in liquidation) v Swynson Ltd*, decided in April 2017.<sup>36</sup> The Court was clear that no transferred loss claim arose on the facts so they are not rehearsed here: the significance of the judgment is the continued lack of clarification on whether the narrower ground or the broader ground should be preferred.

9.28 Lord Sumption explained the principle of transferred loss as a limited exception to a general rule. He pointed out that it had only been recognised in cases involving a transfer of property.<sup>37</sup> He also noted that on the broader ground it would not be so limited, and that the modern case law had all been driven by legal necessity to avoid black holes whereby D

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<sup>31</sup> [2001] 1 AC 518 at 546, per Lord Goff.

<sup>32</sup> [2001] 1 AC 518 at 534, per Lord Clyde.

<sup>33</sup> [2001] 1 AC 518 at 577, per Lord Browne-Wilkinson.

<sup>34</sup> [2001] 1 AC 518 at 577, per Lord Browne-Wilkinson.

<sup>35</sup> *Panatown* was criticised by Judge Richard Seymour QC in *Rolls-Royce Power Engineering Plc v Ricardo Consulting Engineers Ltd* [2004] 2 All ER (Comm) 129 at paras 128 and 130 for muddying the waters for practitioners with regard to claims for transferred loss.

<sup>36</sup> [2017] UKSC 32; [2017] 2 WLR 1161.

<sup>37</sup> [2017] UKSC 32 at para 14, per Lord Sumption JSC.

could escape liability.<sup>38</sup> He did, however, express sympathy for the broader ground if an appropriate case should arise.<sup>39</sup>

9.29 Lord Mance summarised both the narrower ground<sup>40</sup> and the broader ground,<sup>41</sup> observing that the latter had been reviewed “inconclusively” by Lord Browne-Wilkinson in *Linden Gardens* and by the members of the House in *Panatown*. He went on to cite Lord Clyde’s remarks on potential difficulties about the theory of performance interest in relation to the broader ground,<sup>42</sup> but did not otherwise indicate support for either ground.<sup>43</sup>

9.30 Lord Neuberger summarised the principle, which he described as “anomalous”, as follows:

“The principle of transferred loss applies where there is a contract between [C] and [D] relating to [C]’s property which is subsequently acquired by [T], and the principle enables [C] to recover damages for [D]’s breach of contract which injures the property, even though the loss flowing from that injury is suffered by [T] and not by [C].”<sup>44</sup>

9.31 Lord Neuberger went on to observe that the principle should only apply in defined and limited circumstances.<sup>45</sup> He suggested the circumstances in which the principle of transferred loss could apply could now be identified as where:

“(a) at the time of making the contract with [C], [D] would reasonably have anticipated that [C] would transfer the property to a person such as [T] and that that person would suffer loss if [D] breached the contract, so that the contract can be seen as having been entered into by [D] partly for [T]’s benefit, and (b) there is nothing in the contract or the surrounding circumstances which negatives the conclusion that the principle should apply.”<sup>46</sup>

9.32 Lord Neuberger observed that *Panatown* had left open a number of points, not least the correctness of the broader ground approach. However, he thought it unnecessary to address that point because, in his view, it clearly could not apply in the case before the Supreme Court.<sup>47</sup> His comments appear to have summarised what he thought as now being settled (in relation to the narrow ground), while highlighting the outstanding issues without attempting to resolve them.

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<sup>38</sup> [2017] UKSC 32 at para 16, per Lord Sumption JSC.

<sup>39</sup> [2017] UKSC 32 at para 17, per Lord Sumption JSC.

<sup>40</sup> [2017] UKSC 32 at para 52, per Lord Mance JSC.

<sup>41</sup> [2017] UKSC 32 at para 53, per Lord Mance JSC.

<sup>42</sup> *Ibid.*

<sup>43</sup> This was perhaps in light of the fact that he saw neither ground as assisting the respondent: [2017] UKSC 32 at para 54.

<sup>44</sup> [2017] UKSC 32 at para 102, per Lord Neuberger PSC.

<sup>45</sup> *The Albazero* and *Linden Gardens* were examples of which: [2017] UKSC 32 at paras 102 and 103, per Lord Neuberger PSC.

<sup>46</sup> [2017] UKSC 32 at para 104, per Lord Neuberger PSC.

<sup>47</sup> [2017] UKSC 32 at para 106, per Lord Neuberger PSC.

## Transferred loss claims in Scotland

9.33 Despite Lord Neuberger's comments on *Panatown*, subsequent cases in Scotland have made it clear that it is the narrower ground which has been adopted. To date, the Scottish cases have all been decided at first instance, principally in the Outer House.<sup>48</sup>

9.34 Following *Panatown*, Lord Drummond Young considered the principle of transferred loss in Scots law in *McLaren Murdoch & Hamilton Ltd v Abercromby Motor Group Ltd*.<sup>49</sup> In the principal action, a firm of architects (D) sued their clients (C) to recover unpaid professional fees. C counterclaimed, seeking damages for breach of contract and negligence in relation to the design of a heating system. D defended the counterclaim on the basis that C was not the owner of the building when the contract was completed, having transferred it to a third party (T, another company in the same group as C), and so it had suffered no loss.

9.35 If successful, D's argument would have seen the claim for breach of contract fall into "the legal 'black hole'" identified in *GUS Property Management Ltd v Littlewoods Mail Order Stores Ltd*.<sup>50</sup> Lord Drummond Young held that the loss had been sustained whilst C was still the owner of the property, so there was no black hole.<sup>51</sup> He went on to consider what the position would be if that conclusion were incorrect.<sup>52</sup> That analysis, which is summarised below, is therefore *obiter*.

9.36 Drawing heavily upon Lord Clyde's judgment in *Panatown*, Lord Drummond Young indicated that Scots law should recognise the principle of transferred loss and adopt the same ground as the majority in the House of Lords in *Panatown* (the narrower ground in *Linden Gardens*).<sup>53</sup> He also rejected the broader ground as being inconsistent with the underlying principles of Scots contract law, in particular noting that the proponents of the broader ground saw damages as a primary remedy, whereas in Scots law specific implement secured direct enforcement of a contract, and damages was a secondary, substitutionary remedy.<sup>54</sup>

9.37 Lord Drummond Young also considered whether the *Albazero* exception is better regarded as a rule of law or as depending on the intention of the parties, citing with apparent approval Lord Clyde's preference for the former approach.<sup>55</sup>

9.38 Lady Smith considered the issue of transferred loss when *Marquess of Aberdeen and Temair v Turcan Connell*<sup>56</sup> called on the procedure roll. The pursuer (C) claimed

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<sup>48</sup> The matter was also briefly but carefully considered by Sheriff Taylor (as he then was) in *Clark Contracts Ltd v The Burrell Company Construction Management Ltd (No 2)* 2002 SLT (Sh Ct) 73. As it was common ground that a *ius quaesitum tertio* existed, however, there was no black hole to fill and no need to apply *Panatown*: see paras 23 to 42.

<sup>49</sup> 2003 SCLR 323.

<sup>50</sup> 2003 SCLR 323 at para 33, per Lord Drummond Young. See also para 9.1 and fn 1 above.

<sup>51</sup> 2003 SCLR 323 at para 34, per Lord Drummond Young.

<sup>52</sup> 2003 SCLR 323 at paras 35 to 43, per Lord Drummond Young.

<sup>53</sup> 2003 SCLR 323 at para 42, per Lord Drummond Young, citing *Alfred McAlpine Construction Ltd v Panatown Ltd* [2001] 1 AC 518 at 535, per Lord Clyde.

<sup>54</sup> 2003 SCLR 323 at paras 40 and 41, per Lord Drummond Young.

<sup>55</sup> 2003 SCLR 323 at paras 35 and 36, per Lord Drummond Young citing *Alfred McAlpine Construction Ltd v Panatown Ltd* [2001] 1 AC 518 at 530, per Lord Clyde.

<sup>56</sup> [2008] CSOH 183; 2009 SCLR 336.

damages against a firm of solicitors (D) who had allegedly negligently omitted to give advice in relation to C's family estates. The claim was advanced both on a breach of contract and on a delictual basis. T, C's son, incurred tax liabilities and other costs as a result of the remedial measures that had to be taken. C's primary position was that he was entitled to the damages sued for, but in the alternative he argued that he was seeking to recover the loss suffered by T, averring that he would account to T for the damages received in due course.

9.39 The question of transferred loss therefore arose in relation to C's alternative case. Lady Smith referred to Lord Clyde's approach in *Panatown*, and agreed with Lord Drummond Young in *McLaren Murdoch* that the application of the rule did not depend upon identifying the intention of the parties, but rather applied as a matter of law.<sup>57</sup> Accordingly, she held that C's alternative case had been relevantly set out and allowed it (with the principal case) to proceed to a proof before answer.

9.40 The issue of transferred loss was considered by Lord Doherty in *Axon Well Intention Products Holdings AS v Craig*.<sup>58</sup> Here, D sold his interests in two companies to another company, C. C then sued D for losses caused to an affiliate company (T) which were allegedly caused by D's breaches of restrictive covenants in the share purchase agreements. T suffered the loss, but had no title to sue under the relevant covenants. However, D argued that C could not make a *Panatown* claim, as T could be put in a position where it potentially had direct remedies against D, albeit non-contractual ones, meaning that there was no black hole.<sup>59</sup>

9.41 Lord Doherty, however, was not satisfied that C's *Panatown* claim was irrelevant at that stage. D had not given notice in its pleadings of the alternative potential remedies and so C had not had an opportunity to supplement its averments.<sup>60</sup> Nor was he satisfied that D had necessarily committed the delict of causing loss by unlawful means.<sup>61</sup> Accordingly, he allowed it to proceed.

9.42 However, Lord Doherty observed that it was appropriate for him to express a view on the matter, given the time taken up on it at debate and the possibility that it might have a bearing on further procedure.<sup>62</sup> As with Lord Drummond Young's comments in *McLaren Murdoch*, these observations are *obiter*. He noted that in *Panatown* it had been settled that the existence of a contractual remedy which gave T a direct right of action against D would exclude a *Panatown* claim by C,<sup>63</sup> and went on to consider whether the availability to T of a non-contractual remedy claim against D would affect C's ability to bring a *Panatown* claim. He stated:

"In my opinion it is conceivable that in some circumstances the availability to a third party of a non-contractual remedy might exclude a *Panatown* claim. However, where there has not been specific provision for, or clear contemplation of, the third party's means of redress, if a non-contractual remedy is to exclude a *Panatown* claim it

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<sup>57</sup> [2008] CSOH 183 at paras 45 and 46, per Lady Smith.

<sup>58</sup> *Axon Well Intention Products Holdings AS v Craig* [2015] CSOH 4. For comment on *Axon Well*, see L MacFarlane, "Black Holes and Revelations on the Transferred Loss Doctrine" (2015) 19 Edin LR 388.

<sup>59</sup> [2015] CSOH 4 at paras 11 to 16.

<sup>60</sup> [2015] CSOH 4 at para 34, per Lord Doherty.

<sup>61</sup> [2015] CSOH 4 at para 35, per Lord Doherty.

<sup>62</sup> [2015] CSOH 4 at para 37, per Lord Doherty.

<sup>63</sup> [2015] CSOH 4 at para 38, per Lord Doherty.

should provide equivalent means of redress and equivalent prospects of success to an action for damages for breach of contract. If it does there is no risk of a legal black hole. If it does not there is such a risk.”<sup>64</sup>

9.43 Whether this is a desirable approach is questionable: it is difficult to see how a test of “equivalent means of redress and equivalent prospects of success” could readily be applied. Indeed, it seems almost to invite satellite litigation: where D wishes to defeat a *Panatown* claim by C, it appears that D would have to offer to prove that T had equivalent prospects of success in (hypothetical) parallel proceedings. The feasibility of establishing that is, perhaps, debatable.

9.44 In summary, it appears that the Scottish courts recognise the principle of transferred loss, on the narrower ground proposed in *Linden Gardens* and restated by Lord Clyde in *Panatown*. It should be noted, however, that none of the above cases was decided on the basis of transferred loss: in *McLaren Murdoch*, C had owned the building at the relevant time when the damage occurred, and so no black hole arose. *Marquess of Aberdeen and Temair* and *Axon Well* were both decisions about relevancy rather than the merits of the claim. An authoritative statement of Scots law in this area, as with English law, is still awaited.<sup>65</sup>

### Potential reforms

9.45 As Lord Neuberger observed in *Lowick Rose*,<sup>66</sup> *Panatown* left open a number of points in a difficult area of law. Several recurring issues have not been resolved, and these form the basis for the following discussion of potential reforms. They are:

- should a transferred loss claim be permitted?
- should T have a direct claim against D?
- what is the proper basis of a transferred loss claim?
- should the availability of other remedies to T (contractual or non-contractual) bar a transferred loss claim?
- should remedies other than damages be available to T?

#### *Should a transferred loss claim be permitted?*

9.46 As noted above, this Discussion Paper is concerned only with issues of transferred loss arising from breach of contract: the particular scenario is one where C and D contract, D breaches the contract and the loss caused by D’s breach falls, not on C, but upon a third party, T. A conventional analysis leaves no-one able to claim damages.<sup>67</sup> The policy concern

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<sup>64</sup> [2015] CSOH 4 at para 42, per Lord Doherty.

<sup>65</sup> Transferred loss may also have arisen as an issue in *Harbro Group Ltd v MHA Auchlochlan* [2014] CSIH 14, but it was decided on other grounds. In *Upton Park Homes Ltd v MacDonalds, Solicitors* [2009] CSOH 159 the pursuer’s claim for loss referred to a third party’s loss also flowing from the breach of contract but their pleadings did not do enough to show that they were claiming that loss on behalf of the third party, and to that extent the claim was held irrelevant.

<sup>66</sup> See para 9.32 above.

<sup>67</sup> See para 9.3 above.

addressed by the principle of transferred loss is preventing losses caused by breach of contract from falling irrecoverably into a legal black hole.

9.47 It appears to us that the policy behind the principle of transferred loss is a sound and rational one. As Lord Drummond Young put it in *McLaren Murdoch*, "...in a well-regulated legal universe black holes should not exist."<sup>68</sup> The principle is one that may only be invoked when driven by legal necessity: it is an exception to the general rule and one which is unavailable if there is another route by which the black hole might be avoided.<sup>69</sup> There is no other obvious mechanism by which the policy concern might be addressed.

9.48 For these reasons, we provisionally suggest that transferred loss claims should be permitted, broadly along the lines that have so far been recognised by the courts. We go on to address questions about who may make the claim, the proper basis for it, its availability, and appropriate remedies in the remainder of this Chapter. However, we would be grateful for consultees' views on the continued existence of the general principle in the first place. We accordingly ask:

- 61. Do consultees consider that in general a party who breaches a contract should be liable in damages for the loss caused by that breach, even if the loss was suffered by someone other than the other party to the contract?**

*Should T have a direct claim against D?*

9.49 At present, a substantial area of potential difficulty in relation to transferred loss claims is the relationship between C and T. To date, the courts have solved the problem that C has title to sue but has suffered no loss, while T has suffered loss but has no title to sue, by permitting C to recover T's loss and account to T for the damages received. The alternative would have been to permit T to raise proceedings, deriving title to sue from C's title, but we are not aware of any case where this has occurred.

9.50 As matters stand, then, only C may bring proceedings in order to recover damages for T's loss. This raises two significant difficulties:

- whether T can compel C to raise proceedings in the first place;
- if damages are recovered, whether, when and how C must account to T.

9.51 On the latter point, it seems accepted that C must account to T,<sup>70</sup> but it is rather less clear when this must take place, or what the enforcement mechanism might be if C refused to account.<sup>71</sup> There is the additional possible problem of T's ranking (if any) as a creditor

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<sup>68</sup> 2003 SCLR 323 at para 33, per Lord Drummond Young.

<sup>69</sup> *Lowick Rose LLP (in liquidation) v Swynson Ltd* [2017] UKSC 32 at para 16, per Lord Sumption JSC.

<sup>70</sup> *The Albazero* [1977] AC 774 at 844, per Lord Diplock; *Alfred McAlpine Construction Ltd v Panatown Ltd* [2001] 1 AC 518 at 535, per Lord Clyde; *McLaren Murdoch and Hamilton Ltd v Abercromby Motor Group Ltd* 2003 SCLR 323 at para 42, per Lord Drummond Young; *Marquess of Aberdeen and Temair v Turcan Connell* [2008] CSOH 183 at para 45, per Lady Smith.

<sup>71</sup> Potentially it is by way of a separate action for count, reckoning and payment. The point appears never to have been explored fully, but in *Marquess of Aberdeen* the pursuer averred that if he succeeded in his alternative (transferred loss) case then he would account to the appropriate party for the damages (see para 21) and

should C become insolvent before accounting for the damages to T. These issues are by no means insoluble, but, as they have not yet been resolved, they add to the uncertainties that surround transferred loss claims. More generally, the existence of an additional step (the requirement to account) might be thought to increase the burden on T. If it were possible to omit the additional step, the risk would be diminished.

#### Can T compel C to raise proceedings?

9.52 This is a rather more significant difficulty with transferred loss claims as they stand. The person entitled to recover is C, but C does not benefit from doing so because C must account to T for the damages recovered. C is, in effect, exposed to the risks and expenses of litigation for the benefit of T without receiving anything in return. The majority of the cases discussed earlier in this Chapter are ones where there is an ongoing relationship between C and T, typically as they are both part of the same group of companies. In those cases, it might be that C is prepared to assume the risk for the benefit of the wider group of companies.<sup>72</sup>

9.53 Where there is no such relationship between C and T, it becomes more difficult to see why C would voluntarily assume the risks of litigation. If C is unwilling to raise proceedings to recover damages for T, the question then arises as to whether T can compel C to do so. In *Panatown*, Lord Clyde thought that "...it may be that there is no necessary right in [T] to compel [C] to sue [D]...", and suggested that collateral warranties might still be required to protect T if T did not have a relationship with C.<sup>73</sup>

9.54 The proposition that one person may compel another to raise legal proceedings against another appears to be a novel one, at least as far as Scots law is concerned. Leaving aside the undecided nature of the point, a number of significant objections can be mounted against the proposition.

9.55 First, it is difficult to see how T in practice could compel C to raise proceedings. Even if it were competent for T to raise proceedings for that purpose, it is difficult to envisage how the court's order could be made sufficiently precise to make C aware of what was required. Secondly, T would realistically need to exercise continuing control over C throughout the proceedings, as otherwise there would be nothing to stop C compromising or abandoning them without reference to T. At that point, it would appear that T is *dominus litis*, and that C is nothing more than a nominal party.<sup>74</sup> Thirdly, C would be exposed to financial risk in relation to the expenses of the proceedings, particularly if they are unsuccessful and an award is made against C.

9.56 For these reasons, the proposition that T may compel C to raise proceedings against D appears to us to be untenable: the adverse consequences are entirely out of proportion to the mischief which the proposition attempts to cure. Accordingly, we do not propose it as a

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counsel for the pursuer asserted that the third party would have a right to an accounting if the pursuer failed to remit the damages (para 37). The matter was not addressed in Lady Smith's judgment.

<sup>72</sup> In *Panatown*, Lord Clyde thought that the absence of a right for T to compel C to raise proceedings was unlikely to be a problem in domestic or familial situations either (say, where a husband instructs and pays for repairs to his wife's house).

<sup>73</sup> [2001] 1 AC 518 at 535, per Lord Clyde.

<sup>74</sup> T Welsh (ed), *Macphail's Sheriff Court Practice* (3rd edn, 2006), paras 4.112 and 4.113.

potential reform. However, all of these difficulties can be avoided if the issue is approached from a different starting point.

#### Potential reform: a direct claim by T against D

9.57 As we note above,<sup>75</sup> requiring C to claim damages on T's behalf is by no means the only way in which the principle of transferred loss could deal with the legal black hole issue. If T were instead permitted to claim directly against D, the issues discussed in the preceding paragraphs would simply be avoided. Not only would it be unnecessary for T to attempt to compel C to raise proceedings, with all its attendant difficulties, but no questions of accounting would arise in the event of success. The fiction of C's involvement in proceedings in which it has no interest, and only a bare title to sue, would be ended.

9.58 Creating a statutory direct right of action for T against D would not, however, be without its own problems. The general policy of our third-party rights law is to allow claims only when such rights are intended by the parties, generally by way of express provision (albeit that the intention to confer a right may not infrequently have to be implied).<sup>76</sup> If in addition a statutory right to make a third-party claim is to be added, it must be quite precisely circumscribed so as not to expose D to a host of third-party claims whenever D perpetrates a breach of contract.

9.59 As the cases discussed earlier in this Chapter make clear, where transferred loss claims have been allowed the relationship between C and T has been crucial, usually involving the transfer of property between them. As a general principle, we think it must be clear that D could reasonably anticipate or foresee that a loss would arise for T: not necessarily a specific T, but someone in a class of persons, such as a subsequent purchaser of a building or goods. As a result, we think that condition should be imposed before T may claim damages against D.

9.60 In order to protect D's interest and avoid double recovery, we also think that T and C ought only to be able to claim for their own respective losses caused by the breach. Where T has an alternative claim for the same loss or part of it against D in, say, delict or unjustified enrichment, we see nothing inconsistent with the general Scots law on concurrent claims in allowing them both to be put in the same action and leaving it to the court to ensure that double recovery was not allowed.<sup>77</sup> There may also be arguments in favour of allowing D to rely, as against T, on any prescription periods that would have applied in a claim by C. We therefore ask:

- 62. Do consultees think that it would be preferable for a third party to be able to seek damages directly from the debtor, instead of relying on the creditor to seek damages on behalf of the third party and then account to the third party for them?**

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<sup>75</sup> See para 9.49 above.

<sup>76</sup> Contract (Third Party Rights) (Scotland) Bill, ss 1 and 2. See further our Report on Third Party Rights (Scot Law Com No 245, 2016), Chapter 4.

<sup>77</sup> On concurrent claims and the avoidance of double recovery see M Hogg, *Obligations* (2<sup>nd</sup> edn, 2006), paras 3.154 to 3.203.

**63. If so, do consultees think that:**

- (a) a third party should only be able to claim damages against a debtor if it was reasonably foreseeable to the debtor that a person in the third party's position might suffer loss;**
- (b) the third party and the creditor should only be able to recover their own losses arising from the debtor's breach of contract;**
- (c) it should be left to the courts to ensure that double recovery is not permitted, rather than making specific provision about it?**

*What is the proper basis of a transferred loss claim?*

9.61 The proper basis of a transferred loss claim has been the subject of judicial and academic discussion since the emergence of the narrower ground and the broader ground in *Linden Gardens*.<sup>78</sup> While the narrower ground appears to have found greater favour, it is notable that the availability of the broader ground has never expressly been disapproved by the House of Lords or the Supreme Court.<sup>79</sup> The Scottish decisions admittedly more uniformly favour the narrower ground, with Lord Drummond Young (*obiter*) dismissing the arguments in favour of the broader ground in *McLaren Murdoch*.<sup>80</sup> While Lord Drummond Young's comments appear to us to have considerable force, the point is by no means settled.

9.62 There can be little doubt, however, that the narrower ground approach to the principle of transferred loss is accepted in both Scotland and England. That being so, we would be grateful for consultees' views on whether the narrower ground is now sufficiently settled that it might usefully be restated in statutory form, with a view to resolving some of the other difficulties around transferred loss that have been canvassed in this Chapter. We tend to the view that any such restatement should be framed in such a way that it does not inhibit the courts from developing the broader ground approach, if a suitable case should ever arise. Accordingly, we ask:

**64. Do consultees think that transferred loss claims should be available only where the following conditions are met:**

- (a) that the contract in question was one to carry out work upon, or provide services in relation to, property belonging to the creditor;**
- (b) that the property was subsequently transferred to a third party;  
and**
- (c) that the third party's loss could have been reasonably foreseen by the debtor at the time of contracting?**

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<sup>78</sup> See para 9.17 ff above.

<sup>79</sup> See para 9.26 above for Lord Browne-Wilkinson's view (despite being the principal proponent of the narrower ground in *Linden Gardens*) and para 9.28 above where Lord Sumption JSC also expresses openness to the applicability of the broader ground if a suitable case arose.

<sup>80</sup> See para 9.36 above.

**65. If so, do consultees agree that it should remain open to the courts to develop the broader ground approach to transferred loss if a suitable case arises?**

*Should the availability of other remedies to T bar a transferred loss claim?*

9.63 At present, it appears clear that a transferred loss claim is excluded if the contracting parties have made alternative provision in the contract, giving T a direct right of action against D, or if a separate contractual arrangement exists between D and T (such as a collateral warranty). We think that this approach is correct, and that it is probably consistent with it to allow the contracting parties also to exclude or limit the extent to which D may be liable in contract for T's losses. Accordingly, parties ought to be able to contract out of any rule of law that permits transferred loss claims.

9.64 We are not persuaded, however, that possible non-contractual liability of D to T should be regarded as excluding a transferred loss claim, as Lord Doherty appeared to contemplate in *Axon Well*. As MacFarlane points out in her commentary on the *Axon Well* case, concurrent liability in contract and delict is generally allowed,<sup>81</sup> and it would be inefficient to force T to make any possible non-contractual claim first (and unsuccessfully) before any transferred loss recovery could become possible.<sup>82</sup> We outline potential further difficulties above.<sup>83</sup>

9.65 Nor does the possibility of C assigning its claim against D to T seem to us to be a relevant ground for denying recovery of T's losses unless T can compel C to assign. That however seems to set up an unnecessary potential obstacle to T's recovery of its loss caused by D's breach of contract. A direct entitlement for T not involving C is surely to be preferred, if the view is that T should bring proceedings rather than C. We return to this point below.

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<sup>81</sup> See e.g. *Marquess of Aberdeen and Temair v Turcan Connell* [2008] CSOH 183, where the pursuer's claim for damages was advanced both in breach of contract and in delict (para 1, per Lady Smith).

<sup>82</sup> MacFarlane, "Black Holes", 392.

<sup>83</sup> See para 9.43 above.

9.66 In summary, we suggest that transferred loss claims should not be available where an alternative contractual remedy exists. They are intended to fill the gap where no such remedy exists. For the avoidance of doubt, where more than one third party suffers loss then the availability of contractual remedies for one or more of them should not affect the ability of the others to advance a transferred loss claim.<sup>84</sup> However, we do not think that the prospect of non-contractual remedies should be taken into account. Nor do we think that the prospect of C assigning its rights to T should bar the availability of a transferred loss claim. Accordingly, we ask:

- 66. Do consultees think that a transferred loss claim should not be available where:**
- (a) the contracting parties have made alternative provision in the contract for the third party to have a right of action against the debtor;**
  - (b) the contracting parties have expressly excluded the operation of transferred loss claims in the contract;**
  - (c) the debtor and the third party have entered into a separate agreement giving the third party a right of action against the debtor, such as a collateral warranty?**
- 67. Do consultees think that a transferred loss claim should be available despite the fact that:**
- (a) the third party may have available to it a non-contractual claim against the debtor;**
  - (b) it is possible that the creditor could assign to the third party its claim against the debtor for breach of contract?**

*Should remedies other than damages be available to T?*

9.67 The transferred loss cases have all been concerned with the remedy of damages only. We would be interested to have consultees' views on whether other possible remedies might be made available to T, in particular the remedy of cure discussed in Chapter 5. This is because, as matters stand, damages in transferred loss claims tend to be assessed on the cost of cure basis.<sup>85</sup> That being so, we wonder whether there would be an advantage to T in being able to require D to effect a cure, rather than (as at present) T having to remedy the defect and then seek damages. At first sight, it would appear difficult for the remedy of specific implement to be available to T. Implement would secure performance of the obligations in the contract – but the parties to it are C and D, not T and D, and so it is unclear how T would benefit. We tend to think that T might, for practical reasons, have to be confined to secondary remedies.

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<sup>84</sup> For example, where a landlord enters into a building contract and it is breached by the builder. An anchor tenant might well have the benefit of a collateral warranty, but other tenants (on full repairing and insuring leases) who did not should be able to make a transferred loss claim even if the anchor tenant sues the builder under the collateral warranty.

<sup>85</sup> See S Rowan, "Cost of Cure Damages and the Relevance of the Injured Promisee's Intention to Cure", [2017] CLJ, forthcoming November 2017.

9.68 However, we would be grateful for consultees' views on any potential remedies that might potentially be made available to T. Accordingly, we ask:

- 68. Do consultees consider that a third party should only be allowed to claim damages for breach of contract?**
- 69. If not, what alternative remedies (such as the right to cure) should be available to third parties?**

# Chapter 10 Contributory negligence

## Introduction

10.1 Contributory negligence is carelessness on the part of the pursuer or a disregard for the pursuer's own interests which has contributed to the loss sustained as a result of the defender's conduct.<sup>1</sup> It has long been available as a defence in delictual claims, but its availability as a defence to claims based on breach of contract has been an open question for some time.<sup>2</sup> That question has twice been considered by this Commission, in 1988<sup>3</sup> and again in 1999,<sup>4</sup> and by the Law Commission for England and Wales in 1993.<sup>5</sup> None of the recommendations made by either Commission has been implemented.

10.2 Since we last considered this subject, there have been few developments in the case law. The publication of the DCFR means, however, that we have an opportunity to revisit the issue and to reassess our previous recommendations in the light of the approach taken by the DCFR. In this Chapter, we examine the rules dealing with concurrent fault under the DCFR and the current state of the law on contributory negligence as a defence to breach of contract in Scotland. We then briefly summarise the recommendations made in our earlier Reports, before setting out possible options for reform.

## The DCFR and Scots law compared

### *The DCFR*

10.3 The DCFR contains a general rule that a party may not exercise any of the remedies for non-performance to the extent that it caused the other party's non-performance.<sup>6</sup> The commentary indicates that the rule is based on considerations of good faith and fair dealing, it being contrary to that principle for the creditor to have a remedy for non-performance for which it is responsible.<sup>7</sup>

10.4 This rule can apply to a wide range of situations, the most obvious being where a creditor directly delays or prevents performance by the debtor: for example, where the employer in a building contract refuses to give the contractor access to the site to start work. More indirect situations are also covered, however: for example, where there is an obligation to provide the other party with information before performance can go forward, and wrong or incomplete information is provided.<sup>8</sup> The breadth of this rule is underscored by the fact that the creditor does not have to be at fault or intend to cause the non-performance: it is

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<sup>1</sup> 1988 Report, para 4.1; *Robinson v William Hamilton (Motors) Ltd* 1923 SC 838 at 841, per the Lord President (Clyde).

<sup>2</sup> 1988 Report, para 4.11; 1999 Report, para 4.1; McBryde, *Contract*, paras 22.34 to 22.36; MacQueen and Thomson, *Contract*, paras 6.43 to 6.46.

<sup>3</sup> 1988 Report, Part IV.

<sup>4</sup> 1999 Report, Part 4.

<sup>5</sup> Contributory Negligence as a Defence in Contract (Law Com No 219, 1993).

<sup>6</sup> DCFR III.-3:101(3).

<sup>7</sup> DCFR III.-3:101 Commentary A.

<sup>8</sup> See DCFR III.-3:101 Commentary A, Illustrations 3 and 4.

sufficient that the conduct causes the non-performance in whole or in part.<sup>9</sup> The effect may be a total or a partial bar on the exercise of remedies, again depending on the extent to which the creditor's conduct has caused the non-performance. The general rule is supplemented by a specific rule that applies to damages. It provides that:

“The debtor is not liable for loss suffered by the creditor to the extent that the creditor contributed to the non-performance or its effects.”<sup>10</sup>

10.5 This most closely parallels the concept of contributory negligence in Scots law, although the language of causation and contributory negligence is not used. The commentary identifies this rule as a particular application of the general rule mentioned above.<sup>11</sup>

10.6 The specific rule embraces two possible scenarios: first, where the “creditor's conduct was a partial cause of the non-performance”, and secondly where the creditor's conduct, “though not in any way responsible for the non-performance itself, exacerbated its loss-producing effects”.<sup>12</sup> The second scenario shades into questions of reduction or mitigation of loss,<sup>13</sup> but it appears that the DCFR does not sharply distinguish between contributory negligence and mitigation of loss, perhaps because of a divergence among the European legal systems as to whether these concepts are treated differently or alike.<sup>14</sup>

10.7 An example of the first scenario is where a creditor orders a piece of bespoke software from the debtor. It fails to perform as intended, partly due to a design defect caused by the debtor, and partly due to the lack of proper instructions given by the creditor. The creditor's loss would be irrecoverable to the extent that it resulted from its own inadequate instructions.<sup>15</sup>

10.8 An example of the second scenario is where a creditor leases a computer from the debtor, specifying in the contract that it is for use in England, where the voltage is 240V. The computer supplied is capable of operating at various voltages, and, despite the contract, is set to operate at 110V. The creditor plugs the computer in and switches it on, ignoring a prominent sign which warns the user to check the voltage settings before doing so, and the computer is damaged. The commentary to the DCFR suggests that “[t]he court may take the view that the loss was at least half [the creditor]'s fault” and reduce the damages accordingly.<sup>16</sup>

10.9 There are two key differences between the DCFR and Scots (or English) law. First, the DCFR benefits from increased conceptual clarity because it separates out three issues: conduct on behalf of the creditor that contributes to the breach, conduct that contributes to the loss, and steps the creditor could have taken to reduce the loss.<sup>17</sup> As we discuss below,

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<sup>9</sup> That said, if the creditor's non-performance is excused due to an impediment (see DCFR III.–3:104) then the debtor is not entitled to damages either (see DCFR III.–3:701(1)).

<sup>10</sup> DCFR III.–3:704.

<sup>11</sup> DCFR III.–3:704 Commentary B.

<sup>12</sup> DCFR III.–3:704 Commentary A.

<sup>13</sup> Which is dealt with in DCFR III.–3:705.

<sup>14</sup> DCFR III.–3:705 Notes 1(a) and (b).

<sup>15</sup> DCFR III.–3:704 Commentary B.

<sup>16</sup> *Ibid.*

<sup>17</sup> The distinctions are by no means clear-cut: see para 10.6 above.

Scots law uses the concepts of contributory negligence, causation and mitigation to achieve similar ends, though the constraints on the availability of contributory negligence mean that the line between causation and contributory negligence is blurred.

10.10 Secondly, in any of the three situations described, the DCFR allows for the apportionment of liability between the creditor and debtor based on relative fault. The artificiality that can flow from the all or nothing nature of causation is avoided as a result.<sup>18</sup>

10.11 The DCFR provisions have the dual benefits of flexibility and conceptual clarity. Arguably however, they may provide less certainty to parties who wish to settle a claim between themselves without resorting to litigation. As relative fault will ultimately be a question for the court, and will involve a value judgment (even if one that will be objectively determined), parties may be less inclined to settle disputes in the hope that they can achieve a more favourable outcome in court.

#### *Scots law: contributory negligence*

10.12 At common law, contributory negligence was not part of contract law.<sup>19</sup> In delict, contributory negligence, if established, operated as a complete defence to a claim for damages.<sup>20</sup> The severity of this rule was mitigated by the Law Reform (Contributory Negligence) Act 1945 (the 1945 Act), which allows for apportionment of damages between the parties. The general principle is that where a party suffers damage partly through its own fault and partly through the fault of another, its damages are to be reduced “to such extent as the court thinks just and equitable having regard to the claimant’s share in the responsibility for the damage”.

10.13 The debate as to whether the 1945 Act extends the operation of contributory negligence as a defence to claims for breach of contract arises because of the way that the 1945 Act defines “fault”. Chitty asserts that the Act was obviously designed for claims in tort, but the definition of fault left the door open to extension into the contractual field.<sup>21</sup> McBryde makes much the same point.<sup>22</sup> The issue has arisen on a number of occasions in the Outer House,<sup>23</sup> but an authoritative resolution is awaited from the Inner House. In England and Wales, the Court of Appeal has held that the 1945 Act can apply as a defence to claims for breach of contract in certain circumstances.<sup>24</sup> We consider these cases below.

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<sup>18</sup> See paras 10.33 to 10.42 below.

<sup>19</sup> MacQueen and Thomson, *Contract*, para 6.46.

<sup>20</sup> *McNaughton v Caledonian Railway Co* (1858) 21 D 160.

<sup>21</sup> Chitty, para 26.077.

<sup>22</sup> McBryde, *Contract*, para 23.33.

<sup>23</sup> *Lancashire Textiles (Jersey) Ltd v Thomson Shepherd & Co Ltd* 1985 SC 135; *Concrete Products (Kirkcaldy) Ltd v Anderson and Menzies* 1996 SLT 587; *Scottish and Southern Energy plc v Lerwick Engineering and Fabrication Ltd* [2008] CSOH 41, 2008 SCLR 317; *Stewart and Stewart v Pure Ltd* [2008] CSOH 49.

<sup>24</sup> *Forsikringsaktieselskapet Vesta v Butcher* [1988] 3 WLR 565.

## Meaning of fault

10.14 The 1945 Act defines “fault” differently for England and Wales and for Scotland. In England and Wales, it means:

“negligence, breach of statutory duty or other act or omission which gives rise to a liability in tort or would, apart from this Act, give rise to the defence of contributory negligence”.<sup>25</sup>

In Scotland, it means:

“wrongful act, breach of statutory duty or negligent act or omission which gives rise to liability in damages, or would apart from this Act, give rise to the defence of contributory negligence”.<sup>26</sup>

10.15 Both definitions have two limbs. The second limb (“...or would apart from this Act, give rise to the defence of contributory negligence”) is identical in each case. It relates to fault on the part of the pursuer alone. The first limb, which is understood principally to relate to fault on the part of the defender, differs. It has been argued that the Scottish version is not confined to delict, as the English is to tort, and that the concept of a wrongful act is broader than that of a negligent act. The argument is then that any breach of contract is a wrongful act capable of sounding in damages, and so the defence of contributory negligence is universally available.<sup>27</sup> An argument of this sort was advanced by the defender in *Stewart and Stewart v Pure Ltd*, but was rejected by Lord Glennie.<sup>28</sup>

10.16 By contrast, if the approach taken in England and Wales is followed in Scotland then the availability of the defence is confined to situations where the debtor owes a concurrent duty in both contract and delict (which in practice will lead debtors to argue that they owed a duty in both contract and delict),<sup>29</sup> but not where the duty was only owed in contract.

## Judicial consideration of the 1945 Act in England and Wales

10.17 In England and Wales, it was unclear whether contributory negligence was available as a defence to claims for breach of contract until the 1980s. Prior to that, first instance authority could be found pointing in either direction.<sup>30</sup>

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<sup>25</sup> 1945 Act, s 4.

<sup>26</sup> 1945 Act, s 5(a).

<sup>27</sup> MacQueen and Thomson, *Contract*, para 6.45.

<sup>28</sup> See para 10.29 below.

<sup>29</sup> MacQueen and Thomson, *Contract*, para 6.43.

<sup>30</sup> See e.g. *Quinn v Burch Bros (Builders) Ltd* [1966] 2 WLR 430 at 437 to 441, per Paul J (Act applicable); *AB Marintrans v Comet Shipping Ltd* [1985] 1 WLR 1270 at 1288, per Neill LJ (Act not applicable, but question not thought to be settled by binding authority).

10.18 The Court of Appeal considered the question in *Forsikringsaktieselskapet Vesta v Butcher*.<sup>31</sup> At first instance, Hobhouse J had set out three categories of contractual claim in which the 1945 Act might apply. These were:

“(1) Where the defendant's liability arises from some contractual provision which does not depend on negligence on the part of the defendant.

(2) Where the defendant's liability arises from a contractual obligation which is expressed in terms of taking care (or its equivalent) but does not correspond to a common law duty to take care which would exist in the given case independently of contract.

(3) Where the defendant's liability in contract is the same as his liability in the tort of negligence independently of the existence of any contract.”<sup>32</sup>

10.19 Following an analysis of the 1945 Act, O'Connor LJ adopted this classification and applied it to categorise a number of cases that had been cited in argument, agreeing that the present case was a category (3) one.<sup>33</sup> He went on to hold that the 1945 Act could only apply in a category (3) case. Neill LJ concurred in those conclusions,<sup>34</sup> as did Sir Roger Ormrod.<sup>35</sup>

10.20 This judgment had the effect of removing the legal anomaly that if a debtor owed a concurrent duty in both contract and tort (as many professionals will to their clients), the creditor could prevent the debtor relying on contributory negligence by framing its claim in contract. However, it also meant that if the debtor could not also establish that it owed a parallel duty in tort, it would be prevented from relying on contributory negligence as a defence.

10.21 The issue was considered again by the Court of Appeal in *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd*,<sup>36</sup> in which *Vesta* was approved. However, that decision was overturned by the House of Lords on another issue.<sup>37</sup> It would therefore appear that *Vesta* is the leading authority on contributory negligence as a contractual defence in English law.

#### Judicial consideration of the 1945 Act in Scotland

10.22 As we note above, the question as to whether the 1945 Act extends the operation of contributory negligence as a defence to claims for breach of contract in Scotland has never been authoritatively answered. It has been considered on a number of occasions in the Outer House (all at procedure roll), and these decisions suggest that the answer is likely to

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<sup>31</sup> [1988] 3 WLR 565. Although subsequently appealed to the House of Lords ([1989] AC 852), the question of contributory negligence was not addressed in the House of Lords, and the judgment of the Court of Appeal was affirmed on other grounds.

<sup>32</sup> [1986] 2 All ER 488 at 508, per Hobhouse J.

<sup>33</sup> [1988] 3 WLR 565 at 527 to 578, per O'Connor LJ.

<sup>34</sup> [1988] 3 WLR 565 at 586, per Neill LJ (even though O'Connor LJ disapproved the approach put forward by Neill LJ in *AB Marintrans*).

<sup>35</sup> [1988] 3 WLR 565 at 589 and 590, per Sir Roger Ormrod.

<sup>36</sup> [1990] 1 QB 818.

<sup>37</sup> [1992] 1 AC 233.

be the same in Scotland as in England, despite the argument that the definition of “fault” is broader in Scots law.<sup>38</sup>

10.23 The question was first considered in *Lancashire Textiles (Jersey) Ltd v Thomson Shepherd & Co Ltd*.<sup>39</sup> The creditor was a carpet supplier who sued the manufacturer (the debtor) in respect of defective carpets which had been rejected by one of the creditor’s customers. The claim was based on the alleged breach by the debtor of its statutory duty under section 14 of the Sale of Goods Act 1979 (implied terms about quality or fitness). That section imposed strict liability on the debtor. The debtor denied any breach of section 14. In the alternative, it argued that any loss suffered by the creditor was caused partly by a lack of skill or care on the part of the creditor or its sub-contractors, and so any damages should be proportionately reduced under section 1 of the 1945 Act.<sup>40</sup>

10.24 Although Lord Davidson allowed a proof before answer on certain of the parties’ averments, he repelled the debtor’s plea-in-law and averments relating to contributory negligence. In rejecting the debtor’s argument, he observed:

“[t]he pursuers rely upon section 14 of the Sale of Goods Act 1979, but that does not mean that they sue in respect of a breach of statutory duty in the sense in which that expression is used in section 5. In my opinion a breach of contract may form the basis of a plea of contributory negligence, but only if that breach can also be described as constituting a wrongful act, breach of statutory duty or negligent act or omission within the meaning of section 5.”<sup>41</sup>

10.25 This suggests that contractual breaches alone cannot give rise to a contributory negligence defence unless they can also be characterised as delictual, or a breach of statutory duty.

10.26 The second reported case to consider the issue was *Concrete Products (Kirkcaldy) Ltd v Anderson and Menzies (Kirkcaldy)*.<sup>42</sup> The debtors were accountants who had audited the creditors’ books. The creditors claimed that the debtors ought to have noticed a series of frauds by the creditors’ employees. The debtors claimed that, as it was the creditors’ employees who had committed these frauds, the creditors had been contributorily negligent. The creditors on the other hand maintained that as they were bringing a contractual claim, any plea of contributory negligence was irrelevant.

10.27 The case came before Lord Dawson, and the reported proceedings largely concerned technical deficiencies in the pleadings as a result of which amendment would be required. Parties however proceeded to debate the relevancy of the debtor’s plea of contributory negligence. Lord Dawson was referred to the view expressed by Lord Davidson in *Lancashire Textiles*,<sup>43</sup> and to the English position as set out in *Vesta*.<sup>44</sup> On that basis, Lord

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<sup>38</sup> See para 10.15 above.

<sup>39</sup> 1985 SC 135.

<sup>40</sup> 1985 SC 135 at 138.

<sup>41</sup> 1985 SC 135 at 141 and 142, per Lord Davidson.

<sup>42</sup> 1996 SLT 587.

<sup>43</sup> See para 10.24 above.

<sup>44</sup> See paras 10.18 to 10.21 above.

Dawson was persuaded that the plea had sufficient merit not to be repelled as irrelevant, and allowed the debtor to amend to cure the various defects identified in the pleadings.<sup>45</sup>

10.28 The final reported case is *Scottish and Southern Energy plc v Lerwick Engineering and Fabrication Ltd.*<sup>46</sup> Works carried out by the debtor to a boiler owned by the creditor resulted in a fire which caused damage to the creditor's property. The creditor claimed for its loss under an indemnity clause in the contract for the works. Lady Clark of Calton had to consider, among other things, whether the debtor could pray in aid the creditor's contributory negligence to reduce the debtor's liability under the indemnity clause. Lady Clark held that the debtor could not, as the indemnity clause did not depend on proof of fault within the meaning of the 1945 Act.<sup>47</sup> She also observed that the debtor had failed to aver a situation where the provisions of the 1945 Act might apply.<sup>48</sup>

10.29 As we note above, it has been argued that the Scottish definition of "fault" in the 1945 Act is wider in scope than its English counterpart.<sup>49</sup> This argument was put to the Outer House in the unreported case of *Stewart and Stewart v Pure Ltd.*<sup>50</sup> The creditors were travel agents who contracted with an aircraft broker to procure aircraft for an outward and a return flight on which the creditors' clients would travel. The outbound flight took place but the debtor did not make an aircraft available for the return flight. The creditors accordingly sued for damages for breach of contract, representing their costs in making alternative arrangements for their clients to return home.

10.30 Lord Glennie adopted the categorisation of claims approved by the Court of Appeal in *Vesta* and observed that *Stewart and Stewart* was a category (1) case: the debtor's liability arose from breach of a contractual provision which did not depend upon the debtor's negligence.<sup>51</sup> While that might have been sufficient to dispose of the matter, Lord Glennie went on to analyse the differences between the Scottish and English definitions of fault in response to the debtor's argument that "fault" had a wider meaning in section 5(a) than it did in section 4. He rejected the argument by reference to the second limb of the definition (that the creditor's conduct would apart from the 1945 Act, give rise to the defence of contributory negligence), commenting:

"Let it be assumed that the defenders' breach of contract in this case could properly be described as a "wrongful act" giving rise to a "liability in damages" within the first limb. One then has to look to the act of the pursuer and ask whether it is a "wrongful act" which gives rise at common law to the defence of contributory negligence. The answer in a Category 1 case such as the present is clearly: No. [...]"

The conduct of the pursuers in the present case cannot be "fault" within the meaning of the Act since it does not give rise to a defence of contributory negligence at common law. That is because their claim is in contract and does not rest upon a breach of a duty of care commensurate with that which would be owed at common

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<sup>45</sup> It should perhaps be noted that this is not a particularly high test: for the plea to be repelled as irrelevant, the court has to be satisfied that it must necessarily fail even if all of the pursuer's averments were proved: *Jamieson v Jamieson* 1952 SC (HL) 44 at 50, per Lord Normand; at 63, per Lord Reid.

<sup>46</sup> [2008] CSOH 41; 2008 SCLR 317.

<sup>47</sup> [2008] CSOH 41 at para 25.

<sup>48</sup> [2008] CSOH 41 at para 26.

<sup>49</sup> See para 10.15 above.

<sup>50</sup> [2008] CSOH 49.

<sup>51</sup> [2008] CSOH 49 at paras 15 and 16.

law. Put shortly, the 1945 Act does not entitle the defenders to set up a case of contributory negligence as a defence in whole or in part to the pursuers' claim."<sup>52</sup>

10.31 As contributory negligence had not been available for breaches of contract before the 1945 Act, Lord Glennie held that the Act did not create a new form of contributory negligence in contract. He observed that Lady Clark's decision in *Scottish and Southern Electricity plc* appeared to be entirely consistent with his decision.

10.32 In summary, as the law currently stands it appears that contributory negligence is available to debtors in a breach of contract claim if their contractual obligation was concurrent with a delictual obligation, or obligation that would give rise to a breach of statutory duty. This is the case regardless of whether the creditor chooses to frame its action solely in terms of breach of contract.<sup>53</sup> It therefore appears that there is a somewhat arbitrary division in the Scots law of contributory negligence, as delict and contract are treated differently. While the position may be more certain than that under the DCFR, it is not obvious to us that it leads to just results in all, or even many, cases.

#### *Scots and English law: other relevant principles*

10.33 Contributory negligence is not the only doctrine by which Scots (and English) law takes account of a creditor's contribution to losses arising from breach of contract: there is an overlap between contributory negligence, causation and mitigation. There are cases in which the creditor's conduct might equally be dealt with under either causation or mitigation.<sup>54</sup> McBryde observes that:

"The relationship [of mitigation] with causation, remoteness, contributory negligence and theories of economic waste and the like is complex and, perhaps, not fully understood."<sup>55</sup>

10.34 However, these have their limitations. Causation will normally oblige courts to reach an all or nothing conclusion<sup>56</sup> by finding that the creditor was the cause of the loss, and hence receives nothing, or that the debtor was the cause of the loss, and therefore must pay full damages. This is likely to produce unreasonable results where both parties were partly to blame. The cases cited below demonstrate the deficiencies of causation as an alternative to apportionment under the 1945 Act.<sup>57</sup> It seems unduly harsh on the creditor in *Beoco* that an omission to test repairs before using the equipment supplied by the debtor should relieve the latter of any liability. Equally, it might appear that the creditor's failure in *Borealis* to take any action in response to the warning of potential contamination at its plant ought to have entitled the debtor to a reduction in the damages payable.

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<sup>52</sup> [2008] CSOH 49 paras 18 and 19, per Lord Glennie.

<sup>53</sup> See McBryde, *Contract*, para 22.36.

<sup>54</sup> Chitty, para 26.078.

<sup>55</sup> McBryde, *Contract*, para 22.37 and fn 121, citing a similar comment made by Lord Hobhouse in *Platform Home Loans Ltd v Oyston Shipways Ltd* [2000] 2 AC 190 at 208.

<sup>56</sup> 1999 Report, para 4.1. however, this is not always the case- see the English case of *Tennant Radiant Heat Ltd v Warrington Development Corp* [1988] 1 EGLR 48, considered below.

<sup>57</sup> 1999 Report, para 4.10. See also the differing results reached in the following cases: *Lambert v Lewis* [1982] AC 225 (chain of causation broken by continuing to use a trailer after discovering that towing hitch was faulty); *Beoco Ltd v Alfa Laval Co Ltd* [1995] QB 137 (chain of causation broken by failing adequately to test a repair before putting a damaged machine back into use); *Borealis AB v Geogas Trading SA* [2010] EWHC 2789 (Comm) (chain of causation not broken by failing to take action in response to a warning of contamination which was indicative of damage to the creditor's plant by products supplied by the debtor).

10.35 An easy solution to the all or nothing problem would be to adopt a more flexible approach to causation and make an apportionment between the parties based on the causative potency of each party's conduct. A potential example is *Tennant Radiant Heat Ltd v Warrington Development Corporation*,<sup>58</sup> a dispute between tenant (suing in tort on grounds of nuisance or negligence) and landlord (counterclaiming on the basis of breach of the tenants' repairing covenants). Questions of contributory negligence and causation arose.

10.36 The Court of Appeal held that the counterclaim was in contract and could not be formulated in tort. Accordingly, the case was a category (1) case as set out in *Vesta* and the 1945 Act did not apply. However, it went on to reach a similar result using causation principles, ordering the landlord to pay 90% of the damages due to the tenants on the claim, and ordering the tenants to pay 10% of the damages due to the landlord in the counterclaim.

10.37 However, *Tennant Radiant* has been described as an unusual case,<sup>59</sup> and does not appear to have been followed.<sup>60</sup> It is not clear that reforming the law on causation would prove a more attractive option than reforming contributory negligence, and in any event that is beyond the scope of this Discussion Paper.

10.38 Mitigation is limited by the fact that it only operates after the breach, and therefore will not cover situations in which the creditor behaved unreasonably prior to or contemporaneously with the breach of contract.<sup>61</sup>

#### *Scots law: restriction of other remedies for creditor who causes debtor's breach*

10.39 The general DCFR rule that a party may not exercise any of the remedies for non-performance to the extent that it caused the other party's non-performance<sup>62</sup> has no precise parallel in the modern Scots law of contract. A number of other rules do however give rise to similar effects in restricting a party's right to a remedy in response to breach on the other side. McBryde states that:

“[a]s a general rule if a party to a contract impedes or prevents performance of a term of the contract that does not result in a breach of contract by the other party.”<sup>63</sup>

10.40 This is illustrated by reference to a number of cases cited by McBryde.<sup>64</sup> McBryde also gives as an example the doctrine of mutuality under which a party in breach itself may not bring an action for breach against the other party as an example, observing:

“A person is excused from performance of an absolute obligation only when performance is prevented by the actions or default of the other party... This principle

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<sup>58</sup> [1988] 1 EGLR 41.

<sup>59</sup> Chitty, para 26.78 and fn 402. The Court of Appeal itself appeared sceptical of *Tennant Radiant* in *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd* [1990] 1 QB 818 at 904, but the point was not considered in the House of Lords.

<sup>60</sup> Contributory Negligence as a Defence in Contract (Law Com No 219, 1993), para 3.13.

<sup>61</sup> McBryde, *Contract*, para 22.37 and fn 115, citing a number of circumstances in which mitigation cannot operate.

<sup>62</sup> See para 10.3 above.

<sup>63</sup> McBryde, *Contract*, para 20.16 and fn 38.

<sup>64</sup> Indeed, the examples given by McBryde in para 20.16 parallel those mentioned in the commentary to the DCFR (see para 10.4 above): *T & R Duncanson v Scottish County Investment Co* 1915 SC 1106 is an example of refusing tradesmen access to a site; *Robert McAlpine v Lanarkshire and Ayrshire Railway Company* (1889) 17 R 113 is an example of the creditor not supplying all necessary information to the debtor timeously.

is consistent with the mutuality principle. Mutuality involves an active decision to suspend performance because of another's breach. In the obstruction cases, a breach by one party impliedly bars that party from pleading that the other's consequent non-performance is a breach."<sup>65</sup>

10.41 The case of the "absolute obligation" mentioned here also falls to be compared to the "conditional obligation", where some action by one of the parties is a condition (in the technical sense) of the fulfilment of the contract following upon initial acts of performance by the other party. The failure of the first to act appropriately will be taken as meaning the contract is fulfilled. As a result, there is no breach by the second party, and the first has no entitlement to any remedy.

10.42 In the light of the apparent consistency of Scots law with the DCFR principle that a party may not exercise any of the remedies for non-performance to the extent that it caused the other party's non-performance, we ask:

- 70. If a general statutory restatement is pursued, should it provide that a party may not exercise any of the remedies for non-performance to the extent that it caused the other party's non-performance?**

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<sup>65</sup> McBryde, *Contract*, para 20.18.

## Potential reforms

### *Earlier proposals for reform*

10.43 As mentioned above, reform of the law in this area is an issue which has been considered several times in recent decades both by this Commission and by the Law Commission for England and Wales.<sup>66</sup> As the recommendations made by the Commissions remain unimplemented, we think it is helpful to set them out briefly before making further proposals.

### Report on Civil Liability—Contribution (1988)

10.44 In our 1988 Report, the key recommendations on contributory negligence were that:

"20. Where the defender's liability for breach of a contractual duty of care is the same as his liability in delict for negligence, the plea of contributory negligence should be available as a defence whether the action is framed in delict or in contract.

21. The plea of contributory negligence should be available to the defender where he is in breach of a contractual duty of care but is under no corresponding common law duty to take reasonable care.

22. The plea of contributory negligence should not be available where the defender's breach of a contractual obligation does not depend on his having been negligent.

23. In so far as contributory negligence is relevant in actions founded on breach of contract, parties should be entitled to exclude the plea in their contract.

24. The plea of contributory negligence should not be available in answer to any action founded on ... liability for an intentional breach of a contractual duty of care."

10.45 So far as the law stands today, recommendations 20 and 22 appear to have been overtaken by case law.<sup>67</sup> Recommendation 21 would appear to correspond to a category (2) case in the *Vesta* classification and there is no suggestion that Scots law presently permits a plea of contributory negligence in those circumstances. Indeed, the cases would seem to suggest that the plea is available only in category (3) cases, and the only way to reform the law further would be via statutory intervention.

### Contributory Negligence as a Defence in Contract (1993)

10.46 In 1993, the Law Commission for England and Wales recommended that contributory negligence should be available only where the debtor was in breach of a contractual duty of care, not where the breach was of a strict contractual duty.<sup>68</sup> In support of the latter conclusion, the Commission stated that where a creditor had relied on a strict liability obligation, the debtor should be held to this obligation and the creditor ought not to have to take precautions against this breach. It observed that the rules of mitigation prevented a creditor from acting unreasonably after discovering the breach.<sup>69</sup>

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<sup>66</sup> See para 10.1 above.

<sup>67</sup> See paras 10.22 to 10.32 above. Our 1999 Report was rather more circumspect: see para 4.2 and fn 5.

<sup>68</sup> *Contributory Negligence as a Defence in Contract* (Law Com No 219, 1993), para 4.1.

<sup>69</sup> Law Com Report No 219, para 4.2

10.47 The 1993 Report was rejected.<sup>70</sup> We are not aware of any further steps towards reform in England and Wales.

#### Report on Remedies for Breach of Contract (1999)

10.48 This Commission revisited the question of contributory negligence in its 1999 Report. It concluded that the 1988 proposals represented the minimum reform which should be considered, and investigated whether it would be desirable to introduce wider reforms.<sup>71</sup>

10.49 The 1999 Report set out detailed reasons for extending any reform of contributory negligence beyond what had been proposed in 1988 to include cases where the debtor was in breach of a strict contractual obligation.<sup>72</sup> It therefore made a single recommendation, superseding those made in the 1988 Report, as follows:

“3. It should be provided that, where loss or harm is caused partly by a breach of contract and partly by the act or omission of the aggrieved party, the amount of damages should be reducible to take account of the extent to which the aggrieved party's conduct contributed to the loss or harm, the conduct of both parties being taken into account.”<sup>73</sup>

#### *Current proposals*

10.50 It appears to us that there are three possible options at this time:

- to make no positive recommendation for reform, and leave the courts to develop the law in light of *Vesta*;
- to return to our 1988 recommendations, and introduce contributory negligence as a defence in purely contractual claims, but only where the debtor owed a duty of reasonable skill and care;
- to restate our 1999 recommendation, and introduce contributory negligence as a defence for all contractual claims.

#### Option 1: no recommendation for reform

10.51 This option would leave the regime under the 1945 Act as it presently stands. On the face of it, that would only allow contributory negligence as a contractual defence where there is a concurrent claim in delict. We observe that it has never authoritatively been settled whether *Vesta* also represents Scots law, meaning that conceivably the true position is that contributory negligence is never available as a contractual defence in Scots law.<sup>74</sup>

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<sup>70</sup> See <http://www.lawcom.gov.uk/our-work/implementation/table/> .

<sup>71</sup> 1999 Report, para 4.5. It did so in light of its review of the international models (PECL and PICC) which were predecessors to the DCFR: see para 4.4.

<sup>72</sup> 1999 Report, paras 4.6 to 4.12.

<sup>73</sup> 1999 Report, para 4.13.

<sup>74</sup> The High Court of Australia concluded that the equivalent Australian legislation, based on the 1945 Act, did not apply where the claim was for breach of contract: *Astley v Austrust Ltd* [1999] HCA 6; 197 CLR 1. See also D Logan, “Contributory fault in contract – a step back?”, 2000 SLT (News) 81.

10.52 This option would represent a departure from the Commission's previous recommendations. It would do nothing to address the perceived deficiencies in the current law:

- first, there is uncertainty under the current law with regard to whether a duty will be owed concurrently in tort or delict and in contract;<sup>75</sup>
- secondly, this approach is inconsistent with that adopted in the DCFR;<sup>76</sup>
- thirdly, the doctrines of mitigation and causation are inadequate alternatives for dealing with issues which are fundamentally issues of contributory negligence, with extreme results arising in particular in relation to causation.<sup>77</sup>

#### Option 2: limited introduction of contributory negligence as defence to contractual claims

10.53 This option would introduce contributory negligence as a defence in purely contractual claims, but only where the debtor owed a contractual duty of care as recommended by the 1988 Report.<sup>78</sup>

10.54 The principal advantage set out in that Report was that creditors who had contracted for an obligation of strict liability could rely on that obligation until they became aware of a debtor's breach, when the obligation to mitigate would bite. They would not have to take precautionary measures against breach. In addition, there would be no question of any inconsistency with social policy objectives laid down by Parliament, under strict liability regimes such as in the sale of goods. The arguments for departing from this approach were clearly set out in our 1999 Report.<sup>79</sup>

#### Option 3: introduction of contributory negligence as defence to all contractual claims

10.55 This option would introduce contributory negligence as a defence for all contractual claims, as recommended in our 1999 Report. It does not appear to us that the reasons advanced in its support in the 1999 Report have in any way been diminished in the intervening years. As we discuss at the outset of this Chapter, this would leave Scots law in a similar position to the DCFR, with the resulting uncertainty that may ensue.<sup>80</sup> On the other hand, it has rightly been said that:

“it brings the law into disrepute if [defenders] are left to argue that they were negligent, whilst [pursuers] deny this.”<sup>81</sup>

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<sup>75</sup> Contributory Negligence as a Defence in Contract (Law Com No 219, 1993), para 3.27.

<sup>76</sup> Even in our 1999 Report, we observed that this approach was out of step with the international models: see para 4.4.

<sup>77</sup> See paras 10.33 to 10.38 above.

<sup>78</sup> It would also be consistent with the English recommendations in 1993.

<sup>79</sup> 1999 Report, paras 4.6 to 4.12.

<sup>80</sup> See para 10.11 above.

<sup>81</sup> R Stevens, “Should Contributory Fault be Analogue or Digital?” in A Dyson, J Goudkamp and F Wilmot-Smith (eds) *Defences in Tort* (2015), p 247; found quoted in J O’Sullivan, “Contributory Negligence and Strict Contractual Obligations Revisited”, in A Dyson, J Goudkamp and F Wilmot-Smith (eds) *Defences in Contract* (2017), p 237 (also arguing that permitting contributory negligence in cases of breach of strict contractual obligations “is to be preferred”).

10.56 This option is also advocated in *McGregor on Damages*.<sup>82</sup> It is also of note that Ireland introduced a similar scheme in 1961.<sup>83</sup> We therefore ask:

- 71. Should a defence of the creditor's contributory negligence be available to the debtor in any claim for damages for breach of contract, with the effect of reducing the creditor's damages to such extent as the court thinks just and equitable having regard to the creditor's share in the responsibility for the damage?**

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<sup>82</sup> *McGregor on Damages*, para. 7.013.

<sup>83</sup> Civil Liability Act 1961, ss 34 to 42.

# Chapter 11 A general statutory restatement?

## Introduction

11.1 We have now canvassed the full range of topics usually covered under the heading of remedies for breach of contract. A number of possible reforms have been set out, while at the same time a number of areas have been identified as working well and not being in need of any major reform as such. With regard to these areas, however, we have nonetheless raised the possibility of including them in a general statutory restatement of the law on remedies for breach: notably, the bulk of the law of retention (suspension), anticipatory or anticipated breach, rescission (termination) and damages.

11.2 The possibility of modernising the terminology in the field has also been raised several times in the course of our discussion, in particular with regard to the otherwise fairly satisfactory self-help remedies. We set out the general policy for exploring these matters in Chapter 1.<sup>1</sup> A comprehensive modernisation of terminology would, however, only be possible within the framework of a general statutory restatement also embodying the substantive reforms suggested in this Discussion Paper.

11.3 Another reason for consulting on the possibility of a general restatement of the law is that, in some cases, the reforms we suggest would amount to significant innovations on the present law. It might be easier to show how these interact with the existing remedies within a comprehensive statutory scheme: for example, the possible links between specific implement and gain-based awards, or between retention and anticipated breach.

11.4 A comprehensive statutory restatement was raised as a possibility in the equivalent exercise conducted by our predecessors in 1999. It was not proceeded with, “having regard to our current priorities and resources and to the mixed reaction on consultation”.<sup>2</sup> Nearly twenty years later, we think it worthwhile to test the waters of opinion once more. A general statement would make the law more accessible to all, including practitioners and the judiciary, and allow parties choosing Scots law to govern their contracts with knowledge of what that entailed.

11.5 This final Chapter therefore sets out the ground that a general statutory restatement of the law might cover. We again refer to the DCFR as a model for the structure of such a scheme. The summary that follows assumes that all our suggested reforms in the preceding are accepted and implemented, which may of course not be the case. The order in which the topics are presented follows that in the DCFR, but this would not necessarily be the way in which any such statutory restatement was eventually presented.

11.6 We begin by indicating some additional provisions of a general nature that might be necessary in such a project, asking some further questions on the matter.

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<sup>1</sup> See paras 1.37 to 1.45 above.

<sup>2</sup> 1999 Report, para 1.4.

## General part

### *A default system*

11.7 As noted previously in Chapter 1,<sup>3</sup> the DCFR scheme is a general yet default one for all contracts. Particular kinds of contracts may have their own regime of remedies, varying or departing from the general scheme, while parties may likewise create regimes of their own devising for the contract upon which they engage. This is also the present position in Scots law.

11.8 In the event of a general statutory restatement of the law on breach of contract, it might therefore be useful to have an express re-affirmation that it does not affect existing legal regimes for particular contracts or seek to deprive parties of their general contractual freedom (that task, so far as may be thought necessary in this context, being already performed by other legislation and common law rules). We therefore ask:

**72. If a general statutory restatement is pursued, should it provide that it does not affect:**

**(a) any special regime of remedies provided by law for particular kinds of contract;**

**(b) parties' freedom of contract with regard to making provision about remedies in their contracts?**

### *Cumulation*

11.9 The DCFR also provides that remedies which are not incompatible may be cumulated, giving the specific example of damages as not precluded by resort to any other remedy.<sup>4</sup> The major instance of incompatible remedies would appear to be termination and performance orders. There are also specific provisions on the measure of damages following termination,<sup>5</sup> and on a right to damages over and above interest for non-payment of a monetary obligation.<sup>6</sup> Although there seem to be no specific provisions in the DCFR to this effect, presumably there may be cases where an order for performance could be coupled with a claim for damages for loss suffered as a result of previous non-performance.

11.10 The McGregor Code also provides for cumulation or “complementarity” of remedies,<sup>7</sup> and states that termination of the contract does not affect the right to claim damages or prevent either party from seeking restitution.<sup>8</sup> However, it adds the useful provisions that the court cannot give two or more remedies which would result in benefits to the creditor exceeding his loss,<sup>9</sup> and that, although a creditor may switch from one remedy to another, this is barred when an election between substantive rights is involved (as in the conflict between termination and seeking performance) or when the party in breach is prejudiced by

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<sup>3</sup> See para 1.26 above.

<sup>4</sup> DCFR III.–3:102. See also PECL art 8:102.

<sup>5</sup> DCFR III.–3:706 and 3:707. See also PECL arts 9:506 and 9:507; PICC arts 7.3.5(2), 7.4.5 and 7.4.6.

<sup>6</sup> DCFR III.–3:708(2). See also PECL art 9:508(2); PICC art 7.4.9(3).

<sup>7</sup> McGregor Code, para 491.

<sup>8</sup> McGregor Code, para 307(2).

<sup>9</sup> McGregor Code, para 491.

the vacillation.<sup>10</sup> This, however, may be thought inconsistent with the idea canvassed in Chapter 8 allowing gain-based monetary remedies against the debtor whose profit or saving from its breach greatly exceeds the creditor's loss.

11.11 There has been little express recognition in the Scots law of contract that remedies for breach are cumulative, but there is equally little doubt that this is in fact the position in legal principle.<sup>11</sup> It might be usefully provided for in any general statutory restatement.

**73. If a general statutory restatement is pursued, should it provide that:**

**(a) as a general principle, remedies are cumulative except where their exercise together is incompatible;**

**(b) the court cannot give two or more remedies which would result in benefits to the creditor exceeding its loss;**

**(c) although a creditor may switch from one remedy to another, this is barred when:**

**(i) an election between substantive rights is involved; or**

**(ii) the party in breach is prejudiced by the vacillation?**

*Application to unilateral obligations and third-party rights*

11.12 Our 1999 Report stated that its recommendations should also be extended to unilateral voluntary obligations.<sup>12</sup> We think that such a statement should be made in the general part of any statutory restatement of the law on remedies for breach.

**74. If a general statutory restatement is pursued, should it extend to unilateral voluntary obligations?**

11.13 The Contract (Third Party Rights) (Scotland) Bill is presently before the Scottish Parliament. If enacted, express reference to third-party rights in contracts would be unnecessary in any general restatement, as section 7(2) provides that the third party has available, as a remedy for breach of the undertaking in its favour, any remedy which a contracting party would be entitled to were the undertaking in favour of the contracting party.

*Good faith*

11.14 The DCFR recognises a general requirement of good faith and fair dealing, which is said to refer to a standard of conduct characterised by honesty, openness and consideration for the interests of the other party to the transaction or relationship in question.<sup>13</sup> Acting

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<sup>10</sup> McGregor Code, para 492.

<sup>11</sup> See McBryde, *Contract*, para 23.08; MacQueen and Thomson, *Contract*, para 5.6.

<sup>12</sup> 1999 Report, para 6.4.

<sup>13</sup> DCFR I.-1:103(1). Compare PICC (art 1.7) and PECL (arts 1:102, 1:106, 1:201), both of which deploy a general principle of good faith and fair dealing in the exercise of rights and the performance of duties, which may not be excluded or limited by the parties. As the commentaries make clear, these are intended to have a strong influence, similar to the famous principle found in §242 of the BGB. But the principle does not permit the overriding of the contract itself.

inconsistently with one's prior statements or conduct when the other party has reasonably relied on them to that party's detriment is declared to be a particular example of a breach of the good faith/fair dealing requirement.<sup>14</sup> This is applied expressly to questions of breach:

“[a] person has a duty to act in accordance with good faith and fair dealing [...] in exercising a right to performance, in pursuing or defending a remedy for non-performance, or in exercising a right to terminate an obligation or contractual relationship”.<sup>15</sup>

11.15 The duty may not be excluded or limited by contract or other juridical act,<sup>16</sup> but its breach does not give rise directly to remedies for non-performance under the DCFR. It may however preclude the person in breach from:

“[...] exercising or relying on a right, remedy or defence which that person would otherwise have.”<sup>17</sup>

11.16 In Scots law terms, the duty operates rather like personal bar: more as a shield than a sword. The emphasis otherwise would seem to be on mutual cooperation and disclosure, with due regard for the other party's interests.

11.17 Many rules in the DCFR embody the requirements of good faith: for example, the inability of the party who causes the other's non-performance to exercise any remedy in respect of that non-performance.<sup>18</sup> Other examples would include the reciprocity of obligations,<sup>19</sup> limitations on specific enforcement,<sup>20</sup> and the duty to mitigate damage.<sup>21</sup>

11.18 All the concepts underpinning these rules can of course also be perceived within Scots law: for example, mutuality and the equitable control over retention, the court's power to refuse specific implement where the order would be inequitable, and the court's discretion to determine loss other than at the date of breach as well as the reduction of damages upon the creditor's failure to mitigate.

11.19 In Scots law, however, “[g]ood faith ... is generally an underlying principle of an explanatory and legitimating rather than an active or creative nature.”<sup>22</sup> McBryde asserts that it cannot be doubted that Scots law has a doctrine of good faith,<sup>23</sup> and identifies four propositions in relation to it:

“(1) there is no single principle of good faith; (2) except in the context of unjustified enrichment, good faith is usually a shield and not a sword — it is a defence to an

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<sup>14</sup> DCFR I.-1:103(2).

<sup>15</sup> DCFR III.-1:103(1).

<sup>16</sup> DCFR III.-1:103(2).

<sup>17</sup> DCFR III.-1:103(3).

<sup>18</sup> DCFR III.-3:101(3).

<sup>19</sup> DCFR III.-1:102(4).

<sup>20</sup> DCFR III.-3:302(3) and (4).

<sup>21</sup> DCFR III.-3:705(1).

<sup>22</sup> *R (European Roma Rights Centre) v Immigration Officer at Prague Airport and another* [2005] 2 AC 1 at para 60, per Lord Hope of Craighead (quoting H L MacQueen, “Delict, Contract, and the Bill of Rights: A Perspective from the United Kingdom” (2004) 121 South African LJ 359 at 382). See also H L MacQueen, “Good Faith”, in H L MacQueen and R Zimmermann (eds), *European Contract Law: Scots and South African Perspectives* (2006), ch 2; McBryde, *Contract*, paras 17.23 to 17.34.

<sup>23</sup> McBryde, *Contract*, para 17.28.

action and not the foundation of an action<sup>24</sup>; (3) there are established categories where good faith is relevant, mainly, but not entirely, concerned with property rights; namely the rights of the bona fide possessor to the fruits of the subjects, the rights of an acquirer of property in good faith, and payment in good faith; and (4) certain nominate contracts have special rules on good faith, such as insurance, cautionary obligations, agency and partnership.”<sup>25</sup>

11.20 McBryde goes on to observe that “[a] bad motive in termination of a contract is irrelevant” and that “[d]amages are not increased because the contract breaker was in bad faith, although in exceptional cases the law may be changing”,<sup>26</sup> under reference to *Attorney-General v Blake*.<sup>27</sup>

11.21 McBryde explains, however, that the European concept of good faith and the Scots law concept are not equivalent:

“It is possible to take isolated rules and to claim that they represent an underlying, and unrecognised, doctrine of good faith, for example [...] that there is equitable control of the use of remedies, in particular, specific implement. All this may show is that there are controls over actions in [...] enforcing contracts. A European concept of good faith means more than that.”<sup>28</sup>

11.22 As a consequence, we do not think that it would be necessary or desirable at this stage in the development of Scots law to provide for a general requirement of good faith in any statutory restatement of the law on remedies for breach of contract. Instead, as at present, we suggest that bespoke provision can be made in relation to particular remedies where the concept of good faith is relevant.

**75. If a general statutory restatement is pursued, do consultees agree that:**

- (a) it is unnecessary to refer to a general requirement of good faith;**
- (b) bespoke provision should instead be made in relation to particular remedies where the concept of good faith is relevant?**

### *Notices*

11.23 The concept of notice plays an important role in the remedial structure of the DCFR: for example, in the case of the creditor giving the debtor additional time for performance, or in withholding performance and termination. “Notice” is broadly defined in the DCFR.<sup>29</sup> It includes communication of information or of a juridical act, by any means appropriate to the circumstances,<sup>30</sup> and it becomes effective when it reaches the addressee unless it provides for a delayed effect.<sup>31</sup> A notice reaches the addressee on delivery to the addressee or its place of business or its habitual residence, or when the notice is otherwise made available in

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<sup>24</sup> *Menzies v Menzies* (1863) 1 M 1025 at 1037, per Lord Neaves, in the context of bona fide perception and consumption.

<sup>25</sup> McBryde, *Contract*, para 17.29.

<sup>26</sup> McBryde, *Contract*, para 17.32.

<sup>27</sup> [2001] 1 AC 268. See further paras 8.20 to 8.26 above.

<sup>28</sup> McBryde, *Contract*, para 17.32.

<sup>29</sup> DCFR I.–1:109.

<sup>30</sup> DCFR I.–1:109(2).

<sup>31</sup> DCFR I.–1:109(3).

such a way that the addressee could reasonably be expected to obtain access to it without undue delay. Notice may be given electronically, in which case it reaches the addressee when the latter can access it.<sup>32</sup> It may be given by or to an authorised agent.<sup>33</sup> With regard specifically to notices upon non-performance, if properly dispatched or given, a delay or inaccuracy in the transmission of the notice or its failure to arrive does not prevent it from having effect from the time at which it would have arrived in normal circumstances.<sup>34</sup>

11.24 Our Advisory Group noted that the risk of laying down rules on what constitutes a valid notice is that it invites arguments about whether they have been complied with and whether they are mandatory or directory. It also observed that it was not uncommon for solicitors to make mistakes in the service of notices. It therefore suggested that any notice provisions should be made as simple as possible to reduce the scope for error. In addition, it suggested that there should be a very high test for non-validity of notices, given solicitors' propensity to argue about whether a notice is valid or not.<sup>35</sup>

11.25 In Scots law, section 26 of the Interpretation and Legislative Reform (Scotland) Act 2010 provides default rules about the service of documents.<sup>36</sup> It applies where service is authorised or required by an Act of the Scottish Parliament or subordinate legislation made under such an Act.<sup>37</sup> It provides for personal, postal and electronic delivery (the parties must agree to the use of electronic communications for that method to be effective). It also creates a presumption that documents are received 48 hours after sending. In any statutory restatement, section 26 might prove a useful model. We note, however, that it deals only with the service of documents. The DCFR, by contrast, contemplates the possibility of oral notices if they would be appropriate in the circumstances. It might therefore be necessary to provide additionally for notices given orally rather than in writing.

**76. If a general statutory restatement is pursued, should it include default provisions about notices?**

**77. If so, should it be possible to give notice orally?**

### **Particular remedies**

11.26 The DCFR follows its general part on remedies for non-performance with a section on the debtor's right to cure a non-conforming performance. Assuming that it is thought necessary to have a statutory provision to this effect,<sup>38</sup> we might still not expect to see it in such a prominent position in our general restatement.

11.27 The opposite would be true for our new performance order,<sup>39</sup> the DCFR equivalent to which provides the real opening in the text's account of remedies. This is followed in the

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<sup>32</sup> DCFR I.-1:109(4).

<sup>33</sup> DCFR I.-1:109(6).

<sup>34</sup> DCFR III.-3:106.

<sup>35</sup> For a recent example (where the Scottish authorities on construction of notices are reviewed), see *Hoe International v Anderson* [2017] CSIH 17 at paras 27 to 44.

<sup>36</sup> It is, in essence, a more elaborate version of section 7 of the Interpretation Act 1978.

<sup>37</sup> There is nothing to stop parties providing for its application to a contract, however.

<sup>38</sup> See paras 5.8 to 5.13 above.

<sup>39</sup> See paras 6.41 to 6.44 above.

DCFR by a section on withholding performance.<sup>40</sup> The focus of both remedies is performance of the contract but from distinct points of view. Most aspects of anticipated breach apart from termination are dealt with here as well:

- performance orders;
- mutuality;
- retention (suspension, or withholding performance);
- anticipatory (or anticipated) breach;
- the debtor's right to cure;
- price reduction;
- the creditor's right to cure.

11.28 In the DCFR the remedy of termination has 14 articles altogether, grouped in four sub-sections as follows:

- grounds for termination (including anticipated breach);
- scope, exercise and loss of right to terminate;
- effects of termination;
- restitution after termination.

It might be expected that the same ground would be covered in a statutory restatement of Scots law.

11.29 Next the DCFR devotes a single article to price reduction before moving on to 13 articles on damages and interest. Interest is excluded from the scope of the present project, but if any restatement embraces our suggested reforms of the law in this area it would also include provision on transferred loss claims<sup>41</sup> and gain-based damages.<sup>42</sup> It would probably also include rules covering the following points:

- that damages are primarily compensation for any recoverable loss caused to the creditor by the debtor's breach of contract;
- that the guiding principle in assessing damages is to put the creditor in the position that it would have been in had the contract been fully performed;
- that losses which are not reasonably foreseeable to the parties at the time of contracting are irrecoverable;

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<sup>40</sup> See Chapter 2.

<sup>41</sup> See Chapter 9.

<sup>42</sup> See Chapter 8.

- that damages may be reduced to the extent that the creditor unreasonably fails to minimise its loss;
- that damages are to be measured by the currency most appropriately reflecting the creditor's loss;
- that in general loss is assessed as at the date of breach, possibly with specified exceptions to this general rule.

**78. Do consultees have any comments to make on the suggested coverage of a general statutory restatement of the law on remedies for breach of contract?**

**79. Do consultees consider that it would be desirable to prepare a general statutory restatement of the law on remedies for breach of contract?**

# Chapter 12 List of questions and proposals

## Chapter 1 Introduction

1. Do consultees have any information or data on:
  - (a) the economic impact of the current law relating to remedies for breach of contract; or
  - (b) the potential economic impact of any proposed reform of that law?

(Paragraph 1.48)

## Chapter 2 Retention and withholding performance

2. Should the term “retention” be replaced by “suspension” or “withholding” of performance to describe the remedy under which a creditor is entitled as a temporary measure in response to the debtor’s breach not to perform its outstanding obligations under the contract?

(Paragraph 2.6)

3. In view of the present uncertainty about the meaning and scope of mutuality in the law on breach of contract, do consultees consider that adoption of the DCFR’s formulation of its equivalent concept of reciprocal obligations would provide a useful and workable clarification of the position?

4. Alternatively, are other approaches canvassed in recent judicial decisions to be preferred?

(Paragraph 2.15)

5. If mutuality is redefined, should it nonetheless remain capable of stretching across more than one contract, the inter-relationship of which arises from their both being part of a single transaction between the parties?

(Paragraph 2.16)

6. Do consultees consider that party A who is in breach of contract should be entitled to exercise any right or pursue any remedy arising out of party B’s breach of contract, occurring before B has terminated the contract for A’s breach?

(Paragraph 2.23)

7. If a general statutory restatement is pursued, should it provide for a creditor to withhold performance as a response to non-performance by the debtor?

(Paragraph 2.29)

8. Do consultees consider that any general restatement should provide that:
- (a) the debtor's non-performance must be material before the creditor can exercise the remedy of retention or withholding performance; or
  - (b) the courts have power to deal with abusive or oppressive use of the remedy?
- (Paragraph 2.35)
9. Would it be useful for any legislation on suspension or withholding of performance as a remedy for breach of contract to state that it does not apply to special retention?

(Paragraph 2.46)

### **Chapter 3 Retention and withholding performance**

10. Do consultees agree that "anticipated breach" is a more exact way of describing the situation in which a creditor may begin to exercise remedies for breach even although the time for the relevant performance by the debtor has not yet arrived?
- (Paragraph 3.6)
11. Do consultees agree that it is desirable to distinguish clearly between the concepts of anticipated breach and material breach, and that applying the term "repudiation" to both of them is undesirable?
12. If so, do consultees consider that the use of the term "repudiation" would become unnecessary as a result of the suggested changes to the law canvassed elsewhere in Chapter 3?
- (Paragraph 3.12)
13. If a general statutory restatement is pursued, should it provide that the creditor may terminate before performance of a contractual obligation is due if:
- (a) the debtor has declared that there will be a non-performance of the obligation, or it is otherwise clear that there will be such a non-performance; and
  - (b) that non-performance would have been fundamental?
- (Paragraph 3.27)
14. Do consultees consider that there would be any merit in postponing reform on this point in the meantime to see how the decision in AMA is developed?

15. Alternatively, do consultees consider that it would now be desirable to give effect to our 1999 recommendation and reform the law so that, where the creditor has not yet performed its obligation and it is clear that the debtor is unwilling to receive performance, the creditor may nonetheless proceed and recover payment unless:
- (a) the creditor could have made a reasonable substitute transaction without significant effort or expense; or
  - (b) performance would be unreasonable in the circumstances?

(Paragraph 3.47)

16. Do consultees agree that the law should provide that a creditor may respond to indications of the debtor's unwillingness or inability to perform its obligations as and when they fall due under the contract by either:
- (a) notifying the debtor of its concerns and that it is going to withhold performance of its own obligations, while empowering the debtor to end the withholding by sending the creditor an adequate assurance that it will perform its obligation when the time comes; or
  - (b) seeking an adequate assurance directly from the debtor, being thereby entitled to withhold its performance until such assurance is received, and becoming entitled to terminate the contract if one is not received within a reasonable time?

(Paragraph 3.51)

#### **Chapter 4 Termination**

17. Do consultees consider that:
- (a) "rescission" should be replaced with "termination"?
  - (b) "resile" should be replaced with "withdraw"?
18. Should the term "fundamental breach" or "substantial breach" be adopted in place of "material breach" as the term for the kind of breach which justifies termination of a contract?
19. Should persistent non-material breaches be treated as a breach justifying termination?

(Paragraph 4.11)

(Paragraph 4.15)

(Paragraph 4.16)

20. If a general statutory restatement is pursued, should it provide for a right of partial termination where the obligations under a contract are separable?

(Paragraph 4.18)

21. If a general statutory restatement is pursued, should it provide for a creditor to terminate the contract within a reasonable time after material (or substantial or fundamental) non-performance by the debtor?

(Paragraph 4.20)

22. We invite comment on:

(a) a requirement that the creditor notify termination to the debtor; and

(b) the need for the law to specify the prospective effects of termination.

(Paragraph 4.21)

23. If a general statutory restatement is pursued, should it provide for an ultimatum procedure by which a non-material breach of contract could lead to termination of the contract by the creditor who had previously notified the debtor of a reasonable period of time within which the latter must perform the obligation in question?

24. If so, should it also provide that:

(a) during the period of the notice the creditor is entitled to withhold its performance and may claim damages for the period of delay;

(b) the notice may provide for automatic termination by non-performance at the end of the notified period; and

(c) if the notice period is unreasonably short, termination (whether automatic or requiring further notice to the debtor) can take place only at the end of a reasonable period of time?

(Paragraph 4.26)

25. Do consultees agree that where parties have rendered conforming performances under a contract but not received the reciprocal counter-performances, there should be reciprocal restitution of the uncompleted performances after termination for breach?

26. If so, does the system of rules set out on this matter in the DCFR provide a satisfactory approach to the issue?

27. Alternatively, do consultees consider that the law in this area should be left to develop, particularly as to the relationship between breach of contract and unjustified enrichment?

(Paragraph 4.33)

## Chapter 5 Other self-help remedies

28. Should a price reduction remedy along the lines of that provided in sections 24, 44 and 56 of the Consumer Rights Act 2015 also be provided for non-consumer contracts in general?
29. Do consultees have any information or data about the use of this remedy in a consumer context?

(Paragraph 5.7)

30. Should the debtor have a right to carry out a cure (repair or replace or repeat performance) of a prior non-performance notified to it by the creditor if:
  - (a) performance is still possible within any relevant time limit imposed by the contract; or
  - (b) the debtor offers a cure at its own expense, to be carried out within a reasonable time?
31. Should this right exist only if the non-performance is not so fundamental as to entitle the creditor to terminate the contract?
32. If consultees consider that debtors should have such a right, do they agree that while the cure is carried out the creditor may not terminate the contract, but that it may withhold its own performance and that it retains the right to claim damages for the initial non-performance if appropriate?
33. Do consultees also agree that the debtor has the obligation to take back the replaced item at its own expense, while the creditor need not pay for any use made of that item?
34. Do consultees further agree that if the cure is not carried out within a reasonable time the creditor may terminate the contract and exercise any other remedy available to it in respect of the breach of contract?
35. Do consultees finally agree the creditor should not be obliged to accept an offer of cure if:
  - (a) it has reason to believe that the debtor's initial performance was made with knowledge of its non-conformity and was not in accordance with good faith and fair dealing;
  - (b) it has reason to believe that the debtor will be unable to effect the cure within a reasonable time and without significant inconvenience to the creditor or other prejudice to the creditor's legitimate interests; or
  - (c) cure would be inappropriate in the circumstances?

(Paragraph 5.13)

36. Should any creditor have a right to seek cure from the debtor in line with the specific remedy of repair or replacement (or repeat performance of a service) now afforded to consumers under the Consumer Rights Act 2015?

(Paragraph 5.20)

## Chapter 6 Enforcing performance

37. Do consultees agree that the terminology used to describe the remedy used to enforce performance of an obligation could usefully be clarified?

38. If so, do consultees consider that it would be appropriate to call the remedy a “performance order”? Do consultees prefer an alternative formulation?

(Paragraph 6.10)

39. Are consultees aware of any issues arising in relation to actions for payment that we should consider at this time?

(Paragraph 6.14)

40. Should civil imprisonment be retained as the ultimate sanction for wilful refusal to comply with a decree *ad factum praestandum*?

41. If so, should the periods for which civil imprisonment may be ordered for wilful refusal to comply with a decree *ad factum praestandum* and for breach of interdict be aligned in length?

42. As a means of enforcing a decree *ad factum praestandum*, should the courts be empowered to make such orders as may be just and equitable in all the circumstances as an alternative to civil imprisonment?

43. If so, should it be possible for a court to make such orders together with the initial decree?

44. Should it be open to the court to specify a penalty which is to be paid if a party fails to comply with a decree *ad factum praestandum*?

45. If so, should the penalty be payable to the creditor or the state? If the former, should the amount of the penalty be determined having regard to the creditor’s “legitimate interests” as defined in the general law on penalty clauses?

(Paragraph 6.40)

46. Do consultees consider that there would be merit in replacing the current methods of enforcing non-monetary obligations with a single bespoke remedy, encompassing both positive and negative obligations?

47. If so, do consultees support our suggestion that the courts should be given a broad power to make an order which is intended to secure performance of the obligation?

48. Would consultees prefer to confer a general discretion on the courts to select an appropriate order, or to have rules to be applied by the court in order to determine the most appropriate order?
49. Do consultees consider that it would be beneficial to give examples of the sort of order that might be made, particularly for more unusual possibilities such as fines or an extended right to repair and replacement?

(Paragraph 6.44)

## **Chapter 7 Damages**

50. If a general statutory restatement is pursued, should it provide that:
  - (a) damages are primarily compensation for any recoverable loss caused to the creditor by the debtor's breach of contract;
  - (b) the guiding principle in assessing damages is to put the creditor in the position that it would have been in had the contract been fully performed;
  - (c) losses which are not reasonably foreseeable to the parties at the time of contracting are irrecoverable;
  - (d) damages may be reduced to the extent that the creditor unreasonably fails to minimise its loss;
  - (e) damages are to be measured by the currency most appropriately reflecting the creditor's loss?
51. If a general statutory restatement is pursued, should it provide that:
  - (a) in general, loss is assessed as at the date of breach; but
  - (b) exceptions to this general rule may be allowed?
52. If so, what exceptions should be allowed?

(Paragraph 7.13)

53. Subject to the normal remoteness and other rules, should damages recoverable for breach of contract include non-patrimonial loss or harm of any kind?
54. In particular, should loss of the satisfaction of obtaining a contractual benefit, and harm in the form of pain, suffering or mental distress be included?

(Paragraph 7.35)

## **Chapter 8 Gain-based damages**

55. Do consultees consider that reasonable fee awards of damages for breach of contract should be introduced?
56. If so:
- (a) in what circumstances should such an award of damages be available; and
  - (b) how should the courts calculate a reasonable fee?
- (Paragraph 8.43)
57. Do consultees consider that the courts should be empowered to order a debtor to account to a creditor for profits arising from the debtor's breach of contract?
58. If so, do consultees consider that such an order should be available:
- (a) in response to any breach of contract; or
  - (b) only where specified conditions are met?
59. If consultees consider that such an order should only be available where specified conditions are met, they are asked for their views on the appropriateness of the following conditions:
- (a) that specific implement or interdict would have been available to the creditor before the breach occurred;
  - (b) the breach having occurred, that ordinary damages would be inadequate as they would leave the creditor undercompensated as the debtor's gain from the breach would be out of proportion to the creditor's loss; and
  - (c) that no reasonable creditor would have consented to the breach in exchange for a reasonable fee.
60. Consultees are also asked whether they think that any other conditions would be appropriate in addition to, or in substitution for, those conditions.

(Paragraph 8.57)

## **Chapter 9 Transferred loss claims**

61. Do consultees consider that in general a party who breaches a contract should be liable in damages for the loss caused by that breach, even if the loss was suffered by someone other than the other party to the contract?

(Paragraph 9.48)

62. Do consultees think that it would be preferable for a third party to be able to seek damages directly from the debtor, instead of relying on the creditor to seek damages on behalf of the third party and then account to the third party for them?

63. If so, do consultees think that:

(a) a third party should only be able to claim damages against a debtor if it was reasonably foreseeable to the debtor that a person in the third party's position might suffer loss;

(b) the third party and the creditor should only be able to recover their own losses arising from the debtor's breach of contract;

(c) it should be left to the courts to ensure that double recovery is not permitted, rather than making specific provision about it?

(Paragraph 9.60)

64. Do consultees think that transferred loss claims should be available only where the following conditions are met:

(a) that the contract in question was one to carry out work upon, or provide services in relation to, property belonging to the creditor;

(b) that the property was subsequently transferred to a third party; and

(c) that the third party's loss could have been reasonably foreseen by the debtor at the time of contracting?

65. If so, do consultees agree that it should remain open to the courts to develop the broader ground approach to transferred loss if a suitable case arises?

(Paragraph 9.62)

66. Do consultees think that a transferred loss claim should not be available where:

(a) the contracting parties have made alternative provision in the contract for the third party to have a right of action against the debtor;

(b) the contracting parties have expressly excluded the operation of transferred loss claims in the contract;

(c) the debtor and the third party have entered into a separate agreement giving the third party a right of action against the debtor, such as a collateral warranty?

67. Do consultees think that a transferred loss claim should be available despite the fact that:
- (a) the third party may have available to it a non-contractual claim against the debtor;
  - (b) it is possible that the creditor could assign to the third party its claim against the debtor for breach of contract?

(Paragraph 9.66)

68. Do consultees consider that a third party should only be allowed to claim damages for breach of contract?
69. If not, what alternative remedies (such as the right to cure) should be available to third parties?

(Paragraph 9.68)

#### **Chapter 10 Contributory negligence**

70. If a general statutory restatement is pursued, should it provide that a party may not exercise any of the remedies for non-performance to the extent that it caused the other party's non-performance?
71. Should a defence of the creditor's contributory negligence be available to the debtor in any claim for damages for breach of contract, with the effect of reducing the creditor's damages to such extent as the court thinks just and equitable having regard to the creditor's share in the responsibility for the damage?

(Paragraph 10.42)

(Paragraph 10.56)

#### **Chapter 11 A general statutory restatement?**

72. If a general statutory restatement is pursued, should it provide that it does not affect:
- (a) any special regime of remedies provided by law for particular kinds of contract;
  - (b) parties' freedom of contract with regard to making provision about remedies in their contracts?

(Paragraph 11.8)

73. If a general statutory restatement is pursued, should it provide that:
- (a) as a general principle, remedies are cumulative except where their exercise together is incompatible;
  - (b) the court cannot give two or more remedies which would result in benefits to the creditor exceeding its loss;
  - (c) although a creditor may switch from one remedy to another, this is barred when:
    - (i) an election between substantive rights is involved; or
    - (ii) the party in breach is prejudiced by the vacillation?
- (Paragraph 11.11)
74. If a general statutory restatement is pursued, should it extend to unilateral voluntary obligations?
- (Paragraph 11.12)
75. If a general statutory restatement is pursued, do consultees agree that:
- (a) it is unnecessary to refer to a general requirement of good faith;
  - (b) bespoke provision should instead be made in relation to particular remedies where the concept of good faith is relevant?
- (Paragraph 11.22)
76. If a general statutory restatement is pursued, should it include default provisions about notices?
77. If so, should it be possible to give notice orally?
- (Paragraph 11.25)
78. Do consultees have any comments to make on the suggested coverage of a general statutory restatement of the law on remedies for breach of contract?
79. Do consultees consider that it would be desirable to prepare a general statutory restatement of the law on remedies for breach of contract?
- (paragraph 11.29)

# Appendix A

## The 1999 Report: proposals where no action was recommended

### *Forms of breach: (i) Anticipatory breach*

1. We asked whether it should be clarified that remedies for anticipatory breach arise not only when there is a total repudiation of the contract but also when it is apparent that there will be a material breach of the contract.<sup>1</sup> Furthermore, we queried whether it should be clarified that remedies for anticipatory breach can arise in relation to a severable part of a contract.<sup>2</sup> In respect of both matters, we concluded that development of the law should be left to the courts or a more comprehensive legislative restatement.<sup>3</sup>

### *Forms of breach: (ii) Untrue contractual warranties*

2. Another question was that mentioned in our discussion above of the definition of breach: should it be made clear that breach, in relation to contract, covered the situation where a contractual warranty, not involving any obligation to perform, proved to be untrue or inaccurate?<sup>4</sup> We concluded that this matter would be better clarified by text books than legislation,<sup>5</sup> although it might be appropriately addressed in a general statutory restatement of contract law.

### *Relationship between remedies*

3. A majority of consultees supported the proposal that there should be a statutory provision clarifying the relationship between the different remedies for breach of contract and, in particular, making it clear that damages can be claimed whether or not the contract is rescinded.<sup>6</sup> However, we concluded that such a provision would only be appropriately enacted as part of a general statutory restatement of the law in this area.<sup>7</sup>

### *Position where both parties in breach*

4. Following a generally supportive response to the proposal in the Discussion Paper that a party to a contract is not disentitled, merely by being in breach, from any available remedy for the other party's breach of contract,<sup>8</sup> we re-examined the authorities and concluded that the only references to disentitlement in case-law related to situations where the remedy of retention or rescission applied, i.e. a debtor in material breach could not compel a withholding creditor to perform until it performed itself.<sup>9</sup> We concluded that the position suggested for inclusion in a legislative restatement was already sufficiently clear at common law.<sup>10</sup>

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<sup>1</sup> 1999 DP, para 2.7.

<sup>2</sup> 1999 DP, para 2.8.

<sup>3</sup> 1999 Report, paras 7.3 and 7.4.

<sup>4</sup> 1999 DP, para 2.4. See para 1.14 above.

<sup>5</sup> 1999 Report, para 7.2.

<sup>6</sup> 1999 DP, para 2.20.

<sup>7</sup> 1999 Report, para 7.7.

<sup>8</sup> See 1999 DP, paras 2.21 to 2.26 and 1999 Report, para 7.9.

<sup>9</sup> 1999 Report, para 7.12.

<sup>10</sup> We discuss subsequent developments at paras 2.17 to 2.23 above.

### *Retention or suspension of performance*

5. The Discussion Paper contained four proposals for clarification of the law on retention.<sup>11</sup> None of these suggestions individually gained the support of a majority of consultees. But there was a consensus that some limitation on the availability of the remedy would be desirable, for example, by confining suspension of performance to cases of material breach.<sup>12</sup> We discuss these issues in Chapter 2.

### *Rescission*

6. A number of questions about rescission were put in the Discussion Paper.<sup>13</sup> In each case, we concluded that the proposal or answer to a question reflected the existing law or the inevitable development of the existing law, so legislation was unnecessary.<sup>14</sup> This belief has not necessarily been borne out in the case law since 1999. These issues are accordingly revisited and further analysed in Chapter 4 as subjects of further possible reform proposals.

### *Forced deduction of rectification costs*

7. One issue that came close to attracting a call for immediate legislative repeal was the supposed rule in *Ramsay v Brand*,<sup>15</sup> according to which a party claiming payment under a contract which had been substantially performed, apart from some minor breach, can only recover the price subject to a deduction of the cost of rectifying the breach. It was suggested that this rule could produce problematic results where it was unreasonable to expect a minor breach to be rectified (for example, rebuilding a house because the wrong kind of cement had been used by the builder but without deleterious effects upon the state of the property).<sup>16</sup> Upon reflection, we decided that this “supposed rule” had not established itself and would not be followed where it would have absurd results.<sup>17</sup> There was no need for legislative action. But it may be thought that the scenario is one in which the DCFR’s price reduction remedy could do useful work, and accordingly we discuss it in Chapter 5.

### *Other topics raised by consultees*

8. Finally, in response to the Discussion Paper, consultees suggested that there was a need for further work in relation to a number of topics.<sup>18</sup> Not all of these related to remedies for breach of contract, and they are not further discussed in this present Paper: for example, illegal contracts, the severability of contractual obligations, reduction and *restitutio in integrum*, and pre-contractual liability in damages, especially in relation to negligent and fraudulent misrepresentation. The topic of third party rights, including a clarification of the right of a third party beneficiary of a contract to claim damages for breach, was also mentioned by consultees. That is dealt with in the Contract (Third Party Rights) (Scotland)

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<sup>11</sup> 1999 DP, paras 3.10 to 3.15.

<sup>12</sup> 1999 Report, paras 7.14 to 7.19.

<sup>13</sup> 1999 DP, paras 4.6, 4.22, 4.24 and 4.52.

<sup>14</sup> 1999 Report, paras 7.20 to 7.24.

<sup>15</sup> (1898) 25 R 1212.

<sup>16</sup> 1999 DP, paras 5.23 to 5.28.

<sup>17</sup> 1999 Report, para 7.26.

<sup>18</sup> 1999 Report, para 7.41.

Bill which is intended to implement our 2016 Report on this subject. It is therefore not considered here.

9. Two of the topics raised by consultees in 1999 do fall within the scope of the present Discussion Paper, and we return to them in other Chapters:

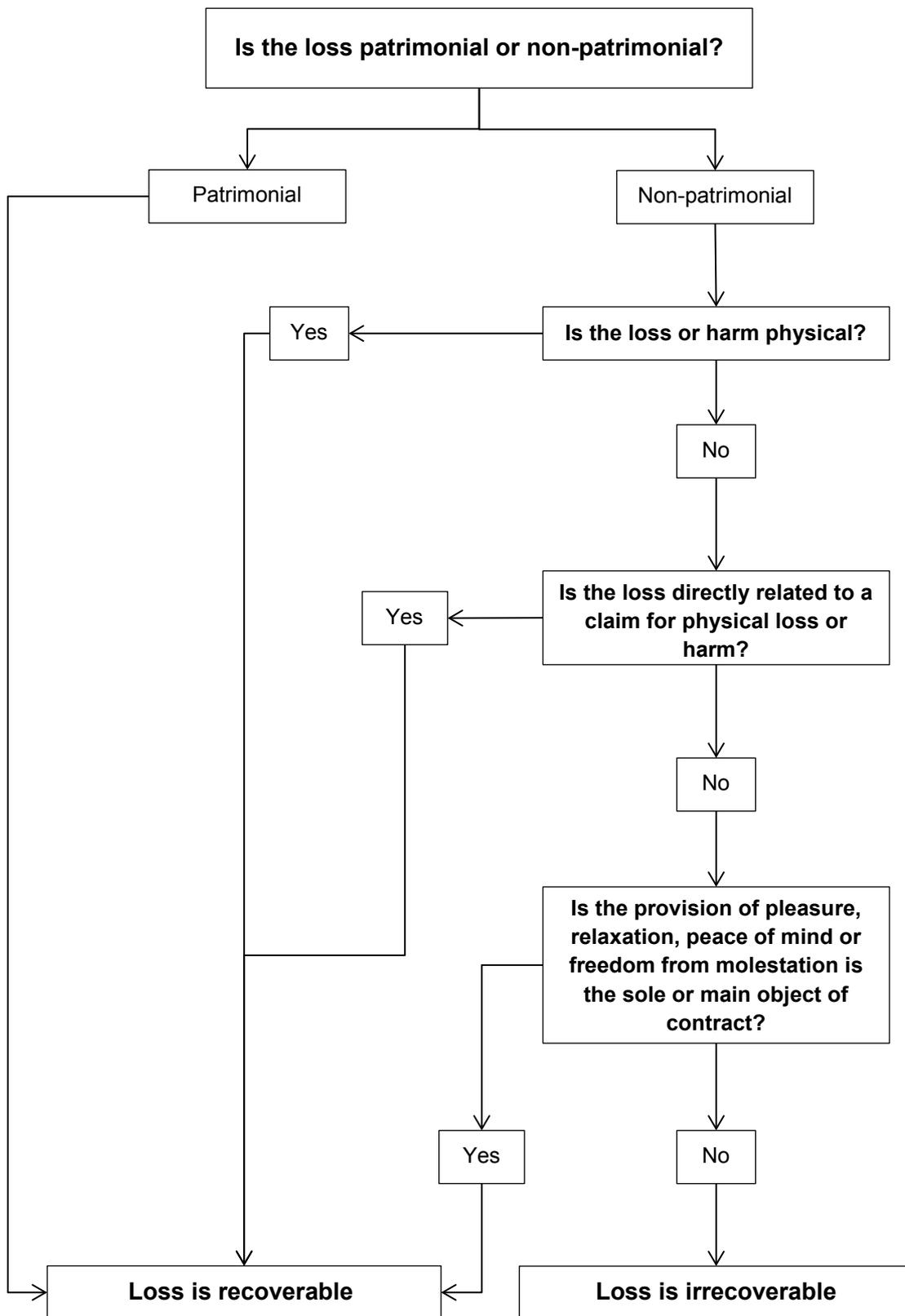
- a remedy of price abatement distinct from a counterclaim for damages (as we have noted, this is now part of Scots consumer law and is essentially the DCFR's price reduction remedy);<sup>19</sup>
- civil imprisonment as the ultimate sanction for non-compliance with a decree for specific implement.<sup>20</sup>

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<sup>19</sup> See paras 5.3 to 5.7 above.

<sup>20</sup> See paras. 6.23 to 6.40 above.

# Appendix B



# Appendix C

## **Judicial Advisory Group**

Lord Doherty

Lord Tyre

Lady Wolffe

## **Advisory Group**

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