

SCOTTISH LAW COMMISSION
Discussion Paper No 109



Discussion Paper on Remedies for Breach of Contract

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This Discussion Paper is published for comment and criticism and does not represent the final views of the Scottish Law Commission

The Commission would be grateful if comments on this discussion paper were submitted by 16 July 1999. Comments may be made on all or any of the matters raised in the paper. All correspondence should be addressed to:

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NOTES

1. In writing a later report on this subject, the Commission may find it useful to be able to refer to, and attribute, comments submitted in response to this paper. If no request for confidentiality is made, the Commission will assume that comments on the paper may be used in this way.
2. Those who wish a copy of this paper for the purpose of commenting on it should contact the Commission at the above address.

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ABBREVIATIONS

Gloag, *Contract*

W M Gloag, *The Law of Contract* (2nd edn, Edinburgh, 1929)

McBryde, *Contract*

W M McBryde, *The Law of Contract in Scotland* (Edinburgh, 1987)

McGregor, *Code*

H McGregor, *Contract Code: Drawn up on behalf of the English Law Commission* (Milan, 1993)

European Principles

The Principles of European Contract Law (Part I: Performance, Non-performance and Remedies), Prepared by the Commission on European Contract Law (Chairman, Professor Ole Lando) (Dordrecht, 1995)

Schlechtriem

P Schlechtriem, *Commentary on the UN Convention on the International Sale of Goods (CISG)* translated by G Thomas (2nd edn (in translation), Oxford, 1998)

Stair Memorial Encyclopaedia

The Laws of Scotland: Stair Memorial Encyclopaedia (25 volumes; Edinburgh, 1987-96)

Treitel, *Contract*

G H Treitel, *The Law of Contract* (9th edn, London, 1995)

Unidroit *Principles*

Principles of International Commercial Contracts (UNIDROIT, Rome, 1994)

US *Restatement*

American Law Institute, *Restatement of the Law Second, Contracts 2d* (St Paul, Minn., 1981)

Vienna Convention

The United Nations Convention on Contracts for the International Sale of Goods (adopted at Vienna, April 1980)

Walker, *Contracts*

D M Walker, *The Law of Contracts and Related Obligations in Scotland* (3rd edn, Edinburgh, 1995)

Part 1 Introduction

Background to discussion paper

1.1 Many thousands of contracts are entered into every day in Scotland. They are not all performed according to their terms. Often discussions and negotiations can resolve matters. Sometimes the contract will itself provide some mechanism for resolving disputes. But in many cases the difficulties caused by breach of contract cannot be resolved informally. The law has to provide a range of remedies to enable the party aggrieved by the breach¹ to obtain either the performance contracted for or some compensation for not receiving it. In the absence of such remedies one of the most basic of legal principles - that contracts must be kept - would be legally unsupported. Problems of breach of contract are by no means confined to large commercial contracts. They can affect anybody. In this paper² we consider the adequacy of the existing Scottish law on remedies for breach of contract.

Scope of discussion paper

Matters covered

1.2 The paper deals with both non-judicial and judicial remedies for breach of contract. The non-judicial remedies covered are suspension of performance (whereby the aggrieved party can withhold performance temporarily until the party in breach performs) and rescission (whereby the aggrieved party can bring the contract to an end so far as all future performance is concerned). The judicial remedies fall into two categories. Some, such as a decree for payment of what is due under the contract and a decree for specific implement, are designed to ensure that the aggrieved party receives the performance contracted for. An interdict may in practice serve the same function in certain types of case. The second category consists of those remedies designed to ensure that the aggrieved party receives monetary compensation. The main example is an award of damages. An award of interest may serve the same function where the breach consists of the late payment of money.

1.3 One of the main practical problems in relation to remedies for breach of contract is caused by uncertainty as to whether the conditions required for the exercise of a particular remedy are fulfilled. The paper discusses whether there would be advantages in a special procedure for obtaining a summary declarator in matters of breach of contract. It also discusses other ways of increasing certainty, such as giving the aggrieved party a right to set a further fixed time for performance, or to seek adequate assurances of performance, with appropriate sanctions in each case.

¹ We use the term "aggrieved party" in this paper. This is preferable to "innocent party" because the party aggrieved by a breach of contract is not necessarily innocent of contractual wrongdoing.

² Published under item 4 of our *Fifth Programme of Law Reform* (Scot Law Com No 159, 1997).

1.4 A proper consideration of remedies for breach of contract requires us to consider whether, and to what extent, the normal remedies for breach of contract apply where both parties are in breach.³

Matters not covered

1.5 In this paper we are not concerned, save incidentally, with the law on unjustified enrichment. A decree for the redress of unjustified enrichment is not a remedy for breach of contract. However, incidental consideration of this subject is required where a contract is terminated by rescission but something has already been done under it. In such a situation the remedy of rescission may have to be supplemented by some mechanism for the return of, or payment for, benefits already received. We consider ways in which that can be done, and in that context we refer briefly to the law on unjustified enrichment, which is one way of dealing with the problem.⁴

1.6 We are not concerned in this paper with the problems arising in cases where neither party is in breach. We are not, for example, concerned with the rules whereby pre-contractual impossibility of performance may in certain cases make a contract invalid or with the rules whereby supervening impossibility of performance may bring a contract to an end.

Nature of discussion paper

1.7 The topic of remedies for breach of contract has given rise to a great deal of academic discussion. The purpose of this discussion paper is not to add to that discussion. Its purpose is to seek views on certain specific and practical possibilities for legislative reform on points where the existing law may be thought to be unsatisfactory.

Strategy for reform

1.8 There are three options for legislative reform of the law on remedies for breach of contract. The first is to do nothing. The second is to enact a few provisions, perhaps in a Contract (Remedies for Breach) (Miscellaneous Provisions) Act, to deal with particular problems, leaving the rest of the law on remedies for breach of contract to the existing common law. The third is to incorporate any necessary reforms in a statutory restatement of the whole of the law on remedies for breach of contract. At a later stage we will have to choose between these options. The choice will turn largely on the results of the consultation on this discussion paper.

Earlier work of the Law Commissions

1.9 In 1966 the English and Scottish Law Commissions began work on a contract code.⁵ The English Law Commission engaged Dr Harvey McGregor to produce a draft code and

³ See paras 2.21 – 2.27.

⁴ See paras 4.31 – 4.52.

⁵ The work was begun by the English Law Commission and the Scottish Law Commission then joined in it "with a view to exploring the possibility of a unified code, or perhaps two harmonised codes". See the Scottish Law Commission's Second Annual Report (Scot Law Com No 7, 1966 – 67) paras 11 and 12.

this draft formed the basis of further discussions within the Commissions. In 1972 the Scottish Law Commission withdrew from the project⁶ and the English Commission decided to deal with contract law by means of working papers on particular aspects which were in need of reform rather than by means of a draft code.⁷ It is clear from the files that a great deal of useful work had been done and that agreement was reached between the Commissions on many matters of policy. Fortunately Dr McGregor has now published his draft code in the form in which it was in 1972 when the project was abandoned. We refer to this publication as the McGregor Code.

International models

1.10 One of the purposes of this paper is to measure the Scottish law on remedies for breach of contract against international standards.

1.11 The United Nations Convention on Contracts for the International Sale of Goods (commonly called the Vienna Convention or the CISG) is now in force in some 50 states and regulates a large proportion of international commerce. It already affects Scottish companies engaged in international trade because the Convention applies if the law governing the contract is the law of a Contracting State and contracts entered into by a Scottish company may well be governed by such a law. The United Kingdom has not ratified the Convention but may yet do so. With each year that passes, the United Kingdom courts lose opportunities to influence the interpretation of the Convention.

1.12 The Vienna Convention has had an influence on two other recent international instruments - the *Principles of International Commercial Contracts* drawn up by Unidroit⁸ and published in 1994 and the *Principles of European Contract Law* prepared by the commission on European Contract Law under the chairmanship of Professor Ole Lando of which the part on remedies was published in 1995.

1.13 All of these instruments were the product of comparative legal discussion. They involved a pooling of ideas from common law countries and civil law countries. Perhaps for this reason their solutions and the current Scottish solutions are remarkably compatible.⁹ It would probably be easier for Scotland than for most countries to achieve full compatibility with international norms on remedies for breach of contract. The fact that the existing contract law of Scotland is not entirely in statutory form but is derived largely from cases disguises the extent to which it is similar to the rules of the modern international instruments mentioned above.

Terminology

1.14 There has in the past been confusion in the use of the words "resile", "repudiate" and "rescind" in the context of contracts. In recent years a standard usage seems to have

⁶ See the Scottish Law Commission's Seventh Annual Report (Scot Law Com No 28, 1971 – 72) para 16.

⁷ See the Law Commission's Eighth Annual Report (Law Com No 58, 1972 – 73) paras 3 – 5.

⁸ The International Institute for the Unification of Private Law.

⁹ See McBryde, "Remedies for Breach of Contract" (1996) 1ELR 43 at 55-56.

emerged, although variations are still encountered. We follow that standard usage in this paper and use the terms in the following way.

To **resile** from a contract means to withdraw from it lawfully, in the exercise of a right to do so, but not in response to a repudiation or breach.¹⁰

To **repudiate** a contract means to indicate clearly, by words or acts, that the repudiator will not perform it, having no right to withhold or refuse performance.¹¹ A repudiation is a wrongful rejection or renunciation of the contract.¹² It does not end the contract but gives the other party an option to rescind.

To **rescind** a contract means to bring it to an end, at least so far as concerns the future performance of primary obligations, in response to a repudiation or material breach by the other party.

1.15 It is inaccurate to talk of the aggrieved party "treating" the contract as rescinded, although this usage is sometimes encountered. What the aggrieved party does is rescind the contract, not treat it as rescinded. The Sale of Goods Act 1979 talks of the party aggrieved by a material breach being entitled to treat the contract as repudiated.¹³ That is different and is not inaccurate so much as incomplete. It leaves it to be implied that the aggrieved party can rescind in response to a repudiation. Nowadays it would be preferable to talk of the aggrieved party being entitled to rescind the contract.

1.16 A repudiation will often be accompanied by, or followed by, a breach of contract but is not, strictly speaking, itself a breach of contract. There can be a repudiation without a breach.

Example. A builder, in the course of a heated dispute about what a building contract requires, says "I'm finished with this contract. You can do what you like. I'm having nothing more to do with it. My men are walking off this site and not coming back." The other party urges another attempt to sort matters out and suggests a compromise solution. An hour later, matters are resolved to the satisfaction of both. The contract is duly performed. There was a repudiation but no breach.

However, a repudiation gives the other party an option to rescind the contract and, if this option is exercised, the repudiation is treated as if it were a breach. Damages can be claimed accordingly. A repudiation can be regarded as a sort of "inchoate breach".¹⁴

1.17 A material breach is not necessarily a repudiation.

¹⁰ A contract, for example, may give either party a right to resile if the consent of a third party to some step is not forthcoming.

¹¹ There is a helpful discussion of the concept of repudiation, and a review of earlier cases, in *Edinburgh Grain Ltd v Marshall Food Group Ltd* 1999 SLT 15 at 21 – 23. See also *Anderson v Commercial Union Assurance Co plc (No 2)* 1988 GWD 30 – 1537; *Eurocopy Rentals v Tayside Health Board* 1996 SLT 224; *Oceaneering International Services Ltd v Offshore Project Management Support Services Ltd* 1998 GWD 17 - 841.

¹² The word "renunciation" is used in some English cases. See eg *Universal Cargo Carriers Corporation v Citati* [1957] 2 QB 401 at 436.

¹³ See s 15B(1)(b).

¹⁴ The expression used by Lord Dunpark in *Monklands District Council v Ravenstone Securities* 1980 SLT (Notes) 30 at 31. Earlier Lord Dunpark had said that a repudiation was in itself a breach but, for the reasons given in the text, the idea of an inchoate breach seems more accurate.

Example. A is a young man who is just setting up in the computer maintenance business. He enters into a contract with B to maintain a system which is unfamiliar to him. He has every intention of performing, being anxious to do a good job, build up his reputation and acquire useful experience, but his performance is disastrous. His early attempts to rectify a minor problem make matters worse and cause B great loss. There is a material breach of contract. B rescinds the contract while A is still trying to repair the system and asks A to leave. A pleads for another chance to rectify the problem. He has to be escorted forcibly from the premises, protesting all the way that he can solve the problem. There was a material breach but no reasonable person could conclude that A was at any time indicating an unwillingness to perform. There was a material breach but no repudiation.

1.18 The term "repudiatory breach" is sometimes used. It is a useful enough term in certain contexts but not precise enough for general use. A breach can have all the effects of a material breach and, in particular, can justify rescission, even although it would be straining language to say that it indicated an intention to repudiate.

1.19 At one time contracts would be "avoided" or declared null and void because of a material breach, such as a failure to pay the price for land which had been bought.¹⁵ This usage reflects an earlier conceptual framework and is not now appropriate. It is noteworthy, however, that the Vienna Convention talks of contracts being "avoided" for breach in contexts where we would say "rescinded". The European *Principles* and the Unidroit *Principles* talk of contracts being "terminated" for breach, a more understandable usage.

Acknowledgments

1.20 The subjects discussed in this paper were considered at our seminar on Remedies for Breach of Contract organised with the University of Edinburgh on 21 October 1995. We are grateful to the distinguished scholars who gave papers at this seminar.¹⁶ For the preparation of a draft of the part of this discussion paper dealing with non-judicial remedies for breach of contract we engaged Professor William W McBryde of the University of Dundee as a consultant. We gratefully acknowledge Professor McBryde's substantial contribution to this discussion paper. The responsibility for its final form and content is, however, ours alone.

¹⁵ See eg *Black v Dick* (1814) Hume 699.

¹⁶ The revised papers are published in the *Edinburgh Law Review*: McBryde, "Remedies for Breach of Contract" (1996) 1 ELR 43; Burrows, "Legislative Reform of Remedies for Breach of Contract: the English Perspective" (1997) 1 ELR 155; MacQueen, "Remedies for Breach of Contract: The Future Development of Scots Law in its European and International context" (1997) 1 ELR 200; Lorenz, "Reform of the German Law of Breach of Contract" (1997) 1 ELR 317.

Part 2 Remedies for Breach in General

What is breach

2.1 In general "breach" in relation to a contract means a failure, without legal justification, to perform an obligation under the contract as required by the contract.¹ Legal justification may take various forms. For example a party may be justified in withholding performance if the other party is already in breach of a countervailing obligation.² Supervening impossibility may justify a party in not performing. A statute may make it unlawful to perform and thereby justify non-performance. Non-performance of an obligation may be justified if performance requires the co-operation of the other party and the other party obstructs performance.³

2.2 So far as we are aware, the only difficulty in relation to the definition of breach of contract which might lend itself to a legislative solution is a slight uncertainty about the nature of a breach of a contractual warranty. Is a breach of a warranty about past, present or future facts, which is not an obligation to do or pay anything,⁴ a breach of contract which can trigger the normal remedies for breach of contract so far as applicable? The fact that breach is commonly defined by reference to a failure to "perform" may give rise to a doubt. If, for example, X enters into missives to sell heritage and warrants that there has been no adverse planning decision affecting the subjects, and it turns out that there has been such an adverse planning decision, it would be straining language to say that X has failed to "perform" an obligation. And yet there is no doubt that breach of a contractual warranty ought to be treated as a breach of contract.

2.3 The point is not purely theoretical. Doubts on this point may have been partly responsible for some of the problems which arose in the case of *Winston v Patrick*.⁵ Clause 9 of the missives in that case stated:

"The seller warrants that all statutory and local authority requirements in connection with the erection of the subjects of sale and any additions, extensions and alterations thereto have been fulfilled."

It was discovered that an extension to the house had not been built in accordance with the requirements of the local building authority and was defective. The pursuers pleaded that the defenders were obliged to construct the extension "in accordance with their obligation in the said missives" and, having failed to do so, were in breach of contract. The Second Division held that there was no obligation in the clause to do anything. On that narrow

¹ See Walker, *Contracts* 519. Refusal to perform is dealt with below under the heading of anticipatory breach.

² See Part 3.

³ Bell, *Principles* sec 50; *Mackay v Dick & Stevenson* (1881) 8 R (HL) 37. See also *Unidroit Principles* art 7.1.2.

⁴ Some provisions described as "warranties" may be construed as obligations to perform. For example, a warranty that goods supplied will be of a certain description may, when properly construed, be an obligation to supply goods conforming to that description.

⁵ 1980 SC 246.

basis the pursuers' case was dismissed. Clearly the pursuers should have pleaded a breach of the warranty.⁶

2.4 It is unsatisfactory that there should be any doubt as to whether breach of a contractual warranty is a breach of contract. The matter could easily be resolved by legislation.⁷ We invite views.

1. **Should it be made clear that breach, in relation to contract, covers the situation where a contractual warranty, not involving any obligation to perform, proves to be untrue?**

An affirmative answer to this question does not mean that all remedies for breach of contract will necessarily be applicable to a breach of a warranty which does not involve any obligation to perform. Some remedies are, of their nature, available only in relation to a breach consisting of a failure to perform. Indeed, the distinctive feature of a contractual warranty which does not involve any obligation to perform⁸ may be that there is no primary obligation but only a secondary obligation to pay damages in the event of the warranty being untrue.

Anticipatory breach

Repudiation.

2.5 Generally, remedies for breach of contract cannot be pursued until the time for performance of the contract has arrived and a breach has occurred. The doctrine of anticipatory breach, however, provides a well-known exception. The essence of this doctrine is that if one party repudiates the contract⁹ the other party has an option to accept the repudiation,¹⁰ rescind the contract¹¹ 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. The aggrieved party is not obliged to take action in response to the anticipatory breach and may choose to wait until the date of performance before seeking available remedies.¹² If, however, the repudiation is not accepted, the contract remains in force and the repudiating party retains the option, and indeed the obligation, of performing at the due date.

2.6 The doctrine of anticipatory breach by repudiation derives from English law and is found in all common law systems.¹³ Some civil law systems, such as German, Swiss, Austrian, Dutch, Danish, Greek and Italian law, also recognise that there are similar consequences flowing from an unequivocal declaration by a debtor that the contract will not be performed.¹⁴ Both the *Unidroit Principles*¹⁵ and the *European Principles*¹⁶ recognise

⁶ They would still not have won on the then state of the law, but see now the Contract (Scotland) Act 1997.

⁷ The *McGregor Code* provides in s 302 that "A party to a contract any of whose undertakings as to an event or to a state of fact or law is not duly fulfilled commits a breach of contract".

⁸ Eg a warranty as to an existing state of facts.

⁹ See para 1.14.

¹⁰ For a discussion of what may amount to acceptance of a repudiation see *Vitol SA v Norelf Ltd* [1996] AC 800.

¹¹ We consider later whether the aggrieved party's remedies should include suspension of performance. See para 3.10.

¹² Gloag, *Contract* 598 and 599.

¹³ The classic English case is *Hochster v De La Tour* (1853) 2 E & B 678.

¹⁴ Treitel, *Remedies for Breach of Contract: A Comparative Account*, 380-381; *European Principles*, 179-180.

anticipatory non-performance. It is clearly a useful doctrine and we make no proposals for fundamental change.

Anticipated material breach.

2.7 It is for consideration whether it should be made clear that the aggrieved party has similar remedies where there is not total repudiation but where there is nonetheless something which indicates conclusively that there will be a fundamental or material breach. On principle, anything which makes it clear that there will be a material¹⁷ breach of the whole contract ought to give the aggrieved party the option to rescind the contract and exercise other available remedies.¹⁸ If, for example, a builder who has contracted to build a house says that he will be able to lay the foundations but not to do anything else, it seems clear that the other party to the contract should be able to treat this as a repudiation of the contract and act accordingly. This is in accordance with the rules in international conventions. The Vienna Convention provides that

"If prior to the date for performance of the contract it is clear that one of the parties will commit a fundamental breach of contract, the other party may declare the contract avoided."¹⁹

The Unidroit *Principles*²⁰ and the European *Principles*²¹ have very similar rules. We invite views on the following question.

2. **Should it be made clear that the aggrieved party's remedies for anticipatory breach arise not only when there is a total repudiation of the contract but also when it is clear that there will be a material breach of the contract?**

Anticipatory breach of severable part of contract.

2.8 There may also be a need for clarification of the law on the effect of a repudiation or anticipated breach of a severable, but perhaps small, part of a contract. Suppose that a builder who has contracted to build a house says that he will not be able to supply a particular kind of window lock which is specified, and charged for separately, in the contract. It seems clear that that should not entitle the other party to bring the whole contract to an end. There could also be difficulty in allowing a claim for damages so long as the contract continues unchanged. The builder might be able to obtain the window locks and may tender performance notwithstanding his earlier statement. Damages might prove to be premature. On the other hand it would seem reasonable to give the aggrieved party the option to bring the part of the contract relating to the window locks to an end (if it is a

¹⁵ Art 7.3.3.

¹⁶ Art 4.304.

¹⁷ We consider the concept of material breach at paras 2.9 – 2.17.

¹⁸ Treitel, *Contract* 773.

¹⁹ Art 72. The Vienna Convention uses the expression "declare the contract avoided" where we would use "rescind the contract".

²⁰ Art 7.3.3.

²¹ Art 4.304.

severable part of the contract), obtain suitable locks elsewhere and claim damages for any resulting loss.²² We invite views.

3. Should it be made clear that the aggrieved party's remedies for anticipatory breach can arise in relation to an anticipatory breach of a severable part of the contract, the remedies being confined to that part of the contract?

Material breach

Importance and nature of concept

2.9 A breach of contract may be material or not material. The main importance of the distinction is that only a material breach will justify the other party in rescinding the contract.²³ There is no doubt that some distinction of this kind is essential. Judges have described the concept of "material breach" in various ways – a failure to perform the obligations under the contract "in any material respect";²⁴ a violation of stipulations which are "material or essential" as opposed to "minor and incidental";²⁵ "substantial failure";²⁶ a breach of stipulations going "to the root of the contract";²⁷ a breach which is "of the essence of the contract";²⁸ or which affects "the root and substance of the contract".²⁹ Nowadays the tendency is to concentrate on the materiality of the breach rather than of the term³⁰ but clearly the two are related.³¹ Whether a breach is material is a question of fact and degree.³²

Is terminology satisfactory?

2.10 The only criticism of the present classification of which we are aware is that the word "material" is misleading.³³ The argument is that few breaches of contract are immaterial to the aggrieved party. A breach could be important enough to give rise to a large claim for damages but yet might not be "material" enough to justify rescission. International rules on contract law use the terms "fundamental breach" or "fundamental non-performance".³⁴

Options

2.11 There are three options. The first is to do nothing. The term "material breach" is familiar and is used both in the cases and in statute law.³⁵ It is sufficiently flexible to allow

²² We consider at para 3.11 whether the aggrieved party's remedies should include suspension of any performance corresponding to the obligation in question. In the example in the text the question is whether the aggrieved party should be able to hold the builder to his obligation to supply the locks and in the meantime withhold payment of any advance due in respect of the locks under the contract.

²³ *Davie v Stark* (1876) 3 R 1114 at 1119; *Wade v Waldon* 1909 SC 571 at 576.

²⁴ *Turnbull v McLean & Co* (1874) 1 R 730 at 738.

²⁵ *Davie v Stark* (1876) 3 R 1114 at 1119.

²⁶ *Collard v Carswell* (1892) 19 R 987 at 996.

²⁷ *Wade v Waldon* 1909 SC 571 at 576.

²⁸ *Council of Johannesburg v D Stewart & Co (1902) Ltd* 1909 SC 860.

²⁹ *Graham v United Turkey Red Co* 1922 SC 533 at 536.

³⁰ This is reflected in the wording of s 15B of the Sale of Goods Act 1979, introduced by the Sale and Supply of Goods Amendment Act 1995. See the report of the English and Scottish Law Commissions on *Sale and Supply of Goods* (Law Com No 160; Scot Law Com No 104, 1987) para 4.15.

³¹ See generally McBryde, *Contract* 319 – 323.

³² *Blyth v Scottish Liberal Club* 1982 SC 140 at 148.

³³ McBryde, *Contract* 319.

³⁴ See eg art 25 of the Vienna Convention; art 7.3.1 of the Unidroit *Principles* and arts 3.103 and 4.301 of the European *Principles*.

³⁵ Sale of Goods Act 1979 s 15B. See also Supply of Goods and Services Act 1982 s 11F.

various factors to be taken into account. There is no evidence that it gives rise to any difficulty in practice. The second would be to change to the term "fundamental breach". This would correspond more closely to modern international instruments and would perhaps convey a more accurate idea of the type of breach required for rescission.³⁶ The third option would be to have a statutory provision to define or explain the type of breach which will justify rescission.

International models

2.12 There are three international models which are worthy of consideration.

2.13 The Vienna Convention has this definition.³⁷

"A breach of contract committed by one of the parties is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result."

It should be noted that this formula leaves it open to the parties to fix the nature of the breach in the contract. They can provide, for example, that failure to perform by a stipulated time is to be a fundamental breach.³⁸

2.14 The European *Principles* provide as follows.³⁹

"A non-performance of an obligation is fundamental to the contract if:

(a) strict compliance with the obligation is of the essence of the contract; or

(b) the non-performance substantially deprives the aggrieved party of what he was entitled to expect under the contract, unless the other party did not foresee and could not reasonably have foreseen that result; or

(c) the non-performance is intentional and gives the aggrieved party reason to believe that he cannot rely on the other party's future performance."

2.15 The Unidroit *Principles* contain a more elaborate provision which is not so much a definition as a list of factors to be taken into consideration.⁴⁰

"In determining whether a failure to perform an obligation amounts to a fundamental non-performance regard shall be had, in particular, to whether

(a) the non-performance substantially deprives the aggrieved party of what it was entitled to expect under the contract unless the other party did not foresee and could not reasonably have foreseen such result;

³⁶ The term "fundamental breach" had at one time a special meaning in English law. See *Alexander Stephen (Forth) Ltd v J J Riley (UK) Ltd* 1976 SLT 269; *W L Tinney & Co Ltd v John C Dougall Ltd* 1977 SLT (Notes) 58; *Wolifson v Harrison* 1977 SC 384. But there is no reason why a former difficulty in English law should rule out the use of a useful term.

³⁷ Art 25.

³⁸ Schlechtriem 173 - 185.

³⁹ Art 3.103.

⁴⁰ Art 7.3.1(2).

(b) strict compliance with the obligation which has not been performed is of essence under the contract;

(c) the non-performance is intentional or reckless;

(d) the non-performance gives the aggrieved party reason to believe that it cannot rely on the other party's future performance;

(e) the non-performing party will suffer disproportionate loss as a result of the preparation or performance if the contract is terminated."

Assessment

2.16 We are not satisfied that any change or definition is required. If a definition were thought desirable we would have a provisional preference for something on the lines of article 3.103 of the European *Principles*. A list of factors, as in the Unidroit *Principles*, would not seem appropriate when a difficult decision has to be taken by parties themselves, often at short notice, rather than by a court.

Request for views

2.17 We invite views in response to the following questions.

4. **(a) Would there be any advantage in having a statutory provision defining or explaining the type of breach which will justify rescission ?**

(b) If so, what should be its essential features?

The structure of remedies

2.18 The structure of the Scottish law on remedies for breach of contract can be set out as follows.

A. Non-judicial remedies

(1) Suspension of performance (without termination of contract)

(2) Rescission (termination of contract)

B. Judicial remedies

(1) Remedies enforcing performance

(a) Specific implement

(b) Interdict

(c) Decree for payment of sum stipulated by contract

(2) Substitutionary remedies (in money)

(a) Damages⁴¹

(b) Interest.

Declarator could also be considered as a judicial remedy but it would usually be sought only as a supplement to one of the other remedies and we have not therefore included it in the list. In addition to the generally available remedies there may also be special remedies provided by provisions in the contract itself. The contract may, for example, contain an irritancy clause⁴² or a penalty clause.⁴³ We have already issued a discussion paper on penalty clauses⁴⁴ and will be publishing a report shortly.

2.19 The existing structure of remedies seems to us to be essentially satisfactory. The difficulties arise within particular heads rather than with the overall structure. To give consultees an opportunity to express views, however, we ask:

5. (a) Is the existing structure of remedies for breach of contract satisfactory?

(b) Are any additional remedies needed?

The relationship between the remedies

2.20 There have in the past been problems with the relationship between different remedies. For example, it was at one time thought that damages could not be claimed for breach of a contract of sale unless the contract was rescinded and the property returned. This defect has now been rectified. Section 3 of the Contract (Scotland) Act 1997⁴⁵ provides that

"Any rule of law which precludes the buyer in a contract of sale of property from obtaining damages for breach of that contract by the seller unless the buyer rejects the property and rescinds the contract shall cease to have effect."

We are not aware of any similar problems in relation to other types of contract. The existing law of Scotland seems to be the same as that set out in the European *Principles* which provide that⁴⁶

"Remedies which are not incompatible may be cumulated. In particular, a party is not deprived of his right to damages by exercising his right to any other remedy."

⁴¹ In some systems reduction of price (the *actio quanti minoris*) is viewed as a separate remedy (as in the European *Principles*, article 4.401). In Scotland the remedy of damages is seen as sufficient. The former rule against the *actio quanti minoris* was seen as simply a bar on the recovery of damages by the buyer for breach of a contract of sale where the property was retained. See our report on *Three Bad Rules in Contract Law* (Scot Law Com No 152, 1996) Part 4.

⁴² That is, a clause enabling one party to bring the contract to an end on the occurrence of some specified event.

⁴³ Typically a clause providing for an agreed sum to be payable, instead of damages, in the event of breach.

⁴⁴ Discussion Paper No 103, Dec 1997.

⁴⁵ This implemented a recommendation in our report on *Three Bad Rules in Contract Law* (Scot Law Com No 152, 1996). The defect had already been rectified in relation to the sale of corporeal moveables by the Sale of Goods Act 1893 and later the Sale of Goods Act 1979 ss 15B and 53A.

⁴⁶ Art 3.102.

If there were to be a comprehensive statutory restatement of the law on remedies for breach of contract there would clearly be advantages in setting out the existing law in positive rather than negative form. In the absence of such a restatement we see no need for legislative intervention. However we invite views.

6. **Would there be any advantage in a statutory provision making clear 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?**

The position of the contract breaker

2.21 There is some authority for the proposition that in the law of Scotland a party who is in breach of contract cannot sue for breach of contract.⁴⁷ We express this cautiously because it is clear, first, that some of the statements appearing to support this supposed rule are expressed too widely⁴⁸ and, secondly, that there is an overlap with the rules on suspension of performance. It is not always clear whether the court is saying that the contract breaker cannot sue for breach or that the contract breaker cannot sue because the other party is entitled to withhold performance until the contract breaker performs. In the latter case the contract breaker cannot sue because there is simply no breach by the other party.

2.22 If there were a general rule that a party in breach could not sue for breach then that would be most unsatisfactory.⁴⁹ A party who is in breach may also be due money, - for example, price, commission, damages - from the other party and, if it is assumed that the circumstances are such that the other party is in breach (and is not, for example, entitled to suspend performance),⁵⁰ it would clearly be unfair to deny a claim for what is owed merely because the claimant is in breach. It is thought to be a normal occurrence in the sheriff court for a person suing for the price of work done to be met with a counterclaim based on breach of contract in doing the work. The two claims can be quantified and set off against each other. There is no reason to deny the pursuer an action on the contract in such circumstances.

2.23 An example of the unfairness of the present law is a case often cited as the prime example of what the law is - *Graham & Co v United Turkey Red Co Ltd*.⁵¹ Under two contracts G were to be distributors of the products of UTR and to act solely for them. From July 1916 until termination of the contracts in November 1917 G, in breach of contract, acted for other manufacturers. G sought an accounting for commission, the balance of commission and damages. UTR held at least £300 of commission. The Second Division held that G were not entitled to commission during the period in which they were in breach of contract. They were entitled to an accounting for the period during which they had complied with the contract. UTR did hold commission, but the court treated its amount as irrelevant. The

⁴⁷ *Thorneloe v McDonald & Co* (1892) 29 S L Rep 409; *Graham & Co v United Turkey Red Co Ltd* 1922 SC 533; *Hayes v Robinson* 1984 SLT 300; *Hunter v Wylie* 1993 SLT 1091; *G Dunlop & Son's JF v Armstrong* 1994 SLT 199 and *Lloyds Bank plc v Bamberger* 1993 SC 570.

⁴⁸ Much depends on the order of performance and the nature of the obligations. See *Thorneloe v McDonald & Co* (1892) 29 S L Rep 409 (where the supplier of watches, even if guilty of a later breach, could have sued for the price of watches already delivered and not paid for when payment fell due) and *Bank of East Asia Ltd v Scottish Enterprise* 1997 SLT 1213.

⁴⁹ See McBryde, "Remedies for Breach of Contract" (1996) 1 ELR 43 at 66-69.

⁵⁰ See Part 3.

⁵¹ 1922 SC 533.

amount of any payments to account, or the value of G's trading with others, were not in issue. UTR did not attempt to quantify and claim damages. In effect, by being in breach of contract G forfeited their right to sue under the contract for payment of the commission due to them, whatever the amount might be. The result so far as turning on the effect of G's breach of contract appears random according to what had, or had not, been earned by them and paid to them before the relations between the parties soured.

2.24 Another example is *Thorneloe v McDonald & Co.*⁵² There was a contract to supply watches over a period of time. After some differences between the parties the seller refused to continue to supply or at least threatened to discontinue supplies. It was not clear which. The buyer refused to pay for past supplies. The seller sued for the price and was met by a counterclaim by the buyer for damages arising from the seller's alleged breach in refusing to supply. It was held that the seller's breach was not proved and that the seller was entitled to the price of watches already supplied. However, the court also said that, even if the seller had been in breach, the buyer would not have been entitled, because of its own breach, to claim damages for the seller's breach.

2.25 If there is a rule that a party in breach of contract cannot exercise any remedies for breach by the other party the logical result is that a contract cannot be enforced at all if both parties are in breach. The unsatisfactory consequences of such a rule would be most clearly illustrated by a contract of barter. Suppose that X agrees to exchange goods with Y. The goods are duly exchanged. Both sets of goods turn out to be disconform to contract. X has a claim for damages of £200. Y has a claim for £1000. There would be no sense or justice in denying both parties a remedy.

2.26 We believe that a general rule to the effect that a party in breach cannot sue for breach would be manifestly unfair. No such rule appears in the Vienna Convention, the Unidroit *Principles* or the European *Principles*. We do not believe that there is any such general rule in the law of Scotland, although there is sufficient doubt to make clarification of the law desirable. Our provisional proposal is:

7. **It should be made clear that a party to a contract is not disentitled, merely by being in breach of contract, from any available remedy for the other party's breach of contract.**

2.27 In assessing this proposition it is important to bear in mind that the rules on suspension of performance, based on the principle of mutuality, will often mean that the other party will not be in breach at all. The contract breaker may be denied a remedy not because of a special rule of disentitlement but simply because the contract breaker's own breach entitles the other party to withhold performance of a countervailing obligation and therefore prevents the other party from being in breach.⁵³

A general discretionary control?

2.28 Some remedies for breach of contract have an element of discretion built into them. This is so, for example, with specific implement and interdict.⁵⁴ There is, however, no

⁵² (1892) 29 S L Rep 409.

⁵³ See Part 3.

⁵⁴ See Parts 6 and 7.

general discretion to refuse a remedy on the ground that, for example, the pursuer is not acting in good faith. Nor is there any general rule that rights or non-judicial remedies must be exercised in good faith. Good faith in contract law was the subject of conferences in Oxford, in October 1993⁵⁵ and in the University of Aberdeen in October 1998.⁵⁶ It was clear from the discussion of the papers given at the Aberdeen conference that there would be serious objections to any proposal to introduce a general rule allowing ordinary remedies for breach of contract to be denied on the ground that the person seeking them was not in good faith. In this paper we proceed on the assumption that the solution to particular problems in the existing law on remedies for breach of contract⁵⁷ is likely to be found in specific new rules rather than in recognition of an over-riding general discretion to refuse remedies. There is however a general question at the end of the paper inviting suggestions for reforms not covered by the specific propositions and questions. Consultees who think that a rule that remedies (or non-judicial remedies) for breach of contract must be exercised in good faith would be better than a series of specific solutions to identified problems will have an opportunity to make their point in response to that general question.

⁵⁵The revised conference papers are published in J Beatson and D Friedmann (eds), *Good Faith and Fault in Contract Law* (1995).

⁵⁶It is understood that the conference papers are to be published.

⁵⁷Such as the problem revealed by the case of *White & Carter Councils Ltd v McGregor* 1962 SC (HL) 1.

Part 3 Suspension of Performance

Nature of the remedy

3.1 The idea behind the remedy of suspension¹ of performance is quite simple. If one party has not performed an obligation at the due time the other party can withhold any performance, due at the same time or later, which is the counterpart of the performance which has not been received. The contract is not brought to an end.² The aggrieved party simply withholds performance until the other party performs, adopting the understandable attitude "I am not going to fulfil my part of the bargain until you fulfil yours". The law allows the aggrieved party to adopt that attitude, subject to certain conditions, without being in breach of contract.

3.2 The remedy of suspension of performance is not necessary, and is indeed inapplicable, if the aggrieved party is not under any obligation to perform. This will often be the case. Contracts often provide that performance of certain obligations is conditional on the performance of obligations by the other party. For example the contract may provide that the obligation to pay for certain work arises only when the work has been done. In such a case the person who has contracted for the work to be done does not need to rely on the remedy of suspension of performance in order to refuse payment if the work has not been done. There is not yet an obligation to pay. Similarly, an obligation to do something may be conditional on payment being made or tendered. If payment is not made or tendered the aggrieved party does not come under an obligation to perform.

3.3 The situation where the remedy of suspension of performance is useful is where the contract contains obligations which are the counterpart of each other but does not make either obligation conditional on the performance of the other. For example, a contract may provide that payment for certain work is to be made on regular fixed dates, without making the obligation to pay conditional on the commencement of the work. If the work is not commenced on the due date the other party is entitled to suspend performance of the obligation to pay and will not be in breach of contract in doing so even if the time when the first payment falls due has arrived.

3.4 Questions of timing are important in relation to the remedy of suspension of performance. The party who is bound to perform first cannot withhold performance on the ground that the other party has not yet performed. This is not a special rule of law. It is a simple consequence of the fact that there is not yet a breach by the party who is to perform second. No question of a remedy for breach therefore arises. We consider later whether a right to suspend performance should arise where there is a reasonable anticipation of breach.³

¹ The words "withholding" or "retention" are also used.

² This is what distinguishes suspension of performance from rescission.

³ Para 3.10.

Existing law

3.5 The remedy of suspension of performance is clearly recognised in the existing law, where it is usually explained as an example of the operation of the mutuality principle – that is, the principle that in general a contract contains mutual and reciprocal obligations which are the counterpart of each other.⁴ If one party is not performing, the other can withhold counter-performance.⁵ There have been many cases, for example, where a tenant has been held entitled to withhold rent when the landlord was in breach of contract.⁶ Sometimes the law has been explained by saying that there is a legally implied term that the counter-obligations are conditional on each other⁷ but the technique of expressing legal rules as implied terms is old-fashioned and undesirable. In the present context, for example, it leaves a number of questions relating to the order of performance unanswered.

3.6 The classic statement of the law is by Lord Justice-Clerk Inglis in *Borthwick v Scottish Widows' Fund*.⁸

"Retention is a right to resist a demand for payment or performance till some counter obligation be paid or performed; and it has not the effect of extinguishing obligations ... but barely of suspending them, till the counter obligation be fulfilled. ... It is, according to its true etymological meaning, a right to retain, and nothing else. It seems to follow as a necessary consequence, that this mere passive resistance can never be operative or available to the debtor in an obligation, of which the term of payment has not come..."

3.7 The leading modern case is *Bank of East Asia Ltd v Scottish Enterprise*.⁹ This was an English case which turned entirely on the Scottish law on suspension or retention of performance. Scottish Enterprise claimed to be entitled to withhold payment of sums which had already fallen due under the contract in respect of past performance of an earlier stage of the contract which had been duly performed (subject to a claim for damages which was not disputed). In the House of Lords the court was free to pronounce on the Scottish rules as a matter of law and did so. It held that Scottish Enterprise were not entitled to retain or withhold the sum sued for. The remedy of retention of performance was available only where the obligations in question were the counterparts of each other. Here the obligation to pay was the counterpart of the work already completed at the earlier stage. It was not the counterpart of the builders' obligations under any later stage of the contract. Lord Jauncey said

"in a contract to be performed by both sides in stages, the counter obligation and consideration for payment of stage one is the completion of the work for that stage conform to contract"¹⁰

⁴ For recent discussions of the mutuality principle, see *Barton Distilling (Scotland) Ltd v Barton Brands Ltd* 1993 SLT 1261; *Common Services Agency v Purdie and Kirkpatrick*; *Eurocopy (Scotland) plc v Lothian Health Board* 1995 SLT (Sh Ct) 34 at 43 – 44 and *McCall's Entertainments (Ayr) Ltd v South Ayrshire Council* 1998 SLT 1403.

⁵ *Turnbull v McLean & Co* (1874) 1 R 730; *Davie v Stark* (1876) 3 R 1114; *Meikle & Wilson v Pollard* (1880) 8 R 69; *McDonald v Kydd* (1901) 3 F 923; *Earl of Galloway v McConnell* 1911 SC 846; *National Homecare Ltd v Belling & Co Ltd* 1994 SLT 50; *Bank of East Asia Ltd v Scottish Enterprise* 1997 SLT 1213.

⁶ See McBryde, *Contract* 310 – 311.

⁷ See Gloag, *Contract* 592 – 594.

⁸ (1864) 2 M 595 at 607.

⁹ 1997 SLT 1213.

¹⁰ At 1217I.

and

"retention may be operated against corresponding obligations prestable but unfulfilled, but has no relevance to obligations duly performed".¹¹

3.8 Modern international instruments on contract law have provisions on withholding performance. The European *Principles* state:¹²

"(1) A party who is to perform simultaneously with or after the other party may withhold performance until the other has tendered performance or has performed. The first party may withhold the whole of his performance or a part of it as may be reasonable in the circumstances.

(2) A party may similarly withhold performance for as long as it is clear that there will be a non-performance by the other party when the other party's performance becomes due."

The Unidroit *Principles* have an article¹³ to the same effect as the first of these paragraphs and the Vienna Convention has a rule on suspension of performance in relation to an anticipated fundamental breach.¹⁴

Criticisms of existing law

3.9 The existing law seems to be generally satisfactory. There are, however, three criticisms which might be made of it.

Can there be suspension in response to anticipated breach?

3.10 The first criticism is that the remedy does not appear to be available in relation to an anticipated breach, even if it is clearly going to occur and would be material. And yet from the point of view of commercial people it might seem to be entirely reasonable that a party should not be bound to perform if it is clear that the other party is not going to perform. The Vienna Convention and the European *Principles* so recognise. We invite views on the following question.

8. Should it be made clear that suspension of performance is available where it is clear that there is going to be a material breach?

Can there be suspension in response to a non-material breach?

3.11 The second criticism is that there is some doubt as to whether the remedy of suspension of performance is available only in response to a material breach.¹⁵ This possible limitation does not appear in all judicial statements on the subject and has been criticised by commentators.¹⁶ We would be grateful for views on whether the remedy should be so

¹¹ At 1218B.

¹² Art 4.201.

¹³ Art 7.1.3.

¹⁴ Art 72. A party suspending performance must give notice to the other party and must continue with performance if the other party provides adequate assurance of performance.

¹⁵ In *Turnbull v McLean & Co* (1874) 1 R 730 at 738 Lord Justice-Clerk Moncreiff appears to say that only "a failure to perform any material or substantial part of the contract" would justify suspension of performance.

¹⁶ Gow, *Mercantile and Industrial Law of Scotland* 207, 208; McBryde, *Contract* paras 14-50 to 14-54; McBryde, "Remedies for Breach of Contract" (1996) 1 ELR 43 at 65.

confined. The issue is not entirely straightforward. There is an obvious risk if the remedy of suspension of performance is too readily available. Parties who have received performance would be tempted to find slight failures in the performance rendered in order to delay payment until the faults were remedied. In the European *Principles*¹⁷ and Unidroit *Principles*¹⁸ there is an overriding principle that rights must be exercised in good faith. In the absence of such a principle it would be necessary at least to have an exception for trivial breaches. We invite views.

9. Should it be made clear that, where there has been an actual breach of contract, not being a trivial breach, the remedy of suspension of performance is available even if the breach was not material?

Danger of abuse

3.12 The third criticism is that the remedy can be abused in cases where performance has been substantially completed but it is defective in a way which cannot reasonably be remedied. Suppose that a builder has been engaged to build a house in accordance with certain specifications for a fixed price payable in a lump sum. The builder uses a type of cement other than the type specified.¹⁹ The type used is adequate for the job but would not be adequate for certain more demanding applications. The other party refuses to pay, taking the view that payment can lawfully be withheld until the contract is performed according to its terms. If the remedy of suspension of performance is available without any qualification in this type of case, the result would be unreasonable. The builder can reasonably be expected to pay damages for the breach of contract²⁰ but cannot reasonably be expected to pull the house down and start again. Yet until the defect is remedied the price cannot be recovered. The other party is not in breach. The contract, however, is not terminated and so the builder cannot resort to the law on unjustified enrichment. Any enrichment of the other party is the result of a contract which is still in full force. It is therefore justified.²¹ The builder has no way of bringing the contract to an end.

3.13 This problem is not resolved by the *Bank of East Asia* case.²² The two obligations – completion of the house according to contract and payment for the job – are the counterpart of each other. The employer is not withholding a sum due for past work as a sort of security for claims in relation to future work but is withholding the sum due for the past work until it is duly performed. Under the Unidroit *Principles* and the European *Principles* the problem could be solved by using the overriding rule that rights must be exercised in good faith. The employer would not be in good faith in asking the builder to remedy the defect in this situation.

3.14 What seems to be required is a qualification to the rule on suspension of performance to prevent the remedy from being exercised in this type of case. We invite views on the proposition that

¹⁷ Art 1.106.

¹⁸ Art 1.7.

¹⁹ See *Steel v Young* 1907 SC 360 where it was held that the builder could not sue under the contract. The matter is not resolved by *Forrest v Scottish County Investment Co Ltd* 1916 SC (HL) 28.

²⁰ The method of assessing damages in this type of case is discussed at paras 8.37 – 8.42.

²¹ *Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd* 1998 SLT 992.

²² 1997 SLT 1213. See para 3.7 above.

10. **The remedy of suspension of performance should not be available where the other party has substantially performed but the performance is defective and it would be unreasonable to require the defects to be remedied.**

3.15 As an alternative to the solutions mentioned in the last two propositions it would be possible to provide that the remedy of suspension of performance must be exercised in good faith. If it were not exercised in good faith then the failure to perform would be a breach of contract and the other party would have the usual remedies. This would perhaps be a neater and more flexible solution and more in line with international models. It would be a limited invocation of the principle of good faith and therefore not so likely to introduce excessive uncertainty into contract law. We invite views.

11. **As an alternative to the last two solutions, should it be provided that the remedy of suspension of performance must be exercised in good faith?**

Part 4 Rescission

Nature of the remedy

4.1 Rescission is a non-judicial remedy whereby the aggrieved party brings the contract substantially to an end. It is available in response to a repudiation or material breach but not in response to a non-material breach.¹ We have considered the question of rescission in cases of anticipatory breach² and we have considered what is meant by a material breach.³

Need for the remedy

4.2 Rescission is a useful remedy. It enables the aggrieved party to terminate an unsatisfactory contractual relationship, seek damages where appropriate and enter into a contract with another party. The remedy of rescission is well established in Scottish contract law and is also found in international instruments on the subject. The European *Principles*, for example, provide that⁴

"A party may terminate the contract if the other party's non-performance is fundamental."

There is a similar provision in the Unidroit *Principles*.⁵

"A party may terminate the contract where the failure of the other party to perform an obligation under the contract amounts to a fundamental non-performance."

We do not suggest any fundamental change in the remedy of rescission. There are, however, some incidental, but important, questions which merit discussion.

Intimation to party in breach

4.3 There has been little discussion in the cases and textbooks of the method by which the aggrieved party exercises the remedy of rescission. Gloag stated:⁶

"A party faced with a breach of contract which he regards as material would be well-advised in making a definite intimation to the defaulter that he regards the contract as at an end through his fault, and that he proposes to claim damages".

¹ Certain breaches may be deemed to be material by the contract or by statute. See eg the Supply of Goods (Implied Terms) Act 1973 s 12A(2); the Sale of Goods Act 1979 s 15B(2); the Supply of Goods and Services Act 1982 s 11F(2).

² Paras 2.5 – 2.8.

³ Paras 2.9 – 2.17.

⁴ Art 4.301.

⁵ Art 7.3.1 (1).

⁶ *Contract* 620.

This, however, is framed in terms of what it would be wise to do, rather than what must be done.

4.4 It seems clear on principle that intimation of some kind, however informal, is necessary. An effective juridical act requires something more than a private uncommunicated decision. The Scottish cases are consistent with this view.⁷ There is no suggestion, however, that the notice need take any particular form or even state the reason for rescission.⁸

4.5 The Vienna Convention provides that

"A declaration of avoidance of the contract is effective only if made by notice to the other party".⁹

The notice does not have to be in writing (although this, or a written confirmation of an oral statement, may be advisable). There is provision for dealing with dispatch of the notice and delay or error in communication.¹⁰ The European *Principles* also require notice¹¹ as do the Unidroit *Principles*.¹²

4.6 The absence of any clear Scottish authority on this point is regrettable. We invite views on the following proposition.

12. It should be made clear that rescission is effected by intimation to the party in breach.

We wish to stress, however, that we do not consider that any particular form of notice, or form of words, should be required. The important point is that the decision to respond to the repudiation or breach by bringing the contract substantially to an end should be communicated to the other party. Lay people cannot be expected to use any particular form of words or even to use legal terms like "rescind" in communicating their intentions.

Rescission for remediable breach

The question

4.7 The question for consideration is whether, in the case of a material breach which is remediable, the aggrieved party should, or should not, be entitled to rescind without giving the party in breach an opportunity to remedy the situation. The question can be approached from the contract breaker's point of view by asking whether there should be a right to cure.

⁷ In *Charisma Properties Ltd v Grayling (1994) Ltd* 1996 SC 556 Lord Wylie said at 565E that rescission "could not of course take effect before the other parties had been informed of the decision". See also *Cumming v Brown* 1994 SLT (Sh Ct) 11. Sometimes the problem is resolved by the contract itself. See eg *Grovebury Management Ltd v McLaren* 1997 SLT 1083.

⁸ *Owen v Fotheringham* 1997 SLT (Sh Ct) 28 at 30D.

⁹ Art 26.

¹⁰ Art 27. Rules on the content of the notice seem to be related to the specific problems of sale of goods; art 39.

¹¹ Art 4.303(1) – "A party's right to terminate the contract is to be exercised by notice to the other party."

¹² Art 7.3.2(1) – "The right of a party to terminate the contract is exercised by notice to the other party."

The concept of remediable breach.

4.8 Whether a breach is remediable depends partly on the contract and partly on the facts. If the contract provides, for example, that something must be done by a certain date and makes it clear that performance after that date will be unacceptable and will, in effect, be regarded as non-performance, then a failure to perform by that date will be irremediable.¹³ Failure to deliver a wedding dress in time for the wedding could not be remedied by delivering it the day after the wedding. In cases where the contract does not itself rule out remediability it will be a question of fact whether a breach is remediable. In such cases, the term "remediable breach" is intended to cover not only the case where a single defective performance, such as failure to do a single job of work to the required standard, can be rectified but also the case where a continuing breach of a continuing contract, such as a lease, which still has a considerable period to run can be rectified for the future.

Existing law

4.9 The existing law contains conflicting statements and conflicting rules. There is no right to cure in the case of contracts for the sale or supply of goods. In the case of a material breach the aggrieved buyer has a statutory right to reject the goods and rescind the contract.¹⁴ The buyer does not need to give the seller an opportunity to remedy the breach. At common law the seller has a similar right where the buyer is in material breach.¹⁵

In *Barclay v Anderston Foundry Co*¹⁶ sellers of a large quantity of cast iron by instalments were faced with the position that the buyer, who was in financial difficulties, had not paid in a satisfactory manner for any of the instalments delivered. They stopped supplies and, when pressed to resume, said that the contract was at an end. The buyer sued for damages and the case went to a civil jury. The buyer requested the judge to direct the jury that the sellers were not entitled to rescind without giving the buyer an opportunity to honour outstanding bills. The judge refused to give the direction. On appeal to the Inner House it was held that he had been right to do so.

4.10 There is a statutory right to cure in the case of certain leases of land.¹⁷ Where the material breach (or deemed material breach) consists of the non-payment of money by the tenant the landlord must give notice allowing an opportunity to remedy the breach by paying within a short time.¹⁸ Unless this opportunity has been given the landlord is not entitled to rescind. In the case of other material breaches (or deemed material breaches) the

¹³ The terms of contracts are not always clear or consistent on such matters. Sometimes, for example, the contract will provide that payment on a certain date is "of the essence of the contract" and then provide that late payment will still be acceptable. See eg the terms of the contract considered in *Groebury Management Ltd v McLaren* 1997 SLT 1083.

¹⁴ Supply of Goods (Implied Terms) Act 1973 s 12A; Sale of Goods Act 1979 s 15B; Supply of Goods and Services Act 1982 s 11F.

¹⁵ The Sale of Goods Act 1979 s 62(2) preserves the common law except in so far as inconsistent with the provisions of the Act. The seller's right to rescind is not inconsistent with the Act.

¹⁶ (1856) 18 D 1190.

¹⁷ Under the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985 ss 4 – 7. The Act applies to irritancy as well as rescission for material breach. It does not apply to a lease of land used wholly or mainly for residential purposes or to land comprising an agricultural holding, a croft, the subject of a cottar or the holding of a landholder or statutory small tenant. In all of these cases other statutory protections will often apply. S 6(1) prevents the parties from contracting out of the statutory right.

¹⁸ Law Reform (Miscellaneous Provisions) (Scotland) Act 1985 s 4. The period allowed for payment is normally 14 days.

landlord cannot rely on the breach to rescind the contract "if in all the circumstances of the case a fair and reasonable landlord would not seek so to rely".¹⁹ In considering this question in relation to a breach which is capable of being remedied within a reasonable time "regard shall be had to whether a reasonable opportunity has been afforded to the tenant to enable the breach to be remedied".²⁰ There are a few judicial statements suggesting that even at common law a landlord could not rescind for a material breach, such as a failure by the tenant to occupy the subjects or carry out improvements, without giving the tenant an opportunity to remedy the breach.²¹ There are also statements suggesting that a tenant cannot normally rescind for a material breach by the landlord without giving an opportunity for the breach to be rectified.²²

In *McKimmie's Trs v Armour*²³ a house had become uninhabitable because of damp and an intolerable smell – a material breach of the landlord's obligations. The tenant gave the landlord ample opportunity to remedy the defects but, when this was not done, rescinded the contract. It was held that, on these facts, he was entitled to do so. There were statements, not necessary for the decision, to the effect that if a landlord gave reasonable grounds for believing that a remediable breach would be promptly remedied the tenant would not be entitled to rescind without allowing time for matters to be put right.²⁴

4.11 The question whether the aggrieved party must give an opportunity for cure before rescinding for a remediable material breach has been considered in a few more recent cases involving different types of contract but none answers the question in a conclusive way.

4.12 In *Lindley Catering Investments Ltd v Hibernian Football Club Ltd*²⁵ there was a contract whereby caterers were to supply catering at the club's ground. Numerous breaches of contract were averred: supplies of food and drink running out; food and drink cold or lukewarm; Bovril urns left to stagnate from week to week; and slow service. The club rescinded the contract and were sued for damages. Damages were awarded by Lord Thomson. He referred to the rule that a material breach entitled the aggrieved party to rescind and then continued:²⁶

"But if the breach is such, by degree or circumstances, that it can be remedied so that the contract as a whole can thereafter be implemented, the innocent party is not entitled to treat the contract as rescinded without giving to the other party an opportunity so to remedy the breach."

It is not clear whether the basis of the decision was that the breach was not material (remediability being a relevant factor in arriving at that conclusion) or that it was material but an opportunity to rectify matters required to be given as a matter of law before there could be rescission.

¹⁹ S 5(1).

²⁰ S 5(3).

²¹ *Hamilton v Hamilton* (1845) 8 D 308 in Lord Fullerton's dissent at 312 ("I think the landlord is entitled to make the tenant say whether he will implement or not; and if he will not, to have the contract of lease set aside."); *Edmond v Reid* (1871) 9 M 782. These and other cases are discussed in Hogg, "To Irritate or to Rescind: Two Paths for the Landlord?" 1999 SLT (News) 1.

²² See *Davie v Stark* (1876) 3 R 1114 at 1123; *McKimmie's Trs v Armour* (1899) 2 F 156.

²³ (1899) 2 F 156.

²⁴ See the statements by Lord McLaren and Lord Kinnear at 162.

²⁵ 1975 SLT (Notes) 56.

²⁶ 1975 SLT (Notes) 56 at 57.

4.13 *Charisma Properties Ltd v Grayling(1994) Ltd*²⁷ turned on the interpretation of a contract for the sale of farms which provided that failure to pay on a certain date was to be a material breach and that the sellers were to be entitled to rescind, on giving "prior notice",²⁸ if the price were not paid within 21 days thereafter. There were pronounced differences of view in this case²⁹ but it was held in the Inner House that once the 21 days had elapsed no further period of grace had to be allowed. Lord Sutherland said that

"As a general rule if there is a material breach of contract the innocent party is entitled to rescind the contract forthwith".³⁰

4.14 In *Strathclyde Regional Council v Border Engineering Contractors Ltd*³¹ Lady Cosgrove said:

"It is clear however that it is a basic principle of the law of contract that if one party is in breach, the innocent party is not entitled to treat the contract as rescinded without giving the other party an opportunity to remedy the breach."

The statement is remarkably wide and unqualified. The case was, however, concerned not with rescission but with prescription of an obligation to make reparation. Cases on the right to cure were not discussed or cited.

4.15 The only safe conclusion about the existing Scottish law is that the underlying common law rule is uncertain and possibly in a state of flux. There is some recognition of the desirability of giving the party in breach a right to cure remediable breaches in certain cases but no clear law on the existence or content of such a right.

Assessment.

4.16 It is not satisfactory that the basic rule on this point should be uncertain. In the case of a remediable material breach the basic rule, applying in the absence of any special rule for particular types of contract or particular situations, must be either

- the aggrieved party is entitled to rescind without allowing an opportunity for the breach to be remedied, or
- the aggrieved party is not entitled to rescind without allowing an opportunity for the breach to be remedied.

²⁷ 1996 SC 556.

²⁸ The words "prior notice" were the cause of the difficulty in the case. Did they just mean "notice"? Or did they mean that there had to be two notices – one giving an opportunity to remedy the non-payment and then another one rescinding the contract if payment had still not been made? The majority favoured the first view.

²⁹ Lord Penrose, who decided the case at first instance, was overruled. Lord Milligan dissented. Lord Sutherland and Lord Wylie appeared to differ as to the need for an opportunity to cure to be given in a case where non-payment on a particular date was declared by the contract to be a material breach.

³⁰ We consider below the closely related question of whether the right to rescind will be lost if performance is tendered before rescission takes place. See para 4.26.

³¹ 1998 SLT 175 at 177L.

It cannot be both. Once the basic rule has been determined it can be considered whether any special rules are needed for certain types of contracts – such as consumer contracts, employment contracts and certain leases.

4.17 There are arguments against the recognition of a general right to cure on the part of a party who is in material breach of contract.

- The requirement that the breach must be material is already stringent. It is not necessary to place additional obstacles in the way of the aggrieved party.
- In deciding whether the breach is material, factors such as the seriousness and remediability of the breach can be taken into account. There is no need to apply a remediability test twice.
- There will be cases where the nature of the breach is such that the aggrieved party, with good reason, loses all confidence in the other party. It would not be reasonable in such cases to require the aggrieved party to afford an opportunity to cure.
- There will be cases where the aggrieved party would suffer grave inconvenience or loss as a result of attempts to cure.
- Recognition of a right to cure would provide an incentive for inadequate, cost-cutting performance. Unscrupulous people would know that if defects were discovered there would always be a right to cure.
- A right to cure could be used by unscrupulous people to spin out non-performance indefinitely.
- In general, recognition of a contract breaker's right to cure would alter the balance of power in cases of serious breach of contract in favour of the contract breaker.

4.18 There are arguments the other way.

- Recognition of a right to cure on the part of the contract breaker would help to prevent unreasonable resort to the extreme remedy of rescission. Materiality is not always a sufficient test to prevent unreasonable results, particularly where the law or the contract deems minor breaches to be material.
- Recognition of a contract breaker's right to cure would help to maintain workable contractual relations, which is a desirable policy objective particularly in the case of continuing contracts.
- A right to cure would help to avoid unnecessary waste and expense.

- The right can be so expressed and qualified that the legitimate interests of the aggrieved party are protected and the balance of power is not shifted too much in favour of the contract breaker.

4.19 The arguments are fairly evenly balanced. Much would depend on the sophistication of any rules allowing the contract breaker an opportunity to remedy a material breach notwithstanding a purported rescission. A general right to cure, not qualified in such a way as to protect the legitimate interests of the aggrieved party, would seem to be undesirable.

International models.

4.20 The Vienna Convention³² and the European *Principles*³³ have limited provisions on the right to cure by the non-performing party. The provisions in the Vienna Convention are designed, as is natural, for sales contracts and would not be suitable for general application.³⁴ The provision in the European *Principles* covers only the situation where a tender of performance has been rejected³⁵ and would not apply very easily to continuing contracts. The Unidroit *Principles* have the most sophisticated rules on this topic. Their effect is that, in appropriate cases, an aggrieved party could not rescind for a remediable material breach without allowing an opportunity for the breach to be remedied. They are as follows.³⁶

"(1) The non-performing party may, at its own expense, cure any non-performance, provided that

- (a) without undue delay, it gives notice indicating the proposed manner and timing of the cure;
- (b) cure is appropriate in the circumstances;
- (c) the aggrieved party has no legitimate interest in refusing cure; and
- (d) cure is effected promptly.

(2) The right to cure is not precluded by notice of termination.

(3) Upon effective notice of cure, rights of the aggrieved party that are inconsistent with the non-performing party's performance are suspended until the time for cure has expired.

(4) The aggrieved party may withhold performance pending cure.

(5) Notwithstanding cure, the aggrieved party retains the right to claim damages for delay as well as for any harm caused or not prevented by the cure."

³² Art 48.

³³ Art 3.104.

³⁴ They relate only to cure by the seller and they do not prevent the buyer from bringing the contract to an end for fundamental breach.

³⁵ Art 3.104 provides that "A party whose tender of performance is not accepted by the other party because it does not conform to the contract may make a new and conforming tender where the time for performance has not yet arrived or the delay would not be such as to constitute a fundamental non-performance."

³⁶ Art 7.1.4.

These rules seem to achieve a reasonable balance between the interests of the contract breaker and the aggrieved party.

4.21 It is instructive to consider how the Unidroit rules would have applied in the cases considered earlier. In the *Barclay* case (non-payment for instalments of cast iron) they would have allowed the buyer, when told that the contract was at an end, to give notice that all outstanding bills would be promptly honoured and then to honour the bills and keep the contract alive. In the *McKimmie* case (uninhabitable house) the result under the Unidroit *Principles* would probably have been the same as it was in the actual case. The landlord had been given ample opportunity to cure and had failed to do so promptly. The tenant could rescind. However, in a case where the landlord had not been given an adequate opportunity to cure, a purported rescission would have been ineffective under the *Principles* if met by a prompt notice indicating the steps the landlord proposed to take to effect a cure. This was the result which the judges in the *McKimmie* case considered to be the reasonable one in that situation. In the *Lindley* case (football catering) the caterers would have been able to respond to the notice of rescission by giving notice of the steps they proposed to take to prevent future breaches. The rescission would have been suspended to allow these steps to be promptly implemented.³⁷ In the *Charisma* case (late payment of price for farms) the question³⁸ would have been whether a further opportunity for cure was "appropriate" given that a period of grace of 21 days had already been allowed under the contract and had expired. Again the result might well have been the same.

Request for views.

4.22 We would be grateful for responses to the following questions.

13. (1) **In the case of a remediable material breach, should the basic rule be**
 - (a) **that the aggrieved party cannot rescind unless the other party has been given a reasonable opportunity to remedy the breach, or**
 - (b) **that the aggrieved party can rescind without giving the other party an opportunity to remedy the breach?**
- (2) **If (a) were adopted would the rules in article 7.1.4 of the Unidroit *Principles* (set out in paragraph 4.20) provide a suitable model for a provision which attempted to recognise the legitimate interests of the aggrieved party?**

When we refer to the "basic rule" we mean the rule which applies in the absence of any special statutory provision for particular kinds of contract. It would be for consideration at a later date whether, in the light of the basic rule, any special rules for particular types of contracts would merit re-examination.³⁹

³⁷ The result would have been different from, and might well have been better than, the result in the actual case where the contract did come to an end and the football club had to pay damages.

³⁸ If it is assumed that the words "prior notice" were construed in the context as meaning "notice".

³⁹ The English and Scottish Law Commissions considered, but rejected, the introduction of a right to cure to the law on sale of goods. See the Commissions' joint consultative paper on Sale and Supply of Goods (SLC Consultative Memorandum No 58, 1983) para 4.50 and the Commissions' joint report on Sale and Supply of Goods (Scot Law Com No 104, 1987) para 5.28.

Loss of right to rescind

By lapse of time

4.23 Where performance has taken place but in a way which is materially disconform to contract it would be unreasonable to allow the right to rescind to last indefinitely. The party who has performed has a legitimate interest in knowing within a reasonable time if the contract is to be terminated. This is recognised in the Sale of Goods Act 1979⁴⁰ and the European *Principles*.⁴¹ There is a neat formulation in the *Unidroit Principles*.⁴²

"If performance has been offered late or otherwise does not conform to the contract the aggrieved party will lose its right to terminate the contract unless it gives notice to the other party within a reasonable time after it has or ought to have become aware of the offer or of the non-conforming performance."

Of course the loss of the right to rescind does not mean that the aggrieved party is deprived of remedies. The remedy of damages is still available. It is important to note that the *Unidroit* rule applies only where performance has been given or offered. It does not apply where performance is overdue and not forthcoming. In that situation there is, as it were, a continuing material breach and the right to rescind can be exercised at any time.

4.24 The existing Scottish law on this point, in areas not covered by the Sale of Goods Act 1979, is unclear. There could be advantages in clarifying it. We invite views on the following proposition.

14. **It should be made clear that if performance has been made or offered, but in a way which is a material breach of the contract, the right to rescind is lost after the lapse of a reasonable time from the date when the aggrieved party became, or could reasonably have been expected to become, aware of the breach.**

Again we are referring here to the general background rule. The rules in the Sale of Goods Act 1979 could be examined, if necessary, at a later date.

By waiver or personal bar

4.25 There is no reason to doubt that a right to rescind, like any other right, can be lost by waiver or personal bar.⁴³ The loss, on acceptance of the goods, of the buyer's right to reject the goods and rescind the contract under the Sale of Goods Act 1979,⁴⁴ is a special statutory example. The Vienna Convention, *Unidroit Principles* and European *Principles* do not have provisions on waiver or personal bar but similar results would be achieved by the principle

⁴⁰ S 35(4). The buyer loses the right to reject the goods and rescind the contract if "after the lapse of a reasonable time he retains the goods without intimating to the seller that he has rejected them".

⁴¹ Art 4.303(2) and (3).

⁴² Art 7.3.2(2).

⁴³ See Gloag, *Contract* 620; *Cumming v Brown* 1994 SLT (Sh Ct) 11.

⁴⁴ S 35.

of good faith, aided by some special rules for special situations.⁴⁵ We are proceeding on the assumption that the basic Scottish law on these points is satisfactory and that no legislative reform is required. We are also assuming that a request by the aggrieved party that a breach be remedied would not by itself amount to waiver of the right to rescind or to personal bar.⁴⁶ Views, however, would be welcomed.

By tender of performance

4.26 If a material breach is irremediable then the right to rescind will not be lost if the contract breaker purports to tender performance after the breach has occurred. A breach of a contract to put on a fireworks display on the last night of the Edinburgh Festival could not be remedied by offering a display the following night, and any right to rescind would not be affected by such a tender. We are here concerned only with remediable breaches. Where a remediable material breach has occurred and, before the contract has been rescinded, effective performance is tendered then the right to rescind is lost.⁴⁷ A contract which has not been rescinded remains in existence for the benefit of both parties and if effective performance is tendered while the contract is still in being the other party is bound to accept it. One of the points of rescinding is to free the rescinding party from the obligation to accept further attempts at performance. The main difficulty in practice in this area is in deciding whether a breach is remediable. Where the contract makes it clear, for example that late payment cannot be treated as performance at all then failure to pay in time will be an irremediable breach. The law on this point seems to be satisfactory and in accordance with principle and we make no suggestions for change.

Prospective effect of rescission

Existing law

4.27 Different legal systems have different rules as to the effects of rescission. In some systems it operates retrospectively.⁴⁸ In Scotland it has a prospective effect. As long ago as 1670 a rescinded contract had been found not to be null from the beginning but not to be obligatory for the future.⁴⁹ Lord Justice-Clerk Moncreiff said in 1874 that a contract was rescinded "except so far as it has been performed."⁵⁰ In this century English House of Lords

⁴⁵ For example, the European Principles have a special rule to prevent the aggrieved party from terminating the contract after knowingly allowing the other party to continue making preparations for late performance and unreasonably failing to give notice that performance will not be accepted. Art 4.303 (3)(b).

⁴⁶ This is clear under the Sale of Goods Act 1979 s 35 (6)(a).

⁴⁷ See Gloag, *Contract* 620. In *Grovebury Management Ltd v McLaren* 1997 SLT 1083 it was held, for the purposes of interdict, that a late tender of payment was *prima facie* an effective tender of performance at a time when, there having not yet been rescission, the contract was *prima facie* still in existence. The case was not made easier by the fact that the contract provided that payment by a certain date was of the essence and then contained provisions making it clear that it was not. The decision is consistent only with the view that time was not treated as being of the essence. Late performance was still effective performance. In *Cumming v Brown* 1994 SLT (Sh Ct) 11 it was held that the aggrieved party could not rescind after late payment had been tendered. It was conceded that the tender was of effective performance. *Ford Sellar Morris Properties plc v E W Hutchison Ltd* 1990 SC 34, which is sometimes cited in this connection, was not a case of rescission for breach but a case where, on a head landlord's consent not being obtained by a certain date, **either** party could resile from the contract in accordance with its terms.

⁴⁸ Treitel, *Remedies for Breach of Contract: A Comparative Account* 382-385.

⁴⁹ *Raith v Wolmet* (1670) Mor 9154 at 9155.

⁵⁰ *Turnbull v McLean & Co* (1874) 1 R 730 at 738.

decisions have indicated that clauses such as arbitration clauses or exclusions or limitations of liability might survive rescission.⁵¹

4.28 The law can be summarised in the following propositions.⁵²

Rescission releases both parties from their obligations to effect and receive future performance under the contract.

Rescission does not preclude a claim for damages for breach of contract.

Rescission does not affect any provision of the contract for the settlement of disputes or any other provision of the contract which, properly construed, is clearly intended to operate even after rescission.⁵³

Rescission does not preclude a claim for payment of any sum, or performance of any obligation, to which there was an accrued right at the time of rescission provided that any necessary counter-performance has been given⁵⁴ or, in a case where counter-performance was not required under the contract, any necessary condition has been met.⁵⁵

International models

4.29 The existing law of Scotland as to the effects of rescission is essentially the same as the rules set out in the *Unidroit Principles*⁵⁶ and *European Principles*.⁵⁷

No need for change

4.30 The basic law on the effects of rescission appears to us to be satisfactory and in line with modern international instruments on the subject. We make no suggestion for change.

Redressing economic imbalances after rescission

Nature of the problem

4.31 There may be no imbalance caused by a rescission. A contract may, for example, be rescinded in response to a repudiation before there has been any performance on either side. Or a contract providing for performance to be given in instalments may be rescinded in response to a repudiation after all performance already due has been received and paid for. In either case damages for the loss of the benefit of future performance will be an adequate remedy.

⁵¹ *Heyman v Darwins Ltd* [1942] AC 356; *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827.

⁵² See *Lloyds Bank plc v Bamberger* 1993 SC 570 by Lord Justice-Clerk Ross at 573.

⁵³ Examples are arbitration clauses, clauses prorogating jurisdiction, clauses specifying the proper law of the contract, exclusion clauses, clauses limiting liability and clauses providing for liquidate damages.

⁵⁴ Common examples are arrears of rent due under a lease, or the price due for goods duly supplied under a contract for the supply of goods in instalments.

⁵⁵ An example is the right to have property conveyed under an option which has been duly exercised prior to the rescission. See *McCall's Entertainments (Ayr) Ltd v South Ayrshire Council (No 1)* 1998 SLT 1403 and *(No 2)* 1998 SLT 1421.

⁵⁶ Art 7.3.5.

⁵⁷ Art 4.305.

4.32 Often, however, the effect of rescission will be to leave an unbalanced situation in which one party is enriched at the expense of the other. A buyer may have paid in advance for goods which will not now be received because the contract has been rescinded before any delivery has been made. If the seller can retain the price, the seller will be enriched at the expense of the buyer. A buyer may have paid for goods which have been delivered but which are so disconform to contract that the buyer rejects them, allows the seller to retrieve them⁵⁸ and rescinds the contract, leaving the seller with both the goods and the money. Again the seller would be enriched at the buyer's expense if allowed to retain the price and pay nothing. A seller may have supplied goods on credit but, before the time for payment has arrived, may have rescinded the contract in response to an intimation from the buyer that payment will not be made.⁵⁹ The buyer would be enriched at the seller's expense if allowed to retain the goods without having to pay for them. A contracting party may have done work under a contract which will not now be paid for because the contract has been rescinded. The other party may have been saved the expense of employing someone else to do the work and may thereby be enriched at the first party's expense if there is no provision for payment for the work received.

4.33 It would clearly be unjust to leave the disadvantaged party in such unbalanced situations without a remedy. The problem is to find the best way of doing that. There has been a good deal of discussion of this problem in the legal literature.⁶⁰

4.34 The rule that rescission does not affect accrued rights goes some way to redress unbalanced situations but it cannot solve all the problems. The contract may be brought to an end by rescission at a time when benefits have been received on one side but no corresponding rights have accrued on the other. Nor is the problem completely solved by the law on damages for breach. Damages provide no remedy at all for the party who is in breach of contract, if the other party is not in breach.

Example. X has contracted to pave Y's front garden for a price of £1800 payable within 28 days after completion. £1800 is in accordance with the going rate for that type of work. The job has to be completed by 10th June when the paved area is needed for car parking for a function at Y's house. The paving will reduce the value of Y's property but Y wants it done. On 7th June when the job is one third done X informs Y that he cannot complete it. Y rescinds the contract and employs Z to finish the job. Because of the short notice Y has to pay Z £200 more than the going rate for such work and agrees to a price of £1400. X cannot sue for the price because the contract is at an end and no right to the price had accrued before rescission. He cannot sue for

⁵⁸ Under the Sale of Goods Act 1979 s 36 the buyer who rejects goods, having the right to do so, is not bound to return the goods to the seller but must intimate the non-acceptance to the seller so that the seller can collect the goods.

⁵⁹ The seller would not need to rescind in this situation but could sue for the price. However, a natural reaction by a seller who was not legally advised would be to say "All right, return the goods and we'll regard the contract as ended."

⁶⁰ Eg R Evans-Jones, "Unjust enrichment, contract and the third reception of Roman law in Scotland" (1993) 109 LQR 663; W J Stewart, "Restitution, non-materialisation and contract in Scotland" 1993 JR 318; H L MacQueen, "Unjustified enrichment and breach of contract" 1994 JR 137; J A Dieckmann and R Evans-Jones, "The dark side of Connelly v Simpson" 1995 JR 90; W J Stewart, "Contract v Restitution" in *The Law of Restitution in Scotland, A Supplement* (1995) 62 para 12E; G D MacCormack, "The *condictio causa data causa non secuta*" in R Evans-Jones (ed), *The Civil Law Tradition in Scotland* (1995) 253; H L MacQueen and W D H Sellar, "Unjust Enrichment in Scots Law," in E J H Schrage (ed), *Unjust Enrichment* (1995) p 289; W D H Sellar, *Unjust Enrichment* in Stair Memorial Encyclopaedia vol 15 paras 10-86; H L MacQueen, "Contract, unjustified enrichment and concurrent liability: A Scots perspective" 1997 Acta Juridica 176 reprinted in F Rose (ed), *Failure of Contracts* (1997) p 199; R Evans-Jones and P Hellwege, "Some observations on the taxonomy of unjustified enrichment in Scots Law," 1998 ELR 180.

damages because Y is not in breach. Yet Y has been enriched because he has been saved the expense of paying for a third of the paving work. Justice, it might be thought, would be done by allowing X to claim £600 for the work done⁶¹ and by allowing Y to set against that his claim for damages for the excess cost of employing Z – that is, the £200 that he had to pay Z over and above the rate charged by X – and for any other costs incurred as a result of the breach of contract.

Damages may not even provide a satisfactory solution in the case where the aggrieved party is the party who has made the part performance under the contract before it is rescinded.

Example. X has agreed to supply goods to Y at a price of £1800. £600 is to be paid in advance and the remainder on delivery. X knows that Y has made an exceptionally bad bargain. X could make a good profit by supplying the goods but he soon sees a chance to make an even better profit by selling the goods to another gullible purchaser for £1800. He repudiates the contract with Y before delivery. Y rescinds the contract, buys equivalent goods elsewhere for £1200 and claims the return of the £600 paid in advance to X. X refuses to repay. He argues that Y is only entitled to damages and that, as he has obtained equivalent goods for £1200, he has got what he wanted for a total expenditure of £1800. If the contract had been duly performed Y would have had to pay £1800. Y has suffered no loss and is therefore entitled to no damages.⁶² This result seems unsatisfactory. It is one thing to say that if X has made a good bargain he is entitled to his profit on performing the contract. It is quite another to say that if X has made a good bargain he can realise a quick profit by deliberately not performing the contract. X has been enriched at Y's expense and has done nothing in return.

4.35 The problem, in short, is that neither the doctrine of accrued rights nor the availability of damages for breach of contract is sufficient to prevent unsatisfactory results in cases where rescission leaves one party in possession of benefits for which the other will not receive the expected counter-performance.

Existing law

4.36 One of the difficulties in stating the existing law with any confidence is that both the law on rescission and the law on unjustified enrichment have developed substantially since some of the cases were decided. It is often difficult to fit statements into the conceptual framework which we now have. Another major difficulty is that there are few, if any, decisive authorities but a number of conflicting statements.

4.37 Before the case of *Connelly v Simpson*⁶³ it was widely accepted that a buyer who rejected the property (so that it remained with, or reverted to, the seller) and rescinded the

⁶¹ If X had charged less than the going rate then the reasonable solution would be to limit his claim to the contract rate, and not to allow him the greater amount that Y has saved by not having to pay the going rate to someone else. This would be achieved under the modern law on unjustified enrichment where, on principle, the measure of recovery is the lesser of the loss on one side and the gain on the other. It is only to the extent of the actual contract rate that Y's enrichment is at the expense of X.

⁶² X could go further and argue that even if Y had had to buy goods for £1700 he would have suffered no loss for which damages could have been claimed. Damages are compensatory, not restitutionary and certainly not a mix of both. They are not intended to recover payments which would have been made even if the contract had been fully performed. X could have referred to the Sale of Goods Act 1979 s 51 (which does not appear to include any restitutionary element) and to *Connelly v Simpson* 1993 SC 391.

⁶³ 1993 SC 391.

contract, being entitled to do so, was entitled to repayment of any price paid.⁶⁴ The position of the buyer who had paid and that of the buyer who had not yet paid was thought to be similar, the only difference being that the former had to recover the price whereas the latter could simply not pay it. It was not thought that the buyer who had paid had to enter into the potential difficulties of quantifying damages if all that was required was a return of the price.⁶⁵ More generally, there was reason to suppose that any benefit of a returnable nature, which had been conferred under a rescinded contract in the anticipation of a performance which had not been provided, was recoverable.⁶⁶ Gloag stated the rule quite generally in a passage headed "Rescission of Contract Involves Restitution"⁶⁷

"In cases of breach of contract the party aggrieved has an action for damages, but in addition to this, and whether damages have been suffered or not, he is clearly entitled to recover any part of the price or other consideration which he may have paid."

There was also authority for the proposition that a person who had provided services under a contract which had been rescinded before the emergence of any accrued right to payment for the services, had a right to recover something for the services if the other party had been enriched.⁶⁸ The theoretical basis for the right and the precise measure of recovery were not always clear but the prospects of some recovery for a person who had provided money, property or usable work under a rescinded contract in the anticipation of a counter-performance lost because of rescission were reasonably good.⁶⁹

4.38 The case of *Connelly v Simpson*⁷⁰ must now be considered. It was a complicated case but essentially the pursuer had bought 33 shares in a company which at the time of the purchase had 100 shares. He thought he was buying a third of the equity at a fair price. He paid the price - £16,000 – but, for his own reasons, asked for the transfer to be delayed until

⁶⁴ *McCormick & Co v Rittmeyer* (1869) 7 M 854 at 858; *Duff & Co v The Iron and Steel Fencing and Buildings Co* (1891) 19 R 199. The Sale of Goods Act 1979 specifies measures of damages which do not read as if they include repayment of price (ss 51 and 53A(1)) but makes it clear that the Act does not affect the "right...to recover money paid where the consideration for the payment of it has failed"(s 54). The buyer will not, however, be entitled to repayment of a deposit which was intended to remain with the seller no matter what happened to the contract: *Commercial Bank of Scotland v Beal* (1890) 18 R 80; *Roberts & Cooper v Salvesen & Co* 1918 SC 794; *Zemhunt (Holdings) Ltd v Control Securities plc* 1992 SC 58.

⁶⁵ Lord President Inglis in *McCormick & Co v Rittmeyer* (1869) 7 M 854 at 858 stated the law as follows. "When a purchaser receives delivery of goods as in fulfilment of a contract of sale, and thereafter finds that the goods are not conform to order, his only remedy is to reject the goods and rescind the contract. If he has paid the price, his claim is for repayment of the price, tendering re-delivery of the goods..." Now, of course, the purchaser can also retain the goods and claim damages. Sale of Goods Act 1979 s 15B; Contract (Scotland) Act 1997 s 3.

⁶⁶ *Watson v Shankland* (1871) 10 M 142 at 152 by Lord President Inglis; *Cantiere San Rocco v Clyde Shipbuilding and Engineering Co* 1923 SC (HL) 105 (a case where the contract was ended by frustration but which contains some quite general statements); *Rohitas Industries Ltd v Urquhart Lindsay and Robertson Orchar Ltd* 1950 SLT (Notes) 5; *Lloyds Bank v Bamberger* 1993 SC 570 at 573 by Lord Justice-Clerk Ross.

⁶⁷ *Contract* 59 – 60.

⁶⁸ *Ramsay & Son v Brand* (1898) 25 R 1212 (the report at (1898) 35 SLR 927 is better); *Steel v Young* 1907 SC 360; *Forrest v Scottish County Investment Co Ltd* 1915 SC 115; 1916 SC (HL) 28; *Graham & Co v United Turkey Red Co* 1922 SC 533; *PEC Barr Printers Ltd v Forth Print Ltd* 1980 SLT (Sh Ct) 118; *Thomson v Archibald* 1990 GWD 26-1438 (where the availability of an enrichment claim was conceded).

⁶⁹ Nowadays the law on unjustified enrichment would probably be regarded as the basis, on the assumption that the rescinded contract no longer provided legal justification for retaining the benefit provided under it in anticipation of a counter-performance. See the general statements on the law of unjustified enrichment in *Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd* 1998 SLT 992 and *Shilliday v Smith* 1998 SC 725. The person who could make use of the work done would be saved the expense of paying someone else to do it and would thereby be enriched.

⁷⁰ 1993 SC 391.

after the completion of divorce proceedings in which he was then engaged. The shares declined drastically in value (allegedly because of actions by the defender who was the controlling mind of the company and who caused the share capital to be increased from £100 to £10,000, thus diluting the value of the shares sold) and then the company got into difficulties and went into voluntary liquidation. The liquidator offered the pursuer £400 being the value of a one-third interest in the company. The pursuer rejected the offer and returned the cheque sent. The pursuer then sought repayment of the price. The pleadings changed in the course of the case. Originally the pursuer concluded for (a) reduction of the contract on the ground of fraud, and repayment of the £16,000 with interest or, alternatively (b) a declarator that the pursuer was entitled to treat the contract as at an end because of material breach by the defender, and repayment of the £16,000 with interest. These conclusions were, however, abandoned in the course of the case. The case was decided by the Inner House on the basis of a simple conclusion for payment of £16,000 with interest, founded on unjustified enrichment and, more specifically, on the *condictio causa data causa non secuta*. It was not argued that the contract was terminated by frustration. It was not argued that the pursuer's conduct in concealing assets for the purpose of the divorce proceedings disentitled him to a remedy. There was no claim for damages, but only a claim for restitution. The action failed. Lord McCluskey said this.⁷¹

"I can find nothing which is explicit authority for the view that a person who has paid in advance of performance the sum of money which will be due in respect of performance but has agreed that there should be no performance until after a significant period of time, can claim anything other than damages when, the time for performance having arrived, the other party, in breach of contract, declines to perform or is unable to do so because, by his own actions, he has put it beyond his power to perform his part of the contract. Leaving aside the other remedies which might arise following a breach of contract, the only remedy available to a person for breach of contract, if he seeks a monetary remedy, is to claim damages which will compensate him for his loss... I see no room, in a breach of contract case... for a remedy in the form of restitution of the price as such."

Lord McCluskey added that damages would be calculated by reference to the value of the thing which fell to be delivered, calculated at the date when delivery was due under the contract. Lord Sutherland, who gave the other majority opinion, drew a distinction between "an advance towards the price" (the price being due at a later date) and a "payment of the price" (the payment being due when it was made). The former would be recoverable if the counter-performance, for whatever reason, did not occur. The latter would not be. In this case the pursuer was seeking to recover a payment of the price which was due when it was made, not an advance towards a price which would only have been due on delivery. The test was whether payment was made early, not whether payment was made for a performance which was not received and would not be received because the contract had come to an end. Lord Brand dissented. He said

"It seems to me to be no more than common sense that a vendor who has been fully paid but is unable to fulfil his obligation under the contract should be liable to make restitution of the price."⁷²

⁷¹ At 407C – 408A.

⁷² At 415F.

He considered that the authorities supported the view that "money paid in purchase", and not just advances made before payment was due, could be recovered.

4.39 A few months after *Connelly v Simpson* Lord Justice-Clerk Ross said this in relation to the effects of rescission of a contract for the sale of land or goods.⁷³

"Under our law, a seller who rescinds such a contract of sale, cannot retain advances or instalments of the price that he has received, but is required to repay these to the purchaser unless the payment falls to be regarded as a deposit."

There is no trace here of the distinction between "advances" made before the obligation to pay has accrued and "payments" made before counter-performance has been received. The distinction is between deposits, intended to be forfeitable whatever happens, and other payments.

Assessment

4.40 There was a poetic justice in the result in *Connelly v Simpson*. The pursuer's plan to make his assets seem less for the purpose of his divorce succeeded better than he expected. The result is also legally unsurprising if the case is read as one in which, a contract being un-reduced and unrescinded, a party who had made a bad bargain was seeking to recover the price on principles of unjustified enrichment.⁷⁴ So long as a contract remains in being, the rights of the parties under it are regulated by it.⁷⁵ Any enrichment enjoyed by one party as a result of the contract cannot be legally unjustified. The contract provides a legal ground which justifies the retention of the benefit.⁷⁶ But if the case is read as laying down a general rule that a buyer who rescinds is confined to a claim for damages assessed by reference to the value of the property at the time when delivery is due, and cannot recover any price paid for a performance which will not be received, it leaves the law of Scotland in an unsatisfactory state. This can readily be demonstrated by an example.

X sells a car to Y for £16000, the price to be payable at once but delivery to be in a week when certain extras have been fitted. Y pays the price. X then strips the car of all its parts and almost all its value and offers Y a wreck worth £400. Y regards this as a material breach of contract on X's part. He rescinds the contract and claims the return of his £16000. X offers damages of £400, founding on *Connelly v Simpson*.⁷⁷

⁷³ *Lloyds Bank plc v Bamberger* 1993 SC 570 at 573F. The case was concerned with the question whether a seller who rescinded could claim interest on the price which would have been due had the contract not been rescinded. It turned on a construction of the contract. A right to interest had not accrued and interest was not recoverable.

⁷⁴ See MacQueen, "Contract, Unjustified Enrichment and Concurrent Liability" in *The Limits of the Law of Obligations* (Visser, ed, 1997) 176 at 195 – 196. It is not clear that the case can be read in this way. The report is surprisingly vague on the questions of material breach and rescission, but it would seem to be unrealistic to suppose that the contract had not been rescinded. The pursuer stated in his pleadings, at 394B, that the defender was in material breach and the pursuer therefore "regards the contract ...as at an end." See Dieckmann and Evans-Jones, "The Dark Side of *Connelly v Simpson*" 1995 JR 90.

⁷⁵ *ERDC Construction Ltd v H M Love & Co* 1995 SLT 254 at 262.

⁷⁶ See *Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd* 1998 SC 725 at 348 – 349 – "A person may be said to have received unjustified enrichment at another's expense when he has obtained a benefit from his actings or expenditure, without there being a legal ground which would justify him in retaining that benefit, and it is in accordance with equity that he should account for that enrichment." See also *Shilliday v Smith* 1998 SC 725 at 734E.

⁷⁷ See, in particular, Lord McCluskey at 407F – "If...the value of the thing, delivery of which has been contracted for, has fallen substantially then the damages will be equal to the value of the article as at the date when, in terms

It cannot be right that Y can claim only damages of £400. Even if it is assumed that damages should be assessed on the basis of what Y would have to pay for a similar car on the open market, it still does not seem right that Y should be put to the difficulty of quantifying damages and that he should have to accept the risk of getting less back from X than he paid. The Sale of Goods Act 1979 may prevent such results in the case of corporeal moveables⁷⁸ but that just means that the law is incoherent because one rule applies to goods and another to other types of property.

4.41 The law also seems to be made incoherent in other respects. It seems that a seller must repay instalments of the price if the seller rescinds⁷⁹ but not, in situations covered by *Connelly v Simpson*, if the buyer rescinds.⁸⁰ The innocent seller is in a worse position than the seller who is in breach. If *Connelly v Simpson* applies to situations other than sale, such as contracts to do work, then it seems that a contract breaker can recover on the basis of unjustified enrichment when a contract is terminated by rescission but the aggrieved party cannot. The aggrieved party is confined to a claim for damages which may be less valuable.

4.42 *Connelly v Simpson* leads to arbitrary results. A great deal is made to depend not only on when payment is made but also on the precise basis on which it is made. If the contract says that the price is payable on performance but that an advance would be appreciated, the rescinding buyer need not pay anything and can recover the advance. If the contract says that the price is to be payable partly in advance of performance and partly on performance the buyer cannot recover the part paid in advance under the contract. A buyer who has not paid is in a stronger position than a buyer who has. If the pursuer in *Connelly v Simpson* had not paid for the shares, even if he had been in breach of contract in delaying payment for years, he would not have had to pay anything, it being accepted by the court that the seller was not able to fulfil his contract.⁸¹ The message is clear. "Always pay late. Never perform first." Whether sending out such a message is economically or morally sound may be doubted.

4.43 It is not only in Scotland that there has been difficulty in knowing how, and on what theoretical basis, to redress imbalances arising from rescission.⁸² A thesis could be written on the subject. For the purposes of possible statutory reform of the law on remedies for breach of contract, however, there are two main questions. Should this matter be dealt with in the law on remedies for breach of contract at all, or should it be left to the law on unjustified enrichment? If it should be dealt with as part of the law on remedies for breach of contract, what rules would be appropriate?

of the contract, it should have been delivered, even although that value is materially less than the contract price which has already been paid."

⁷⁸ S 54 makes it clear that the buyer's right to damages does not prevent recovery of money paid where the consideration for the payment of it has failed.

⁷⁹ *Lloyds Bank plc v Bamberger* 1993 SC 570.

⁸⁰ *Connelly v Simpson* 1993 SC 391.

⁸¹ Lord McCluskey concluded at 408D that at the time when the shares fell to be transferred the seller "could not then offer what he had promised".

⁸² See Zimmermann, "Restitution after termination for breach of contract in German law"; MacQueen, "Contract, unjustified enrichment and concurrent liability: a Scots perspective"; Hutton, "Restitution after breach of contract: Rethinking the conventional jurisprudence"; all in *The Limits of the Law of Obligations* (Visser, ed, 1986) at 121, 176 and 201 respectively.

Leave to the law on unjustified enrichment?

4.44 There is much to be said for the view that the redress of imbalances arising out of rescission should be left to the law on unjustified enrichment. That law now rests on a new, more general, foundation – the principle that redress is due where one person is enriched at the expense of another without legal justification⁸³ - and there is no reason why it should not be developed judicially or by statute on that basis so as to provide satisfactory and coherent solutions to the problems under consideration here.⁸⁴ Various general problems have to be solved by the law on unjustified enrichment - including what counts as enrichment,⁸⁵ the measure of recovery,⁸⁶ possible bars to recovery and equitable defences. There is no need to do this work twice, once in enrichment law and again in contract law. There is a danger that any truncated rules on restitution of benefits or remuneration of services enacted as part of a statutory provision on remedies for breach of contract would lack some necessary refinements. There is also a danger of incoherence in the law because it is not only by virtue of rescission that contracts may come to a premature end leaving similar problems to be resolved. They may come to an end because one party exercises a right to resile. They may be frustrated.

4.45 Against this it could be said that it may take some time for the law on unjustified enrichment to develop, that the law on unjustified enrichment would probably have to have rules for rescinded contracts in any event,⁸⁷ that there are identifiable difficulties when contracts are rescinded and that there is no reason why these difficulties should not be addressed as part of a reform of the law on remedies for breach of contract. Regulation of a remedy is not complete if it leaves the potential for frequent injustices in its wake.

4.46 A subsidiary question is whether, if the solution to problems of imbalance after rescission were left to the law on unjustified enrichment or regulated by provisions in a contract statute, anything should be done about claims for reasonable remuneration on the basis of what has been earned – the so-called *quantum meruit* rule.⁸⁸ There is authority to the effect that if a contractor rescinds a contract after work has been done under it the contractor has a claim for remuneration *quantum meruit*.⁸⁹ If these claims had been based on unjustified enrichment, the argument being that the other party had been enriched by being saved the expense of paying for the work at ordinary or market rates, there would be no problem.⁹⁰

⁸³ *Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd* 1998 SLT 992; *Shilliday v Smith* 1998 SC 725.

⁸⁴ The problems caused by rescinded contracts are, for example, addressed in the Draft Rules on Unjustified Enrichment appended to the Scottish Law Commission's Discussion Paper on *Judicial Abolition of the Error of Law Rule and its Aftermath* (DP No 99, 1996).

⁸⁵ In the present context an important point is that a person can be enriched by being saved an expenditure. Stair I.8.8. If, for example, a contractor does work under a contract and the contract is rescinded it will be important to ask whether the other party is or is not saved expenditure because of the contractor's work. If the work has to be done again from the beginning, there will be no enrichment. If it, or some part of it, is used, and expenditure saved, there will be enrichment.

⁸⁶ Where the unjustified enrichment results from A's being saved expenditure by receiving B's services, an appropriate measure of recovery would, on principle, be the lesser of A's gain and B's loss. A's gain is the amount saved by not having to pay for the services at the going market rate. B's loss is the amount lost by not being paid at the contract rates. It is only the lesser of these amounts which represents A's enrichment at B's expense.

⁸⁷ If only to make it clear that a rescinded contract would not provide legal justification for benefits transferred under it in anticipation of a performance which would not, after rescission, be received.

⁸⁸ See Wolffe, "Contract and recompense: *ERDC Construction Ltd v H M Love & Co*" (1997) 1 E L R 469 – 479.

⁸⁹ The cases are considered in *ERDC Construction Ltd v H M Love & Co* 1995 SLT 254 at 262. This case re-affirmed that there can be no claim on the basis of *quantum meruit* so long as the contract remains unrescinded.

⁹⁰ Note that the law on unjustified enrichment is sufficiently adaptable to ensure that the contract rates would provide a ceiling on the claim (because only to that extent would the defender be enriched at the expense of the

The claims would fit into the law on unjustified enrichment. The difficulty is that so-called *quantum meruit* claims have been presented and considered as if they were made on a different and independent basis. As sometimes happens, Latin tags have taken on a life of their own. *Quantum lucratus* has come to signify a claim under the law on unjustified enrichment and *quantum meruit* a claim on some sort of contractual basis, never very clearly identified. Sometimes *quantum meruit* claims are said to be based on implied contract⁹¹ but it is difficult to imply a contract in fact when the parties have been proceeding under an express contract. Unless the claims are based on unjustified enrichment, which is not spelled out in the authorities, it seems that they must be regarded as being based on an independent rule of law. The result is over-provision for the situation. There is no need for overlapping remedies.

4.47 Our preliminary view is that all these matters would be better left to the law on unjustified enrichment, it being made clear that a claim for redress of unjustified enrichment is available to both parties on rescission notwithstanding the decision in *Connelly v Simpson*⁹² and that a rescinded contract does not provide legal justification for the retention of benefits conferred in the expectation of a counter-performance lost by the rescission, but it may be that others may think differently. It may be useful, therefore, to consider the rules found in recent international instruments on contract law.

International models

4.48 The Vienna Convention provides that

"A party who has performed the contract either wholly or in part may claim restitution from the other party of whatever the first party has supplied or paid under the contract. If both parties are bound to make restitution, they must do so concurrently."⁹³

In one respect that is a fairly restricted solution. It does not apply to services or other non-returnable benefits, as is only to be expected in a Convention on sale of goods. In another respect the solution is perhaps wider than necessary because it appears to give a right to restitution in both directions even where the part performances balance each other. The solution would not seem to be suitable as a general model.

4.49 The Unidroit *Principles* have a slightly longer provision.

"(1) On termination of the contract either party may claim restitution of whatever it has supplied, provided that such party concurrently makes restitution of whatever it has received. If restitution in kind is not possible or appropriate allowance should be made in money whenever reasonable.

pursuer) and that the pursuer could not claim for unrequested work thrust on the other party (because a party cannot deliberately and knowingly force another into an enrichment obligation by doing work which has not been asked for and then charging for it: *Varney (Scotland) Ltd v Lanark Town Council* 1974 SC 245).

⁹¹ *PEC Barr Printers Ltd v Forth Print Ltd* 1980 SLT (Sh Ct) 118.

⁹² It goes without saying that a person who recovers the price under the law on unjustified enrichment should not be entitled to damages on the footing that the price had been paid. Recovery of the price places the payer in the same position with regard to a claim for damages as a person who has not paid in advance.

⁹³ Art 81(2).

(2) However, if performance of the contract has extended over a period of time and the contract is divisible, such restitution can only be claimed for the period after termination has taken effect."⁹⁴

This is more suitable as a general model but again the concentration on restitution makes it less suitable than it might be for dealing with remuneration for services provided. Also, it is not clear that paragraph (2) draws the dividing line at the best point. The important question is whether a part performance under a divisible contract has been met by a counter performance, not whether the period covered by the obligation was before or after the date of termination.

4.50 The European *Principles* have three articles on the subject.⁹⁵

"On termination of the contract a party may recover money paid for a performance which he did not receive or which he properly rejected.

On termination of the contract a party who has supplied property which can be returned and for which he has not received payment or other counter-performance may recover the property.

On termination of the contract a party who has rendered a performance which cannot be returned and for which he has not received payment or other counterperformance may recover a reasonable amount for the value of the performance to the other party."⁹⁶

4.51 It seems to us that, if it were thought appropriate to regulate these matters in a statute on contract law, rather than leave them to the law on unjustified enrichment, the rules in the European *Principles* would provide a suitable basis for further development of the law. They would certainly be clearer, more accessible and more satisfactory than the existing law. Either approach would render a separate right based on *quantum meruit* unnecessary and redundant. It is not, in our view, an objection to either approach that restitution might enable the aggrieved party to escape from a bad bargain. A person who wants to retain the benefits of a good bargain should not repudiate the contract or commit a material breach. It is important that the person who has paid in advance of the other party's performance should not be in a worse position than the person who has not yet paid.

Request for views

4.52 We invite responses to the following questions.

15. Should the redressing of economic imbalances caused by rescission of a partly performed contract be

(a) left to the law on unjustified enrichment, it being made clear that recourse to the law on unjustified enrichment is not precluded by the existence of a claim for damages and that a rescinded contract does not

⁹⁴ Art 7.3.6.

⁹⁵ Arts 4.307, 4.308 and 4.309. The headings and numbers are not reproduced here. Art 4.306 confers a right to reject property on rescission in certain circumstances. This deals with a slightly different problem.

⁹⁶ The Principles give examples of calculation of the benefit which take into account, amongst other factors, the enrichment of one party.

provide legal justification for the retention of benefits conferred in the expectation of a counter-performance lost by the rescission, or

(b) regulated in a statute dealing with reform of the law on remedies for breach of contract?

16. If the redressing of imbalances caused by rescission of a contract were to be regulated by statute, would articles 4.307 to 4.309 of the European *Principles* provide an appropriate model?
17. If either of the above solutions were adopted, should it be made clear that the so-called *quantum meruit* rule (that is, the rule to the effect that a person who has provided work or services under a rescinded contract is normally entitled to reasonable remuneration) is an example of the operation of the law on unjustified enrichment or of the new statutory rule, as the case may be, and is not an independent rule of law?

Part 5 Decree for Payment

Nature of the remedy

5.1 A decree for payment of money due under the contract is the most common, and the most necessary, of all remedies for breach of contract. Unlike the remedies of suspension of performance or rescission it is a judicial remedy. Like specific implement it is designed to compel performance rather than obtain damages for non-performance. The differences between a decree for payment and a decree for specific implement are technical. A decree for payment of a sum due under the contract is executed by the forms of diligence appropriate to the enforcement of pecuniary debt, including arrestment of funds or pouncing and sale. A decree of specific implement relates to an obligation *ad factum praestandum* (that is, an obligation to do something other than pay money) and is enforceable by imprisonment (subject to statutory restrictions) or alternative sanctions, including payment of a sum of money.¹ A decree for payment is normally available as of right. The court has more discretion as to the granting of a decree of specific implement.²

Definition

5.2 There is not usually any difficulty in identifying what is an action for payment although occasionally problems may arise. The case of *Mackenzie v Balerno Paper Mill Co*³ is one example. In that case, the pursuers sought to enforce a decree in an action of count, reckoning and payment ordaining consignation of money. This case turned on the interpretation of a provision of the Debtors (Scotland) Act 1880⁴ which, in short, abolished imprisonment for debt but retained the sanction in respect of decrees and obligations *ad factum praestandum*. The court held by a majority that the order in question was one *ad factum praestandum* and accordingly did not fall within the abolishing words of the statute.

"A decree for consignation is, in its essential nature, a decree for depositation, not a decree for payment."⁵

This case was exceptional and we are not aware of any need to define what is meant by an action for payment.

Assessment of existing law

5.3 There is no doubt that an action for payment of money due under a contract should be readily available. In general, the law seems to be satisfactory. There are, however, two possible defects in the law which may require legislative attention.

¹ Law Reform (Miscellaneous Provisions) (Scotland) Act 1940 s 1.

² See paras 6.2 – 6.7.

³ (1883) 10 R 1147.

⁴ S 4.

⁵ (1883) 10 R 1147 at 1153.

5.4 The first is that an action for payment of a sum due under the contract may be abused in cases where one party, being in a position to perform without co-operation from the other, is informed that the other party no longer wants performance but nonetheless continues to provide unwanted performance in order to raise an action for payment of the full contract price as of right at the date when payment becomes due.⁶

5.5 The second is that there may be a technical, and probably unnecessary, restriction on actions for payment of the price due under building contracts to the effect that the cost of any rectification required must be deducted from the price sued for.⁷ Although in many cases this works in a perfectly reasonable way, there are cases where it would be grossly unreasonable to insist on rectification and where the rule, if rigidly applied, could produce unjust results.

Payment for unwanted performance

The existing law

5.6 The leading case is *White & Carter (Councils) Ltd v McGregor*.⁸ The case involved a contract for the display of advertisements of the business of a Clydebank garage for three years. In 1954 there had been an agreement to display the advertisements. In 1957 there was a further three year contract, which became the subject of the dispute. The second contract was made by the sales manager of the garage but on the day it was made the defender William McGregor wrote to the pursuers to cancel the contract. The pursuers refused to accept this cancellation and the advertisements were displayed. The pursuers successfully brought an action for the price due under the contract.

5.7 Because *White & Carter (Councils) Ltd* involved a party who did not claim damages, but instead the price due under the contract, the rules on mitigation of loss did not apply. The result was wasted and unwanted performance.⁹ Lord Keith, dissenting, gave the example of the expert who goes to Hong Kong and prepares a report for a fee of £10,000, knowing from the beginning that the report is no longer wanted.¹⁰ Many similar examples could be given.

5.8 A possible qualification of the rule affirmed in *White & Carter (Councils) Ltd* may be recognised if the pursuer had no "legitimate interest" in performing. Lord Reid left this possibility open when he said:¹¹

"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."

This has enabled *White & Carter (Councils) Ltd* to be distinguished in England when it has appeared that full performance of the contract was wasteful.¹²

⁶ The most famous illustration of the problem is *White and Carter (Councils) Ltd v McGregor* 1962 SC (HL) 1.

⁷ *Ramsay v Brand* (1898) 25 R 1212.

⁸ 1962 SC (HL) 1.

⁹ Treitel, *Contract* 915-918; Burrows, *Remedies for Torts and Breach of Contract* (2nd ed, 1994) 318-322.

¹⁰ 1962 SC (HL) 1 at 24.

¹¹ 1962 SC (HL) 1 at 14.

5.9 The problems were illustrated again in *Salaried Staff London Loan Company Ltd v Swears and Wells Ltd*.¹³ Tenants under a 35 year lease repudiated the lease after 5 years. The landlords refused to accept the repudiation and held the tenants to their contract. The tenants were sued for rent and service charges for a period of nearly a year subsequent to the repudiation. The landlords' action succeeded, the tenants having failed to aver any circumstances which would have justified the court in refusing the landlords' remedy. Could the landlords have sued each year for the decades remaining of the term of the lease? Lord President Emslie said:¹⁴

"If the pursuers continue to maintain the contract and continue to sue for payment of unpaid rent in subsequent actions it may well be that different considerations will then arise."

Similar reservations were expressed by Lord Cameron¹⁵ and Lord Ross, who referred¹⁶ to the possibility that

"it might be inferred that it would be manifestly unjust or unreasonable to allow the pursuers to continue suing for rent".

This leaves open, and uncertain, the circumstances in which a claim for rent would be barred.

5.10 The rule in *White & Carter (Councils) Ltd* operates only when, as in that case, one party could perform without the co-operation of the other party. The advertisements were placed on litter bins. The pursuers could perform without the assistance of the garage. It would presumably have been a different matter if it had been the first contract between the parties and the garage had been required to provide the material for the advertisement. The pursuers would have had no option but to seek damages. It is difficult to defend a principle which turns on the distinction between contracts which require the co-operation of the other party for performance, and those which do not.¹⁷ It should not, however, be thought that contracts which can be performed with no assistance from the other party are unusual. In a commercial lease the landlord may be able to comply with the landlord's obligations with no assistance from the tenant.¹⁸ The position may sometimes, but not necessarily always, be similar with the hire of equipment or the charterparty of a ship.¹⁹

5.11 There is, in the existing law, a conflict between two principles or assumptions -

- contracts should be performed

¹² *Attica Sea Carriers Co v Ferrostaal Poseidon Bulk Rederei GMBH* [1976] 1 Lloyd's Rep 250; *Clea Shipping Co v Bulk Oil International Ltd (The Alaskan Trader)* [1984] 1 All ER 129.

¹³ 1985 SC 189.

¹⁴ At 194.

¹⁵ At 197.

¹⁶ At 199.

¹⁷ Scott [1962] CLJ 12 at 14.

¹⁸ See *Salaried Staff London Loan Co Ltd v Swears and Wells Ltd* 1985 SC 189.

¹⁹ See *Attica Sea Carriers v Ferrostaal Poseidon Bulk Rederei GMBH* [1976] 1 Lloyd's Rep 250 (where Orr LJ thought that one party required the co-operation of the other in order to fulfil the contract) and *Clea Shipping Co v Bulk Oil International Ltd (The Alaskan Trader)* [1984] 1 All ER 129 (where this point was left open).

- one party should not be allowed, by wasteful or unreasonable conduct, to increase the burden on the other party.²⁰

Judges²¹ and commentators²² are not unanimous on which should rule.

Criticism

5.12 The law is uncertain. It is not clear how far exceptions to the rule laid down in the *White and Carter (Councils)* case can be, or will be, recognised. Unless some adequate exception is recognised the law will allow one party to increase the burden on the other by wasteful or unreasonable conduct.

Options for reform

5.13 The first option would be to do nothing. The general principle would remain as laid down in *White and Carter (Councils) Ltd v McGregor*. The courts would be left to develop exceptions based on absence of a legitimate interest in rendering unwanted performance. This would do nothing in the short term to remove existing uncertainty.

5.14 A second option would be to restore the law to the position it was in prior to the decision of the House of Lords in the *White and Carter (Councils)* case.²³ Unfortunately, however, just what that law was is not entirely clear. It seems to have involved the proposition that an aggrieved party who did not accept a repudiation could not perform the contract after repudiation and seek payment of the price or specific implement,²⁴ except in special circumstances. If this means that a repudiation would throw the onus of showing "special circumstances" on to the aggrieved party it would not be acceptable. In an action for an agreed sum, the onus should fall on the party in breach to show that the aggrieved party has no legitimate and substantial interest to require performance. We would not, therefore, favour a return to the pre-1962 law.

5.15 It might be thought that a third option would be to allow the party who is told that the contract is repudiated, and that further performance is not wanted, to proceed to implement the contract subject to a duty to minimise or mitigate loss. However, such an option makes no logical sense. The performing party is not suing for damages for loss. The claim is for payment under the contract.

5.16 A fourth option would be to give the court a general discretion to refuse to grant a decree for payment where to do so would be unreasonable or inequitable. Clearly, however,

²⁰ In relation to damages this assumption finds expression in the rules on mitigation of loss but we are not here concerned with damages or loss.

²¹ There was a difference of opinion in the *White and Carter (Councils)* case itself. In the Court of Session it was clear that the judges thought there should be no recovery for the unwanted and rejected performance and were content to follow the earlier Scottish case of *Langford & Co Ltd v Dutch* 1952 SC 15, which also concerned cancellation of an advertising contract. In the House of Lords there were two dissents. There has been a subsequent divergence of judicial opinion. *White & Carter* was followed in *Anglo-African Shipping Co of New York Inc v J Mortner Ltd* [1962] 1 Lloyd's Rep 81 and *The Odenfeld* [1978] 2 Lloyd's Rep 357 but distinguished in *Hounslow London Borough Council v Twickenham Garden Developments Ltd* [1971] Ch 233; *Attica Sea Carriers v Ferrostaal Poseidon Bulk Rederei GMBH* [1976] 1 Lloyd's Rep 250 and *Clea Shipping Co v Bulk Oil International Ltd (The Alaskan Trader)* [1984] 1 All ER 129.

²² See citations in Burrows, *Remedies for Torts and Breach of Contract* (2nd ed, 1994), p 319 footnote 1.

²³ 1962 SC (HL) 1.

²⁴ *Langford & Co v Dutch* 1952 SC 15, opinions of Sheriff-Substitute Dobie and the First Division.

such a general discretion would give rise to too much uncertainty in the law. Some more limited solution is necessary.

5.17 A fifth option would be to give the court a strictly limited discretion to refuse to grant a decree for payment in circumstances where the pursuer has insisted, unreasonably, in forcing unwanted performance on the other party. This seems to us to be the most attractive option if any legislative intervention is to occur.

International models

5.18 The European *Principles* have the following article.²⁵

"(1) The creditor is entitled to recover money which is due.

(2) Where the creditor has not yet performed his obligation and it is clear that the debtor will be unwilling to receive performance, the creditor may nonetheless proceed with his performance and may recover any sum due under the contract unless:

(a) he could have made a reasonable cover transaction without significant effort or expense; or

(b) performance would be unreasonable in the circumstances."

This is similar to the fifth option considered above. The starting point is that, notwithstanding a repudiation, a contracting party is entitled to perform in accordance with the contract and to sue for the contract price, but there are exceptions for the cases where there is no legitimate interest in performing rather than rescinding and claiming damages or where performance would be unreasonable.

5.19 The first paragraph of the article merely states the right to recover money due under the contract and is quoted here merely to put the second paragraph in context.

5.20 The reference to a "cover transaction" in paragraph (2)(a) is to a transaction by which the creditor obtains a substitute performance. A common example would be that of a commercial manufacturer of standard goods with a ready market who is able to obtain another buyer without difficulty. The manufacturer could not force unwanted goods on a purchaser and sue for the price. Another example would be that of a landlord whose tenant repudiates a lease which has still many years to run. The landlord could not go on claiming rent for the whole duration of the lease if the subjects could be re-let to another tenant without significant effort or expense. The landlord would, of course, be able to rescind and claim damages for the difference between the rent obtainable from the new tenant (if less) and the rent due under the repudiated contract.

5.21 Paragraph (2)(b) deals with the situation where performance would be unreasonable.²⁶ A typical example would be a case like the *White and Carter (Councils)* case

²⁵ Art 4.101.

²⁶ See also *Clea Shipping Co v Bulk Oil International Ltd (The Alaskan Trader)* [1984] 1 All E R 129, where the court held that the question was simply whether continued performance by one party against the wishes of the other was reasonable in the circumstances.

where, before performance has begun, the party entitled to it says that it is no longer required.

Assessment and request for views

5.22 A rule like that in article 4.101(2) of the European *Principles* appears to us to offer a principled solution and would be our preferred option for reform. We invite views on the following question.

18. **Would there be any advantage in a provision, designed to solve the problem revealed by *White & Carter (Councils) Ltd v McGregor*, along the lines of Article 4.101(2) of the Principles of European Contract Law which provides as follows?**

"Where the creditor has not yet performed his obligation and it is clear that the debtor will be unwilling to receive performance, the creditor may, nonetheless, proceed with his performance and may recover any sum due under the contract unless:

- (a) he could have made a reasonable cover transaction without significant effort or expense; or**
- (b) performance would be unreasonable in the circumstances."**

Deduction of rectification costs

The problem

5.23 The problem with which we are here concerned is encountered in those cases where one party has substantially performed under the contract, the performance is defective but it would be unreasonable to require the defects to be remedied. The question is whether that party should be able to sue for payment, subject to any claim for damages the other party may have.²⁷ It is assumed that the contract is not rescinded.

Example. In building a house, a builder uses a type of cement other than that specified in the contract. The cement used is adequate for the task. The deviation from the contract terms is discovered when the job is completed. The house owner refuses to pay. The builder raises an action for payment.²⁸

The existing law

5.24 There are two obstacles to recovery in the existing law. The first is that the owner may found on the right to suspend payment until the builder performs. We have discussed this obstacle in Part 3 and have suggested that the right to suspend performance should not be available in cases such as this where the contract has been substantially performed subject only to defects which are trivial or which it would be unreasonable to rectify.²⁹ The second

²⁷ Later we make suggestions designed to ensure that the position of the aggrieved party is adequately protected by the right to damages. See paras 8.37 – 8.42.

²⁸ The facts are loosely based on those in the case of *Steel v Young* 1907 SC 360.

²⁹ Para 3.13.

obstacle is that it has been said or assumed that, even if the builder has a right to payment, the amount sued for must be automatically reduced by the cost of rectification.

5.25 The starting point was the case of *Ramsay v Brand*³⁰ in which Lord President Robertson said that if a builder deviated from a contract only in respect of minute details, the right to sue for payment was not lost. The builder was entitled to payment of the price, less whatever sum was required to complete the work in exact compliance with the contract. It is this notion of a compulsory deduction which causes difficulty. *Ramsay* was assumed to state the law correctly in the subsequent case of *Steel v Young*,³¹ although the absurdity of the consequences in certain types of case was noted. *Ramsay* has since been doubted and criticised³² but also followed³³ and never expressly over-ruled. The line of cases beginning with *Ramsay* was subjected to severe criticism in *Stewart Roofing Co Ltd v Shanlin*.³⁴ The Sheriff refused to follow *Ramsay v Brand* and *Steel v Young* on the ground that subsequent cases³⁵ had thrown the law into such confusion that he was entitled to do so. He suggested that it was time for reconsideration of this whole area of the law. In the case before him he held that the cost of rectifying the work would not be unreasonable but added:³⁶

"Had the remedy entailed something quite unreasonable in the way of cost, compared with the total contract price, then I should have had to adopt some other method of quantifying the result..."

Criticism

5.26 The existing law is unclear. If it is the law that the cost of rectification must in all cases be deducted from the amount of the payment³⁷ even if the defects are such that it would be wholly unreasonable to require them to be remedied then the results seem unsatisfactory and unjust. A rigid rule to this effect is also plainly unnecessary. There is no reason why a claim for damages by the aggrieved party should not enable full justice to be done to both parties. We discuss later the way in which damages should be assessed in such cases.³⁸ It should not necessarily be by reference to the cost of rectification. The curious effect of the existing law is that a building contractor would often be better off if the other party rescinded for a material breach (in which case the way would be open to a claim by the contractor for redress of unjustified enrichment) than if the other party upheld the contract and allowed the contractor to sue for payment (in which case there might be no claim at all because the cost of rectification would be so great).

Options for reform

5.27 There appears to be only one reasonable option for reform and that is to make it clear that there is no such rule as that laid down in *Ramsay v Brand*.

³⁰ (1898) 25 R 1212.

³¹ 1907 SC 360.

³² See *Forrest v Scottish County Investment Co* 1915 SC 115 especially by Lord President Strathclyde and Lord Johnston in the Court of Session. In the House of Lords (1916 SC (HL) 28), Lord Parmoor doubted *Steel*.

³³ *Spiers Ltd v Petersen* 1924 SC 428; *Charles Gray and Son Ltd v Stern* 1953 SLT (Sh Ct) 34; *Barr Printers v Forth Print* 1980 SLT (Sh Ct) 118.

³⁴ 1958 SLT (Sh Ct) 53.

³⁵ *Forrest v Scottish County Investment Co* 1915 SC 115 and 1916 SC (HL) 28; *Spiers Ltd v Petersen* 1924 SC 428.

³⁶ 1958 SLT (Sh Ct) 53 at 56.

³⁷ This is, of course, on the assumption that there is a right to payment in the particular case – that is, that the right to suspend performance is not available or is waived. See para 3.13.

³⁸ Paras 8.37 – 8.42.

Request for views

5.28 We invite responses to the following question.

19. **In order to remove doubts and difficulties caused by statements in *Ramsay v Brand* (1898) 25R 1212, would it be useful to provide that there is no rule of law that a party claiming payment under a contract which has been substantially performed, but with defects in performance which cannot reasonably be rectified, must necessarily have subtracted from the payment the cost of rectifying the work? (This would be without prejudice to any claim for damages the aggrieved party may have.)**

Part 6 Specific Implement

Nature of the remedy

6.1 A decree for specific implement of a contractual obligation¹ orders the defender to perform the obligation. If performance of the obligation requires something to be rectified or undone then the defender can be ordered to rectify or undo accordingly. Non-compliance with a decree of specific implement is punishable by various sanctions, including imprisonment and monetary sanctions.² Specific implement is a primary remedy for breach of contract³ and not, as is the equivalent English remedy of specific performance,⁴ a remedy which is not available if damages would be an adequate remedy. In Scotland it is not in the option of the defender to pay damages rather than perform the contractual obligation. There are, however, certain situations in which a decree for specific implement will normally be refused.

When will specific implement be refused?

Decree sought not sufficiently precise

6.2 Specific implement will not be granted unless the decree sought is sufficiently precise for the defender to know what is required for compliance.⁵ This requirement has been tested in a series of recent cases concerning "Keep open clauses" – that is, clauses in commercial leases requiring the tenants to keep the premises open for business of a certain type. After initial hesitations⁶ it appears now to be clear that, although much will depend on the obligations sought to be enforced in particular cases,⁷ the requirement of sufficient precision does not prevent specific implement from being used to enforce performance of the obligations in such clauses.⁸ An order may be flexible in the sense that it specifies the end to be achieved but leaves open the precise means by which the end is to be achieved.⁹

¹ Other than one for the payment of money. See Part 5.

² Law Reform (Miscellaneous Provisions) (Scotland) Act 1940 s 1. Before ordering imprisonment the court must be satisfied that the failure to perform is due to the wilful refusal of the debtor. It is beyond the scope of this paper to consider the effectiveness of the sanctions. That is more a matter for the law of diligence.

³ See *Davidson v Macpherson* (1889) 30 SLR 2; *Stewart v Kennedy* (1890) 17 R (HL) 1 at 10; *Salaried Staff London Loan Co Ltd v Swears and Wells Ltd* 1985 SC 189 at 193, 195-6 and 199.

⁴ *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1997] 3 All ER 297 at 301.

⁵ *Middleton v Leslie* (1892) 19 R 801 at 802; *Lochgelly Iron and Coal Co Ltd v North British Railway Co* 1913, 1 SLT 405 at 414; *Retail Parks Investments Ltd v The Royal Bank of Scotland plc (No 2)* 1996 SLT 669 at 677. A preliminary question is whether the obligation itself is sufficiently precise. If it is too vague it may be void for uncertainty.

⁶ *Grosvenor Developments (Scotland) Ltd v Argyll Stores plc* 1987 SLT 738; *Retail Parks Investments Ltd v The Royal Bank of Scotland plc (No 2)* 1996 SLT 52.

⁷ *Co-operative Insurance Society Ltd v Halfords Ltd* 1998 SLT 90 and 1998 SCLR 11.

⁸ *Retail Parks Investments Ltd v The Royal Bank of Scotland plc (No 2)* 1996 SLT 669; *Co-operative Wholesale Society Ltd v Saxone Ltd* 1997 SCLR 835; *Highland and Universal Properties Ltd v Safeway Properties Ltd* unreported 5 December 1997 (Lord Penrose).

⁹ *Retail Parks Investments Ltd v The Royal Bank of Scotland plc (No 2)* 1996 SLT 669 at 678F.

Performance not possible

6.3 It is clear that a decree of specific implement could not appropriately be granted, and would not be granted, if performance would be impossible.¹⁰

Performance would be of a highly personal nature

6.4 The court will not normally order performance of obligations of a highly personal or intimate nature.¹¹ Specific implement of a contract of employment or partnership would not generally be granted under the common law.¹²

Replacement performance readily available

6.5 A decree of specific implement will be refused if equivalent performance could readily be obtained from another source. The obvious example is a contract for the sale of generic goods which can be readily purchased in the open market.¹³

Decree could not be enforced

6.6 A decree of specific implement would not be granted if it were known in advance that there was no possibility of enforcing it. The main application of this rule used to be in relation to corporate bodies. When the only sanction for breach of a decree of specific implement was civil imprisonment it was settled that a decree would not be granted against such a body.¹⁴ Now, however, that alternative sanctions, including a monetary payment, are also available¹⁵ there is no reason why a decree for specific implement cannot be granted against a company or other body corporate.¹⁶

Enforcement would cause exceptional hardship or injustice

6.7 The court has a residual discretion to refuse a decree of specific implement if "very cogent"¹⁷ circumstances would make enforcement "inconvenient and unjust"¹⁸ or "hard".¹⁹

Interim remedy

6.8 It would be a serious defect in the remedy of specific implement if an interim remedy were not available. At one time it was thought that there was no appropriate interim

¹⁰ *McArthur v Lawson* (1877) 4 R 1134; *Moore v Paterson* (1881) 9 R 337 at 343; *Bell Bros (HP) Ltd v Reynolds* 1945 SC 213 at 216.

¹¹ *McArthur v Lawson* (1877) 4 R 1134 at 1136. The example given was a contract to marry but that is now covered by the Law Reform (Husband and Wife) (Scotland) Act 1984, s 1(1).

¹² *McArthur v Lawson* (1877) 4 R 1134 at 1136. See also Gloag, *Contract* 657.

¹³ *Davidson v Macpherson* (1889) 30 SLR 2 at 6.

¹⁴ *Lochgelly Iron and Coal Co Ltd v North British Railway Co* 1913, 1 SLT 405 at 414.

¹⁵ By virtue of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1940 s 1. This section is not happily drafted. On one view the applicant would have to apply for a pointless, and unobtainable, warrant for imprisonment before the alternative sanctions could be used. Reform is, however, beyond the scope of this paper.

¹⁶ *Postel Properties Ltd v Miller and Santhouse plc* 1993 SLT 353; *Retail Parks Investments Ltd v The Royal Bank of Scotland plc* (No 2) 1996 SLT 669.

¹⁷ *Grahame v Magistrates of Kirkcaldy* (1882) 9 R (HL) 91 (an interdict case but regarded as providing guidance also in relation to specific implement – see *Salaried Staff London Loan Co Ltd v Swears and Wells Ltd* 1985 SC 189 at 198-199).

¹⁸ *Stewart v Kennedy* (1890) 17 R (HL) 1 at 10.

¹⁹ *Davidson v Macpherson* (1889) 30 SLR 2 at 6.

remedy. Fortunately, it has now been held²⁰ that, although interim specific implement as such is not available, an interim remedy can be obtained under sections 46 and 47(2) of the Court of Session Act 1988 which give the court general powers to make specific orders in proceedings pending before it.²¹ The position in the sheriff courts is unclear.²²

International models

6.9 The Scottish law on specific implement is in line with recent international instruments on contract law. The European *Principles*, for example, contain the following rules.²³

"(1) The aggrieved party is entitled to specific performance of an obligation other than one to pay money, including the remedying of a defective performance.

(2) Specific performance cannot, however, be obtained where:

- (a) performance would be unlawful or impossible; or
- (b) performance would cause the obligor unreasonable effort or expense; or
- (c) the performance consists in the provision of services or work of a personal character or depends upon a personal relationship; or
- (d) the aggrieved party may reasonably obtain performance from another source."

The Unidroit *Principles* contain almost identical provisions.²⁴

Assessment

6.10 It seems to us that the Scottish approach to specific implement is consistent with the over-riding policy of fostering respect for contractual obligations, while avoiding unjust or unreasonable results. It is firmly in line with the approach adopted in modern international instruments on contract law.²⁵ We suggest no change in basic approach.

6.11 The main difficulty has been caused by the requirement of sufficient precision but the law has proved up to the task of enabling commercial obligations to be enforced in a sensible way in accordance with the reasonable expectations of the parties. The difficulties have been, we believe, in the nature of the obligations sought to be enforced rather than in the law itself. It may be, however, that we are wrong in this assessment and that those with

²⁰ *Church Commissioners for England v Abbey National plc* 1994 SLT 959.

²¹ S 46 provides: "Where a respondent in any application or proceedings in the Court, whether before or after the institution of such proceedings or application, has done any act which the Court might have prohibited by interdict, the Court may ordain the respondent to perform any act which may be necessary for reinstating the petitioner in his possessory right, or for granting specific relief against the illegal act complained of". (Emphasis added). S 47(2) provides: "In any cause in dependence before the Court, the Court may, on the motion of any party to the cause, make such order regarding the interim possession of any property to which the cause relates, or regarding the subject matter of the cause, as the court may think fit."

²² There are a few cases on special types of order such as interim orders for consignation. See Macphail, *Sheriff Court Practice* (2d edn, 1998) para 21.79. But it would be surprising if the sheriff courts had, at common law, greater powers than the Court of Session.

²³ Art 4.102.

²⁴ Art 7.2.2.

²⁵ See the European *Principles* art 4.102; the Unidroit *Principles* art 7.2.2.

experience of recent commercial cases in this area will be able to suggest legislative improvements.

6.12 The only other problem which might merit legislative attention is the question of an interim remedy. It does not seem entirely satisfactory that resort has to be had to rather unclear provisions in order to provide an interim remedy. There could be some advantage in making a remedy of interim specific implement expressly available as such.

Request for views

6.13 We invite views on the following.

20. **Is there any need for greater clarity as to the circumstances in which a decree of specific implement will or will not be granted?**
21. **Should there be express provision enabling interim decrees of specific implement to be obtained?**

Part 7 Interdict

Nature of interdict

7.1 An interdict is a court order prohibiting something. It is widely used in many contexts. In the context of breach of contract interdict can be used to prohibit conduct which would be a breach, or a continuation of a breach, of the contract.¹ Interdict is a preventive measure rather than a remedy for a wrong that has already been done.² Breach of interdict is punishable by the sanctions for contempt of court, including imprisonment or fine.³ Interim interdict may be granted to preserve the existing position until matters are resolved. In granting or refusing interim interdict the judge of first instance has a large discretion, the principal criterion being the balance of convenience.⁴

Scope of discussion

7.2 It is beyond the proper scope of a discussion paper on remedies for breach of contract to consider the law on interdict in general.⁵ Our concern here is with one particular problem – namely, that uncertainty has been caused by attempts to use interdicts and interim interdicts in breach of contract cases to achieve the same results as specific implement.⁶ The availability of interim interdict probably explains some of these attempts. It was at one time thought that there was no equivalent interim remedy of a positive nature. There is still no special provision for interim specific implement although, as we have noted, a functional equivalent has now been found in more general provisions for interim remedies in the Court of Session Act 1988.⁷

The law reform question

7.3 From the point of view of possible law reform the question is whether it should be competent to grant an interdict if its effect is to compel something to be done, rather than prohibit something from being done.

Positive and negative interdicts

7.4 Interdict as a contractual remedy may be said to enforce negative obligations, that is, obligations to refrain from doing some act. This may be contrasted with the remedy of specific implement⁸ which can be said to enforce obligations to do some act - positive obligations. This seemingly straightforward distinction between positive and negative

¹ Gloag, *Contract* 655; Stair, I, 17, 16; Bell, *Principles*, sec 29.

² *Hay's Trs v Young* (1877) 4 R 398 at 402; *Earl of Breadalbane v Jamieson* (1877) 4 R 667 at 671; *Church Commissioners for England v Abbey National plc* 1994 SLT 959 at 963C.

³ The court may also order something done in breach of the interdict to be undone. See eg *Grahame v Magistrates of Kirkcaldy* (1882) 9 R (HL) 91.

⁴ *Scottish Milk Marketing Board v Paris* 1935 SC 287.

⁵ The fact that our discussion of this topic is necessarily limited in scope does not mean that we consider that the law in areas other than breach of contract is satisfactory.

⁶ See *Retail Parks Investments v Our Price Music Ltd* 1995 SLT 1161 at 1164.

⁷ See para 6.8.

⁸ See generally Part 6.

obligations would appear to mark an unambiguous boundary between these two remedies. Unfortunately, the reality is that the distinction is at best troublesome and at worst unworkable and confusing.

7.5 Almost any obligation can be framed in positive or negative terms. Add to this the fact that obligations may be couched in negative terms but have a positive result and vice versa, and the failings of the distinction become clear. Lord Prosser summed up the matter.

"To resolve any of these issues it seems to me necessary to scrutinise, and preferably analyse, the distinction, or supposed distinction, between an act and its consequences, between ends and means to ends, between positive conduct and negative conduct or absence of conduct, and between positive obligations to act and negative obligations or obligations to abstain. Each of these distinctions is a conceptual and semantic minefield. To embark on a journey through them all, and hope to come out at the far side as a matter of theory, calls for some courage."⁹

7.6 The facts of cases do not always lend themselves to neat divisions into positive and negative. It has been commented that any attempt to make such distinctions

"seems bound to fail and to divert attention from important issues of legal policy to technical issues as to the form of remedy which are complex, unnecessary and sterile."¹⁰

7.7 To the inherent difficulty of the distinction between negative and positive conduct has been added an entirely unnecessary layer of terminological confusion. This stems from remarks of Lord McLaren in *Wemyss v Ardrossan Harbour Co*¹¹ which were heavily relied upon in *Grosvenor Developments*. The remarks referred to a "negative interdict"¹² which, in that case, referred to an interdict having positive effect. The usage does have a certain logic, based on the thinking that an interdict by its very nature is negative and, therefore, that an interdict which results in positive conduct is a negative or "anti" interdict. Nevertheless, the term is rather confusing. Lord President Hope has described its use as "unfortunate"¹³ while Lord Clyde commented that:

"the shorthand phrase ... the 'negative interdict' is not altogether appropriate and should perhaps be discontinued".¹⁴

7.8 The labels positive and negative could more usefully be applied to the obligation compelled. Even this usage is imperfect given the difficulty of classifying obligations as positive or negative.

Interdicts which bring about positive results

7.9 It is clear that interdicts which are perfectly competent may bring about positive results. A distinction has to be drawn between those interdicts which *effect* positive results and those which in terms *require or compel* positive results. Burn-Murdoch considered that

⁹ *Hugh Blackwood Farms Ltd v Motherwell District Council* - 1988 GWD 30-1290.

¹⁰ N R Whitty, "Positive and Negative Interdicts" 1990 JLSS 35, 453 and 510 at 453.

¹¹ (1893) 20 R 500.

¹² At 505.

¹³ *Church Commissioners for England v Abbey National plc* 1994 SLT 959 at 963EF.

¹⁴ At 970C.

"Many interdicts of unquestionable competence may have a positive reaction".¹⁵ There are many cases in which an interdict prohibiting something will have the effect of strongly persuading the performance of some positive act.

"The interdict may have put the defender into a situation where he had little practical alternative to doing something positive, but nevertheless the interdict itself, reinforced as it is with penal sanctions could be obtempered by merely refraining from the action objected to."¹⁶

7.10 The case of *Waddell v Campbell*¹⁷ is illustrative. In that case, the terms of a feu contract required the vassal to cover the roofs of two tenements with "blue Scotch slates". The superior successfully interdicted the vassal from using anything other than blue Scotch slates, such order having the practical result of "compelling", in the ordinary sense of the word, the performance of the feu contract obligation. The pursuers in *Grosvenor Developments (Scotland) plc v Argyll Stores Ltd*¹⁸ sought to argue that *Waddell* was authority for the proposition that the performance of a contractual obligation will be compelled by a grant of interdict. Lord Kincaid rejected this argument.

"While the effect of the interdict was to compel the vassal to cover with blue Scotch slates, the interdict did not per se and in terms compel him to do so."¹⁹

Lord Jauncey was of the same view:

"... I consider that there is a distinction between those cases in which the effect of the order is to leave a party with little or no practical alternative but to follow a certain course of action and the case where the order requires him to take that action under pain of possible imprisonment."²⁰

The distinction is between those cases where the interdict itself compels action and those in which the existence of the interdict coupled with some other obligation or practical requirement compels action.²¹

The modern case law

7.11 In *Grosvenor Developments (Scotland) plc v Argyll Stores Ltd*,²² the defenders were tenants of the principal premises in a shopping centre owned by the pursuers. The premises were leased and run as a supermarket. The lease contained a provision that the defenders were required to continue in occupation of the premises and to conduct business as a supermarket until the expiry of the lease in January 2016. The defenders gave notice to the pursuers that they intended to cease trading and vacate the premises from January 24th 1987. The pursuers then raised an action for interdict and interim interdict against the defenders from "ceasing to continue to occupy and use the supermarket premises....". At first instance, the Sheriff granted interim interdict. The Sheriff Principal (Caplan)

¹⁵ Burn-Murdoch, *Interdict in the Law of Scotland*, (1993) para 190.

¹⁶ *Grosvenor Developments (Scotland) plc v Argyll Stores Ltd* 1987 SLT (Sh Ct) 134 at 136B.

¹⁷ (1898) 25 R 456.

¹⁸ 1987 SLT 738.

¹⁹ *Grosvenor Developments* at 740L.

²⁰ At 744H.

²¹ The distinction was applied in *Anderson v Pringle of Scotland Ltd* 1998 SLT 754.

²² 1987 SLT 738.

subsequently allowed the appeal of the defenders and recalled the interim interdict.²³ The pursuers appealed to the Court of Session where an Extra Division of the Inner House upheld the decision of the Sheriff Principal and refused the appeal.

7.12 It is perfectly clear that the pursuers sought enforcement of the positive obligation on the defenders to continue to occupy the supermarket premises. However, the interdict sought was framed in negative terms – do not cease to continue to occupy - in effect, a double negative. The court relied on Burn-Murdoch as authority for the proposition that it is the substance rather than the form of interdict which is the important factor in determining competency. Burn-Murdoch stated that:

"No mere juggling with words will render competent a prayer for interdict that is objectionable in substance, and a double-negative will not be allowed to cloak a positive order."²⁴

7.13 All three judges in *Grosvenor* considered the interdict sought to be too imprecise.²⁵ Lords Kincaig and Jauncey, in reaching this view, did so by reference to the criteria for specification and precision of specific implement.²⁶ This illustrates the close proximity of the remedies.

7.14 Two modern cases decided before *Grosvenor* illustrated the fine distinction between an incompetent interdict and a competent interdict.

7.15 In *Keeney v Strathclyde Regional Council*²⁷ the pursuer sought to interdict the defenders from transporting his children and others by bus to temporary accommodation, during renovation works at their local school. Apart from consideration of the statutory duty involved,²⁸ Lord Ross, in the Outer House, considered that the petitioner was clearly seeking to compel the local authority to provide schooling locally and expressed the tentative opinion that:

"... it is probably not competent to seek to enforce a positive obligation in this way by interdict."²⁹

Lord Ross's opinion was referred to with approval in the later *Grosvenor* case.³⁰

7.16 This case can be contrasted with *Deane v Lothian Regional Council*³¹ which was heard by the Second Division only two months after *Keeney*. In *Deane*, a parent sought to interdict the local authority from implementing a decision to close a school. In a decision which centred on the grounds for allowing interim interdict and the parents' title to sue, the Second Division held that interim interdict would be granted. Neither the issue of the positive effect of the interdict, nor any question of competency seems to have been discussed. However, the interdict pronounced clearly had the positive effect of compelling the local authority to

²³ Although it should be noted that although the Sheriff Principal recalled the interim interdict as incompetent, he restored the interim order for initially four weeks and thereafter continued it pending the appeal.

²⁴ Burn-Murdoch, *Interdict in the Law of Scotland*, (1933) para 192.

²⁵ See *Grosvenor Developments* at 741E-L, 743F-H, 744L and 745A-E.

²⁶ See *Grosvenor Developments* at 741J-L, 744L and 745A-E.

²⁷ 1986 SLT 490.

²⁸ Education (Scotland) Act 1980, ss 28(1) and 28A.

²⁹ *Keeney v Strathclyde Regional Council* 1986 SLT 490 at 492L.

³⁰ 1987 SLT 738 by Lord Kincaig at 740H and Lord Jauncey at 744J-K.

³¹ 1986 SLT 22.

keep the school open. This was not a case involving a breach of contract and has been distinguished on that ground.³²

7.17 In *Church Commissioners for England v Abbey National plc*³³ a court of five judges confirmed that an interdict, the effect of which is to compel positive action, is incompetent. The defenders were tenants of a retail unit in a shopping centre, under a lease which required them to occupy the premises and run them as a business. The tenants vacated the premises without giving any notice of their intention to do so. In seeking to interdict the defenders "from failing or continuing in their failure" to occupy the premises, the pursuers argued that *Grosvenor Developments* had been wrongly decided and that the breach in question was a continuing breach, repeated every day the tenants failed to open for business and that it was subject to interdict as such. Lord President Hope concluded that *Grosvenor Developments* was correctly decided³⁴ and that in the present case, the Lord Ordinary had been bound to follow *Grosvenor Developments* and that in doing so he had been right to refuse interim interdict. In so finding, Lord President Hope had regard to the "essential nature" of interdict, of which he said:

"[interdict] prohibits action which is threatened or continuing, and it looks to the future not to the past ... It is not the purpose of an interdict to compel the defender to restore the parties to the position which they were in previously, although that may indirectly be its effect."³⁵

He noted that narrow distinctions had to be drawn in this area.³⁶ Lord McCluskey too, recognised that "in practice there may well be grey areas"³⁷ and that in cases which fall into these "grey areas",

"each application for interdict must be considered very carefully in order to see what its true substance is."³⁸

Lord Morison, speaking of the distinction between positive and negative obligations stated that:

"... it is in my view futile for the court to attempt to categorise the obligation, contractual or otherwise, in respect of which the order is sought as being "positive" or "negative" ... any such classification is irrelevant ... The substance of the order, in whatever way it may be expressed, must be to prohibit that activity."³⁹

"... it is anticipated activity in breach of contract which the court can prevent by interdict, not the mere fact that a breach is continuing to occur ..."⁴⁰

If this implies that a continuing breach of contract, presumably whether breach of a negative stipulation or not since the statement is not qualified in any way, cannot be stopped by interdict then it is clearly a point of distinction between contractual and other cases since it is clear that interdict generally is capable of prohibiting an anticipated or continuing illegal act.

³² See *Church Commissioners for England v Nationwide Anglia Building Society* 1994 SLT 897.

³³ 1994 SLT 959.

³⁴ At 963B.

³⁵ At 963C-D.

³⁶ At 963G.

³⁷ At 967C.

³⁸ At 967D.

³⁹ At 967L and 968A.

⁴⁰ At 968B.

Lord Clyde, too, relied on the essential character of interdict in concurring in the decision. However, he noted that:

"At least in matters of contract the court will enforce a contractual obligation unless there are exceptional circumstances making it inequitable to do so."⁴¹

7.18 In another shopping centre case⁴² Lord Gill summarised the results of the cases as follows.

"It is now established that it is not competent to enforce a positive obligation on tenants to trade from premises by interdicting them from ceasing to do so. It is competent, however, to enforce an obligation to keep premises open by interdicting them from vacating the premises."

Criticisms of the existing law

7.19 We have considered the recent cases on interdicts in relation to breach of contract in some detail because only in this way can the difficulties inherent in the present law be fully appreciated. In the world of legal doctrine a distinction has to be drawn between interdicts which in substance prohibit and interdicts which in substance compel. In the real world the question is whether a defender can be prevented from breaching or continuing to breach a contract and blighting a shopping centre. It is a criticism of the law that the questions whether there is a breach of contract and whether it can be prevented by a sufficiently precise order are often submerged in sterile semantic arguments.

Proposal for reform

7.20 The solution seems obvious. Now that the sanctions for breach of interdict and the sanctions available to enforce a decree for specific implement are similar⁴³ it should not matter whether the remedy sought for a proposed or continuing breach of contract takes the form of an interdict or a decree of specific implement. Provided that an interdict is negative in form – as it always would be, because the court will be asked to interdict a person from doing something – it should be competent, even if its effect is to compel performance of a contract.

7.21 There is one necessary proviso. It should not be possible to get round the restrictions on the grant of specific implement by resorting to interdict. For example, a court will not order someone to perform a contract to cohabit with someone else because, quite apart from any considerations of morality, that would be to compel performance of an obligation of a particularly personal nature. It should not be possible to avoid this limitation on specific implement by seeking an interdict against ceasing to cohabit or failing to cohabit.⁴⁴

⁴¹ At 968HI.

⁴² *Retail Parks Investments v Our Price Music Ltd* 1995 SLT 1161 at 1164 (citations omitted).

⁴³ By virtue of the judicial discretion introduced by the Law Reform (Miscellaneous Provisions) (Scotland) Act 1940 s 1 and the abolition of charges to perform by the Debtors (Scotland) Act 1987 s 100.

⁴⁴ The need for a proviso of this nature is already recognised in the law: *Murray v Dumbarton County Council* 1935 SLT 239. See also *Anderson v Pringle of Scotland Ltd* 1998 SLT 754 (interdict in employment situation).

7.22 We seek views on the following provisional proposal.

22. **It should be competent to grant an interdict notwithstanding that in substance it compels performance of a contract. No such interdict should be granted, however, if a specific implement would not be granted in the same circumstances.**

Part 8 Damages

Nature of the remedy

8.1 An award of damages for breach of contract is a judicial award of money to be paid by the party in breach to the aggrieved party. An award of money to a person aggrieved by a breach of contract could perform many functions. It could compensate the pursuer for loss or harm suffered (a compensatory function);¹ it could restore instalments of the price paid in advance (a restitutionary function); it could force the defender to disgorge gains made by the breach even in the absence of any loss or harm to the pursuer (a disgorgement function); it could penalise the defender's conduct (a punitive function); it could reward the pursuer's conduct (an incentive function) or it could serve to indicate that there had been a breach even if no other purpose needed to be served (a declaratory function).² In Scotland, damages are seen as compensatory.³ The first question to be considered is whether this is satisfactory.

8.2 It would be wrong to be doctrinaire about the purpose of damages. In any particular area of the law there may be strong policy reasons for using damages in a way that is not purely compensatory. For example, a strong policy against late payment of commercial debt may justify penal rates of interest on overdue sums. A strong policy in favour of probity in fiduciary relationships may justify disgorgement damages where there is an abuse of a fiduciary position. What we are concerned with here, however, is the general background law. The question is whether, in the absence of any strong policy justification in a particular context, the rule should be that damages are compensatory.

8.3 There are advantages in having a general rule that damages for breach of contract are compensatory only. It is difficult enough to arrive at satisfactory principles for compensatory damages without complicating matters by requiring the general law on damages to perform restitutionary, disgorgement, punitive or declaratory functions. Other branches of the law – for example, the law on unjustified enrichment, the law on fiduciary duties, the criminal law or the law on declarators – can perform these functions. A reformed law on penalty clauses would enable parties to provide in advance for reasonable non-compensatory payments in certain cases.⁴ Special rules may be needed to resolve the problems encountered in special types of situation. Only if other branches of the law, or special rules for special situations, were inherently incapable of performing these other functions would there be a case for extending the general role of damages for breach of

¹ The word "loss" by itself does not clearly cover everything for which compensation might reasonably be required. The word "harm" covers more easily such things as personal injury, whether physical or psychological, and damage to property.

² This is the function served by nominal damages in systems which do not have a developed system of declarators.

³ See generally McBryde, *Contract* 476 – 482. The leading case, which rules out disgorgement damages, is *Teacher v Calder* (1898) 25 R 661 and (1899) 1 F (HL) 39.

⁴ We are currently working on a report on this subject following our discussion paper on *Penalty Clauses* (Scot Law Com DP No 103, 1997). The possibility of regulation by the contract itself is likely to be particularly useful in those cases where one party has a strong interest in performance but is unlikely to suffer easily quantifiable losses even if the other makes enormous gains by a breach.

contract. We are not aware of any such inherent incapability in other relevant branches of the law. In any event there is, in relation to disgorgement or punitive damages, a question as to why the other party, rather than say the state or a charity, should receive a windfall benefit if the reason for exacting the payment is to achieve public policy objectives. The present Scottish approach is in line with that in most countries of the European Union⁵ and in line with the European *Principles*.⁶ We see no need for fundamental change in the basic approach of the Scottish law on damages for breach of contract.⁷

8.4 There is one minor problem. Some judicial statements support the idea that, even in the absence of any loss or harm, nominal damages may be awarded.⁸ In other words damages may be used to perform a declaratory function. Professor McBryde has pointed out⁹ that cases of so-called nominal damages in Scotland have all involved some non-patrimonial loss or harm and that to award purely nominal damages, in the absence of any loss or harm, is contrary to principle. We agree. This small blemish would not be important enough to warrant legislation on its own account but could possibly be swept up in any more general reform.

8.5 We invite views.

23. **Do consultees agree that the purpose of damages for breach of contract should, in general, be compensation for loss or harm caused by the breach and that accordingly there is no need for the general law on damages to provide for restitutionary, disgorgement, punitive or nominal damages for breach of contract?**

We refer to the "general law on damages" in order to leave room for special statutory or other rules in special cases, such as contracts relating to the use of intellectual property or for the performance of fiduciary duties, where there is a strong public policy in favour of using damages in a way that is not only compensatory.

Types of loss or harm

8.6 It is only loss or harm caused by the breach for which damages can be awarded. Deciding questions of causation can be difficult¹⁰ but we do not believe that legislative intervention could help.

⁵ English law, however, shows a tendency to allow disgorgement damages (called "restitutionary damages" there) in certain cases. See *Attorney-General v Blake* [1998] 1 All E R 833 and the critical comment on it by Chen-Wishart in (1998) 114 LQR 363- 370.

⁶ Art 4.501 (1) provides that "The aggrieved party is entitled to damages for loss caused by the other party's non-performance which is not excused ..."

⁷ In a recent report the Law Commission for England and Wales recommended no legislative intervention in relation to restitutionary (or disgorgement) damages for breach of contract and no change to the existing English rule that punitive damages are not available for breach of contract. Report on *Aggravated, Exemplary and Restitutionary Damages* (Law Com No 247, 1997) paras 3.45 – 3.47 and 5.71 - 5.73.

⁸ *Webster & Co v Cramond Iron Co* (1875) 2 R 752 at 754; *Aarons & Co Ltd v Fraser* 1934 SC 137; *Stephenson v Duncan* (1937) 53 Sh Ct Rep 269.

⁹ *Contract* 478. In *Graham v Ladeside of Kilbirnie Bowling Club* 1993 SCLR 813 "token" damages of £500 were awarded for wrongful exclusion from a bowling club but the pursuer was found to have suffered "significant annoyance" and it may be that the damages are to be seen as solatium rather than as merely performing a declaratory function.

¹⁰ See McBryde, *Contract* 449 – 458.

8.7 It is only net loss for which damages can be recovered. Any savings or gains resulting from the breach have to be taken into account in arriving at the net loss.¹¹

Example. A painter bought ten tins of paint for a contract. The other party repudiated the contract after two tins had been opened and almost completely used. The painter rescinded the contract, returned eight tins to the supplier and obtained a full refund of the price. The amount of that refund has to be taken into account in calculating net loss.

Moreover, in accordance with the principle that a person claiming damages can reasonably be expected to mitigate the loss, any loss which could reasonably have been avoided cannot be recovered.¹² The painter could not increase the damages payable by choosing to throw the eight unopened tins away instead of obtaining a refund for them. Again the rules can be difficult to apply in some cases but we do not believe that legislative intervention could help.

8.8 Normally it is only loss or harm to the aggrieved party which can be recovered. There is a statutory exception to this rule in the case of certain contracts for the carriage of goods by sea.¹³ We consider later whether any other exception should be recognised.¹⁴

8.9 Loss or harm caused by a breach of contract may take two forms.

8.10 *Loss of what was contracted for.* This is the primary loss suffered on a breach of contract. It can arise where there is no performance and also where there is partial or defective performance or where there is a failure to fulfil a contractual warranty or representation. The aggrieved party simply does not get what was contracted for. A buyer, for example, does not get the property or services contracted for. The supplier of goods or services does not get the price.¹⁵

8.11 *Other loss or harm.* A breach of contract may cause other loss or harm.¹⁶ This may be called secondary loss or harm, or consequential loss or harm, because it is secondary to or consequential on the failure to receive what was contracted for. A profit expected on resale may be lost.¹⁷ An asset of the aggrieved party may lose value because of the breach. A defectively constructed building or object may cause injury to persons or damage to property. Breach of a contract to provide transport may cause another contract to be lost. Breach of a contract may cause psychological damage ranging from distress to severe mental illness. As a result of the breach the aggrieved party may have to incur litigation expenses or may have to pay damages to a third party.

8.12 There is one type of consequential harm which is sometimes analysed inaccurately. It is sometimes referred to as wasted incidental expenditure but it would be more accurate to

¹¹ See McBryde, *Contract* 459 – 462.

¹² See McBryde, *Contract* 454 – 462.

¹³ Carriage of Goods by Sea Act 1924 s 2 (4). The person who holds the contractual rights under a bill of lading, sea waybill or ship's delivery order can recover damages for loss sustained by the owner of the goods. The damages are recovered "for the benefit of" the owner.

¹⁴ Paras 8.43 – 8.49.

¹⁵ Sometimes the non-acceptance of the actual performance may also be important to the seller. This is recognised in s 37 of the Sale of Goods Act 1979 which makes the buyer liable for any loss occasioned by refusal to take delivery as required by the contract.

¹⁶ See McBryde, *Contract* 470 – 475.

¹⁷ See *Dunlop v Higgins* (1848) 6 Bell's App 195 at 211; *Duff and Co v The Iron and Steel Fencing and Buildings Co* (1891) 19 R 199.

refer to waste of incidental expenditure because it is the waste and not the expenditure that is the loss caused by the breach of contract.

Example. A development company contracts to buy a large area of city land for redevelopment. It tells the sellers that it would like to have surveys and plans done as soon as possible after conclusion of the missives. It is agreed that immediate access will be given to surveyors for this purpose. The development company instructs, obtains and pays for the surveys. The sellers then repudiate the contract. The development company has not paid the price and the land is worth no more than the price. So there is no primary loss. The company does not wish to claim damages for loss of profit on the development because it considers this claim to be too speculative and too difficult to quantify. It claims damages based on the amount which it had to pay for the surveys.¹⁸

Here the loss caused by the breach is not the actual expenditure on the surveys. That expenditure would have been incurred anyway even if there had been no breach. The loss caused by the breach is the diminution in the value of what was obtained by the expenditure. Immediately before the breach the developers had surveys of some value to them, a convenient measure of that value being the amount paid for the surveys. Immediately after the breach the developers had surveys of no value to them. Many similar examples could be given. In some case there will not be a total loss of value. Special equipment bought for a once-in-a-lifetime activity holiday may lose most of its value to the purchaser if the holiday company repudiates the contract but may have a second-hand value. The amount of this particular consequential loss may appropriately be measured as the difference between the amount paid for the equipment and its second hand value.

Existing law on compensatable loss or harm

8.13 The Scottish courts have not adopted an over-technical approach to the assessment of loss caused by a breach of contract.¹⁹ It is recognised that there are different ways of calculating loss and that they may lead to the same result.²⁰ A few broad rules have, however, been developed. Damages are normally assessed by reference to the loss of what was contracted for, with an addition for any consequential loss or harm not regarded as too remote.²¹ The normal measure of damages is such sum as will make the aggrieved party's position as nearly as possible what it would have been if the contract had been duly performed or fulfilled according to its terms.²² Damages will, however, not necessarily be awarded for all types of non-patrimonial loss or harm caused by a breach of contract. In

¹⁸ For a similar case, see *Daejan Developments Ltd v Armia Ltd* 1981 SC 48.

¹⁹ See eg *A/B Karlshamns Oljefabriker v Monarch Steamship Co Ltd* 1949 SC (HL) 1 at 21; *Haberstich v McCormick & Nicholson* 1975 SC 1 at 9.

²⁰ For example, a painter could claim for irrecoverable outlays on paint and materials plus net profit or for the contract price less recoverable outlays. The result would be the same. Where the first method is used it is technically the reimbursement of the outlays by the other party to the contract which is the loss caused by the breach but, where outlays are charged at cost or more than cost by the contract, this does not make the method unacceptable. In some cases it may be useful to use different methods of ascertaining loss as a sort of cross check on each other. *Prudential Assurance Co Ltd v James Grant & Co Ltd* 1982 SLT 423; *Black v Gibson* 1992 SLT 1076. See also *Martin v Bell-Ingram* 1986 SLT 575 (a delict case).

²¹ See *McBryde*, *Contract* 462 – 475; MacQueen, "Remoteness And Breach of Contract" 1996 JR 296 at 299 –300.

²² *Houldsworth v Brand's Trs* (1877) 4 R 369 at 374; *Marshall & Co. v Nicoll & Son* 1919 1 SLT 88 at 90; *Karlshamns Oljefabriker v Monarch Steamship Co* 1949 SC (HL) 1 at 18. The same rule is found in the European *Principles* art 4.502 – "The general measure of damages is such sum as will put the aggrieved party as nearly as possible into the position in which he would have been if the contract had been duly performed. Such damages cover the loss which the aggrieved party has suffered and the gain of which he has been deprived."

particular, there is doubt as to the circumstances in which they may be awarded for mental distress.²³

8.14 Although in general the law appears to work reasonably well, there are areas where some clarification or improvement might be considered. One of these is the so-called remoteness test, which has become enmeshed in semantics.

Remoteness

The present law

8.15 The law is based on a statement in the English case of *Hadley v Baxendale*,²⁴ although similar views had been expressed by earlier Scottish writers.²⁵

In *Hadley v Baxendale* mill-owners employed couriers to convey a broken millshaft to a firm that made millshafts, so that the firm could use it as a model to make a new one. It was established that at the time of the contract being concluded the couriers would have known what it was that they had been asked to carry, and that their employers were mill-owners. The couriers delayed in delivering the millshaft. The mill-owners sued for damages for the profit they were prevented from making because of the delay. Until the new millshaft was obtained the mill had to remain idle.

The Court rejected the claim. The knowledge that the couriers possessed was not sufficient to establish that they would have known that a delay in delivering the shaft would have prevented the owners from realising a profit from working the mill.²⁶ The general rule was set out in terms which have often been cited.²⁷

"Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be *such as may fairly and reasonably be considered [as] either arising naturally, ie, according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.* Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. But, on the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he, at the most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract. For, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to the damages in that case; and of this advantage it would be very unjust to deprive them." (Our emphasis).

²³ See McBryde, *Contract* 481 – 482. See paras 8.23 – 8.28.

²⁴ (1854) 9 Ex 341.

²⁵ Brown, *A treatise on the law of sale* (1821) 313; Bell, *Commentaries* I 478-479; Baron Hume's *Lectures* Vol II 32; Shaw, *A Treatise on the Law of Obligations and Contracts* (1847) 217.

²⁶ At 355.

²⁷ At 354 –355.

8.16 The statement in *Hadley v Baxendale* is accepted as the basis of the present law in Scotland as well as in England and other common law countries.²⁸ It has, however, been the subject of some judicial explanation and refinement. First, it was explained that the two legs of the *Hadley* rule are not two discrete rules, but are rather two components of a general rule based on what could reasonably have been contemplated by the person in breach as a consequence of the breach, given the knowledge possessed by that person at the time of making the contract.²⁹ Then there was much discussion of the precise degree of foreseeability required. Clearly, a contract breaker could not be held liable for anything that a reasonable person could have foreseen as a remotely possible consequence of the breach. On the other hand, liability should not be restricted to what could be foreseen as an inevitable consequence of the breach. Somewhere between remote possibility and inevitable consequence lay the true test. Judges used such terms as "serious possibility or real danger",³⁰ "at least a serious possibility",³¹ "not unlikely or quite likely to happen,"³² "liable to result"³³ and "a very substantial degree of probability."³⁴ It was also made clear that if the kind of damage was reasonably foreseeable the extent did not need to be.³⁵

8.17 The most important recent Scottish case is *Balfour Beatty Construction v Scottish Power*.³⁶

The pursuers were building an aqueduct, using concrete. The concrete was being processed at a batching plant being supplied with electricity by the defenders under a special contract for a temporary supply. The contract provided for a continuous supply of electricity. The defenders knew that the electricity was required for the concrete batching plant and that the concrete was required for work on a major roadway and associated structures. Some way into the operation, the electricity supply to the plant was accidentally interrupted by the rupturing of fuses, and by the time work was able to resume the latest pouring of concrete had hardened. The pursuers could not proceed with the completion of the aqueduct using the concrete already poured. It is impossible to create a satisfactory watertight joint between two pours of concrete where one pour has already set beyond a certain stage. The result was that the pursuers had no alternative but to demolish and rebuild a substantial part of the structure. They sued the defenders for damages for breach of contract.

The House of Lords held that the costs associated with the destruction and reconstruction of the aqueduct could not be recovered. The general rule was that damages would be limited to the loss which the defenders might reasonably have contemplated at the time of the contract, subject to the explanation that it was sufficient that the loss be of a type which might have been so contemplated.³⁷ Here the Lord Ordinary had found in fact that demolition and reconstruction of the aqueduct were beyond the defenders' reasonable contemplation. Because their crave for damages was in respect only of the losses brought about by having to demolish and repair the aqueduct the pursuers got nothing in damages.

²⁸ For a recent discussion, and application, see *Cosar Ltd v UPS Ltd* 1999 SLT 259.

²⁹ *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528 at 539 – 540. For further statements on the rule see *A/B Karlshamns Oljefabriker v Monarch Steamship Co Ltd* 1949 SC (HL) 1 and *Koufos v C Czarnikow Ltd* [1969] 1 AC 350 at 395.

³⁰ *H Parsons (Livestock) Ltd v Uttley, Ingham & Co* [1978] 1 QB 791 at 802.

³¹ *A/B Karlshamns Oljefabriker v Monarch Steamship Co* 1949 SC (HL) 1 at 29.

³² *Koufos v C Czarnikow Ltd* [1969] 1 AC 350 at 390.

³³ *Koufos v C Czarnikow Ltd* [1969] AC 350 at 410 – 411.

³⁴ *Balfour Beatty Construction (Scotland) Ltd v Scottish Power plc* 1994 SLT 807.

³⁵ *H Parsons (Livestock) Ltd v Uttley, Ingham & Co* [1978] 1 QB 791; *Brown v KMR Services* [1995] 2 Lloyds Rep 513.

³⁶ 1994 SLT 807.

³⁷ At 809A.

International models

8.18 The European *Principles* have a rule which performs the same function as the law set out above but which contains a special rule for the case where the breach was intentional or grossly negligent.

"The non-performing party is liable only for loss which he foresaw or could reasonably have foreseen at the time of conclusion of the contract as a likely result of his non-performance, unless the non-performance was intentional or grossly negligent."³⁸

The Unidroit *Principles*³⁹ and the Vienna Convention⁴⁰ have a similar rule but without the special exception for intentional or grossly negligent breach.

Assessment

8.19 The present law, as explained in recent cases, seems to be sound in substance. Given that there need be no culpability in breach of contract it would be unacceptable to hold a contract breaker responsible for loss or harm which was not foreseen and could not reasonably have been foreseen. From an economic point of view the insurance of such risks is more efficiently undertaken by insurance companies than by ordinary providers of goods and services. Although there have been divergences of view on the best way of describing the degree of foreseeability required it seems probable that in practice little will turn on differences between such expressions as "likely", "not unlikely" or "liable to result". There are, however, two questions which might be asked.

8.20 The first is whether there would now be an advantage in establishing a new base for the law which would relieve Scottish advisers, advocates, judges and writers from the task of beginning with statements in an English case dating from 1854 and proceeding through pages of hair-splitting commentary and analysis in subsequent English cases – what Lord Denning referred to as "this sea of semantic exercises".⁴¹ Purely as a matter of form and accessibility there might be an argument for a fresh start, building on what has been learned. Article 4.503 of the European *Principles* might provide a suitable model. There would perhaps be some advantage in resolving the semantic problems in favour of "a likely result", which seems preferable to the double negative in "not unlikely" and no worse than any of the other formulations attempted. There would perhaps also be some advantage in using terms like "foreseen" and "reasonably foreseeable" rather than "contemplated" and "such as may reasonably be supposed to have been in the contemplation of the parties". There is a gain not only in elegance but also in accuracy. It is sufficient if the loss is foreseen or reasonably foreseeable. There is no need for anyone to spend time contemplating it. Moreover "foreseeability" is a more familiar test in the context of delict and, although the factual situation may often be different in cases of breach of contract cases because the parties have the opportunity to exchange information and allocate risks in advance, there is

³⁸ Art 4.503.

³⁹ Art 7.4.4.

⁴⁰ Art 74. This article refers to what was foreseen or ought to have been foreseen "as a possible consequence of the breach of contract".

⁴¹ In *H Parsons (Livestock) Ltd v Uttley, Ingham & Co* [1978] 1 QB 791 at 802.

no reason to give the impression that there is a significant difference between what is reasonably contemplatable and what is reasonably foreseeable.

8.21 The second question is whether, as in the European *Principles*, there ought to be liability even for loss or harm which was not reasonably foreseeable at the time of entering into the contract if the breach was intentional or grossly negligent. In the *Balfour Beatty* case, for example, should the result have been different if it had been proved that the defenders had intentionally switched off the power for a prolonged period in deliberate breach of their contract to provide a continuous supply for the purpose of the concrete batching plant? It is at least arguable that that should make a difference, particularly if the defenders had been told by the time of the breach of the importance of a continuous pour on the day in question. The decision in the case was a marginal one even on its own facts⁴² and would veer into the unacceptable if the breach had been deliberate or grossly negligent. On the other hand it would be a departure from the normal rules to allow damages to be recovered for unforeseeable loss and the term "grossly negligent" could be difficult to apply and is not now viewed with favour.

Request for views

8.22 We invite responses to the following questions.

24. **Would it be useful to provide that the party in breach of contract is liable only for loss or harm which it foresaw or could reasonably have foreseen at the time of conclusion of the contract as a likely result of the breach?**
25. **Should there be an exception to the preceding rule if the breach was intentional or grossly negligent?**

Non-patrimonial loss or harm

The question

8.23 The question for consideration is whether it should be made clear that there is no bar, other than the remoteness rule, to the recovery of damages for non-patrimonial loss or harm caused by a breach of contract. Non-patrimonial loss may take the form, for example, of loss of reputation⁴³ or loss of amenity or loss of the satisfaction of obtaining what was contracted for. This last type of non-patrimonial loss, which could also be described as "disappointed expectations", may be particularly important in cases where damages cannot be awarded for other types of loss. If damages for this type of loss cannot be awarded there may be cases where no damages at all can be awarded even if the aggrieved party has been deprived of the performance contracted for.⁴⁴

⁴² The House of Lords recalled a unanimous interlocutor of the Second Division of the Court of Session. The defenders knew that the pursuers were engaged in large scale construction work involving huge quantities of concrete. The pursuers had contracted for a continuous supply of electricity for a concrete batching plant. It must have been reasonably foreseeable that an interruption to the supply of electricity would be highly likely to interrupt the flow of concrete and that this was likely to cause serious engineering problems which might be expensive to rectify.

⁴³ Loss of reputation may in turn lead to financial loss. For example, loss of an employee's reputation for honesty may lead to a loss of employment opportunities. There is no reason why such financial loss should not be recovered in appropriate cases. See *Mahmud v BCCI* [1998] AC 20; *Johnson v Unisys Ltd* [1999] 1 All ER 854 at 860.

⁴⁴ See *Ruxley Electronics Ltd v Forsyth* [1996] AC 344 at 374.

Example. For nostalgic reasons A wishes to have the lower parts of the walls of a new house constructed from granite from the part of the country where he was born and brought up. He contracts for this specifically and informs the builder, B, of the importance he attaches to the source of the stone. B uses local granite which costs the same but is of a superior quality for building. One of B's employees tells A where the stone came from but by this time the house is completed. The court would not order specific implement because that would be too harsh and unreasonable.⁴⁵ It would not order damages based on the cost of tearing the house down and rebuilding it because that would be equally unreasonable.⁴⁶ The house is no less valuable than it would have been with the other granite. So no damages could be obtained on the basis of diminution in value. Yet most people would probably consider that A should receive some damages for B's breach of contract.⁴⁷

Non-patrimonial harm may take the form, for example, of physical illness or injury, pain or suffering, distress or more severe psychological harm, or trouble and inconvenience. These lists are not intended to be exhaustive.

Existing law

8.24 Damages can be recovered for physical illness or injury caused by a breach of contract,⁴⁸ although often there will be an overlapping claim in delict which may mask the contractual claim. Damages can also be recovered for trouble and inconvenience caused by a breach of contract.⁴⁹ It is not clear whether damages can be recovered for loss of reputation caused by a breach of contract.⁵⁰ It was for a long time considered that, following the decision of the House of Lords in the English case of *Addis v Gramophone Co*,⁵¹ damages could not be recovered for mental distress or injured feelings caused by a breach of contract.⁵² More recently, exceptions have been recognised in cases where, because of the nature of the contract, the likelihood of distress was or ought to have been in the contemplation of the defender at the time of the contract. For example, damages were awarded when a photographer was in breach of a contract to take photographs at a wedding⁵³ and a proof was allowed on a claim for damages for "upset and distress" when a caravan site proprietor was in breach of a contract to provide a site "of the highest amenity" for a residential caravan.⁵⁴ There have also been cases in England where the nature of the contract has meant that the likelihood of distress or injured feelings being caused by a breach was reasonably foreseeable at the time of the conclusion of the contract.⁵⁵ There have been suggestions in

⁴⁵ See para 6.7.

⁴⁶ See paras 8.37 – 8.42.

⁴⁷ A similar case was first mentioned by Cardozo J. in *Jacob & Youngs v Kent* (1921) 129 N.E. 889. Other examples of the same kind were given in *Ruxley Electronics Ltd v Forsyth* [1996] AC 344.

⁴⁸ See eg *Cameron v Young* 1907 SC 475; *Dickie v Amicable Property etc Building Society* 1911 SC 1079; *Fitzpatrick v Barr* 1948 SLT (Sh Ct) 5.

⁴⁹ *Webster & Co v Cramond Iron Co* (1875) 2 R 752; *McArdle v City of Glasgow DC* 1989 SCLR 19; *Hardwick v Gebbie* 1991 SLT 258; *Mills v Findlay* 1994 SCLR 397.

⁵⁰ The question was raised but not settled in any satisfactory way in *Millar v Bellvale Chemical Co* (1898) 1 F 297 and *Dodwell v Highland Industrial Caterers Ltd* 1952 SLT (Notes) 57. In English law, the statements in *Mahmud v BCCI* [1998] AC 20 are rather against recoverability of damages for non-financial aspects of loss of reputation.

⁵¹ [1909] AC 488.

⁵² See Gloag, *Contract* 686. It is by no means certain that, properly read, *Addis* justifies any such general conclusion. There was earlier Scottish authority to the contrary effect. See *Cameron v Fletcher* (1872) 10 M 301; *Campbell v MacLachlan* (1896) 4 SLT 143.

⁵³ *Diesen v Samson* 1971 SLT (Sh Ct) 49.

⁵⁴ *Colston v Marshall* 1993 SCLR 43.

⁵⁵ *Jarvis v Swan Tours Ltd* [1973] QB 233 (contract to provide holiday); *Jackson v Horizon Holidays Ltd* [1975] 3 All E R 92 (contract to provide holiday); *Heywood v Wellers* [1976] QB 446 (solicitor failed, in breach of contract, to

some of these cases that a distinction falls to be drawn between commercial and "social" contracts but the soundness and practicability of that distinction is doubtful. The true distinction seems to be between those cases where the likelihood of distress or injured feelings is foreseen or reasonably foreseeable at the time of the contract and cases where it is not. Mental distress or injury to feelings cannot be suffered by a company or other legal entity, although such an entity can be put to trouble and inconvenience,⁵⁶ and that in itself serves to rule out this head of damages in many commercial contracts.

8.25 Some of the judges in the English case of *Ruxley Electronics Ltd v Forsyth*⁵⁷ clearly favoured the allowance of damages for non-patrimonial loss caused by a breach of contract, including loss of the personal value to the aggrieved party in receiving the performance contracted for, but the statements on this point in the House of Lords were on a matter which did not fall to be decided at that stage.

International models

8.26 The Unidroit *Principles* have the following rule on the types of loss for which damages may be obtained.⁵⁸

"(1) The aggrieved party is entitled to full compensation for harm sustained as a result of the non-performance. Such harm includes both any loss which it suffered and any gain of which it was deprived, taking into account any gain to the aggrieved party resulting from its avoidance of cost or harm.

(2) Such harm may be non-pecuniary and includes, for instance, physical suffering or emotional distress."

The European *Principles* also expressly allow damages for non-pecuniary harm of any kind.⁵⁹

Assessment

8.27 The courts have shown signs of breaking free from the restrictions once thought to be imposed by the *Addis* case. The law, however, is not clear. *Addis* has never been over-ruled. It creates an unnecessary difficulty and a temptation to resort to unsound distinctions. It would not, in our view, make any sense to perpetuate an arbitrary distinction between inconvenience and distress or to introduce an arbitrary distinction between commercial and social contracts. The normal test for remoteness, particularly if it were reformulated as we have suggested above in terms of what is foreseen or reasonably foreseeable as a likely result of the breach, would be adequate in this area.

Request for views

8.28 We invite views.

obtain injunction against molestation); *Calabar Properties Ltd v Sticher* [1984] 1 WLR 287 (contract for occupation of house as a home); *Ruxley Electronics Ltd v Forsyth* [1996] AC 344 (contract for construction of swimming pool).

⁵⁶ *Webster & Co v Cramond Iron Co* (1875) 2 R 752.

⁵⁷ [1996] AC 344. See in particular Lord Bridge of Harwich at 354; Lord Mustill at 360 – 361 and Lord Lloyd of Berwick at 373 – 374.

⁵⁸ Art 7.4.2.

⁵⁹ Art 4.501(2).

26. **Should it be made clear that, subject to the normal remoteness rule, the loss or harm for which damages may be recovered for breach of contract includes non-patrimonial loss or harm of any kind, and in particular includes loss of the satisfaction of obtaining what was contracted for and harm in the form of pain, suffering or mental distress?**

Damages based on the "reliance interest"

The question

8.29 The question for consideration is whether there is any need to introduce in Scotland a special rule allowing a party aggrieved by a breach of contract to claim damages based on expenditure made in reliance on the contract instead of damages based, in the normal way, on the loss of what was contracted for. Put another way, the question is whether the claimant can recover a sum calculated to restore the claimant's position, not to what it would have been if the contract had been duly performed, but to what it would have been if the contract had never been concluded. Damages on this basis would be designed to protect what has been called the aggrieved party's "reliance interest"⁶⁰ – that is, the interest in recovering sums paid in order to fulfil the contract (essential reliance) or sums paid incidentally in reliance on the contract (incidental reliance).

Example. A catering firm buys perishable food in reliance on a contract to provide the catering at a function. It engages temporary staff. The firm also engages a photographer to take photographs of the function and pays in advance. The catering firm wants to use these photographs for advertising purposes. A late cancellation by the other party to the catering contract causes all the food to be wasted. It is too late to cancel the engagements of the temporary staff and they have to be paid. The money paid to the photographer cannot be recovered. That expenditure is also wasted. The costs of the food and the temporary staff were incurred in essential reliance on the contract, and in order to fulfil it. The cost of the photographer was incurred in incidental reliance on the contract.

English law

8.30 It is said that in English law the aggrieved party is entitled to choose between the normal measure of damages and a claim for reliance losses.⁶¹ However, reliance losses cannot be recovered to the extent that they would exceed damages assessed in the normal way, because to allow this would allow the claimant to escape from the consequences of a loss-making contract.⁶² The burden of proving that the contract would have been loss-making is on the contract breaker.⁶³ The rule is set out in the *McGregor Code* in the following way.⁶⁴

"(1) As an alternative to damages calculated under section 434 [based on the loss of what was contracted for] the claimant is entitled to damages which will place him in

⁶⁰ The term comes from Fuller and Perdue, "The Reliance Interest in Contract Damages" (1936) 46 *Yale Law Journal* 52, 373.

⁶¹ Treitel, *Contract* 849. The cases commonly cited in support of this rule are *Cullinane v British "Rema" Mfg Co* [1954] 1 QB 292; *Anglia Television Ltd v Reed* [1972] 1 QB 60 and *C.C.C. Films (London) Ltd v Impact Quadrant Films Ltd* [1985] QB 16. They have, however, to be read with care.

⁶² Treitel, *Contract* 849; *C.C.C. Films (London) Ltd v Impact Quadrant Films Ltd* [1985] QB 16 at 38.

⁶³ *C.C.C. Films (London) Ltd v Impact Quadrant Films Ltd* [1985] QB 16.

⁶⁴ Art 435.

the position, so far as money can do it, that he would have been in if the contract had never been made.

(2) This alternative entitlement of the claimant is subject ...to the limit that damages so calculated must not place him in a better position than he would have been in if the contract had been fully performed by both parties, the burden of proving that the claimant would thus be placed in a better position being on the party against whom the claim is made."

Scottish law

8.31 There is no Scottish authority to the effect that the pursuer has an option between "reliance damages" calculated on the above special basis and damages based on the loss of the due performance. There have, of course, been many cases where damages have been recovered for wasted expenditure or outlays⁶⁵ but there has been no indication that the awards were made on the application of any special rule.⁶⁶ The most interesting of these cases is *Dawson International plc v Coats Paton plc*.⁶⁷

The pursuers had incurred net underwriting expenses of about four million pounds in an attempted takeover of a company. They averred a breach of contract which caused this expenditure to be abortive. They claimed damages based on the net amount of the abortive expenditure.

Lord Prosser held that there was no contract and that, even if there had been, and even if there had been a breach, the expenditure would have been abortive anyway because another company would probably have won the takeover battle. He noted that both parties accepted that damages were designed to put the aggrieved party in the position it would have been in had the contract been fulfilled and that the pursuers had chosen not to claim for loss of profit and were confining their claim to the abortive expenditure. He said that the onus was on them to show that the expenditure would have been recovered if the contract had been performed and observed that English authorities were of no real assistance in relation to damages of this kind.⁶⁸

International models

8.32 The Vienna Convention contains no special rule on reliance damages. Neither do the *Unidroit Principles* or the *European Principles*.

⁶⁵ A perfectly normal and acceptable way of calculating the loss caused by a breach of contract is to add wasted expenditure on outlays (or, more precisely, the lost reimbursement for such outlays) and expected net profit. Of course, a person cannot recover both for outlays and gross returns because that would involve double compensation. This is the true explanation of the decision of the English Court of Appeal in *Cullinane v British "Rema" Mfg Co* [1954] 1 QB 292. See *T.C. Industrial Plant Pty Ltd v Robert's Queensland Pty Ltd* (1964) 37 ALJR 289 and *Shetland Seafarms Ltd v The Braer Corporation and Others* (Court of Session, Lord Gill, 10 September 1998, unreported).

⁶⁶ The cases are reviewed in Macgregor, "The Expectation, Reliance and Restitution Interests in Contract Damages" 1996 JR 227 – 249. The cases where the focus of attention is most clearly and exclusively on abortive expenditure are *Morrison v Main* (1895) 11 SLR (Sh Ct) 16; *Daejan Developments v Armia Ltd* 1981 SC 48; *Fielding v Newell* 1987 SLT 530 and *Dawson International plc v Coats Paton plc* 1993 SLT 80. In none of them is there any indication that anything other than the normal approach to damages is being adopted. Indeed, in *Fielding v Newell* placing the pursuer in the same position as if the contract had not been concluded would have meant no damages could have been awarded in respect of the abortive expenditure because it would have been incurred anyway if no contract had been concluded.

⁶⁷ 1993 SLT 80.

⁶⁸ 1993 SLT 80 at 99 – 100.

Is there a problem?

8.33 At first sight there seems to be no problem. Normally compensation for wasted outlays, like the cost of the food and the wages of the temporary staff in the example of the catering contract given above, would be covered by compensation for the loss of what was contracted for – in this case the price. An alternative way of arriving at the same result is to add wasted outlays (or, more correctly, the amount which would have been recovered under the contract for the wasted outlays) to net profit. Loss incurred in an incidental transaction with a third party as a result of the breach would be covered by compensation for consequential loss, assuming that it is not precluded by the remoteness rule.⁶⁹ The catering firm can claim damages on the normal principles, based on the price which was payable and, assuming the remoteness rule is satisfied, on the consequential loss incurred by having to pay the photographer for nothing. That is enough. The firm is fully compensated. It has been placed as nearly as may be in the position it would have been in if there had been no breach. There would be double compensation if the firm were to be awarded damages based on the amount of the price and, in addition, an amount for the cost of buying the food.

8.34 There may be cases where it is difficult or impossible to calculate damages on the normal basis. A catering contract, for example, may have provided that the sum payable to the catering firm was to be made up of two parts – (a) reimbursement of costs plus a small extra amount, and (b) a bonus which would depend on the results of a questionnaire to be filled in by those attending the function. If the contract is repudiated shortly before the function it would be impossible to calculate what sum would have been received under it. However, even in such cases there appears to be no problem. There is no rule of law which says that aggrieved parties must claim their full pound of flesh. The catering firm could restrict its claim to the element representing reimbursement of costs and the fixed profit.⁷⁰ If it chose to claim a sum based on its estimated total loss, the court could take the view that part of the claim was too speculative and restrict damages to what could be ascertained with reasonable certainty.⁷¹

Assessment

8.35 We are not satisfied that there is any need to introduce a rule giving the pursuer an option to claim damages designed to restore the pursuer's position to what it would have been if no contract had been entered into. That seems to us to be not only unnecessary but also unprincipled and likely to produce complications and difficulties. The key element in the rule set out in the *McGregor Code* is the shifting of the onus of proof to the defender. It is for the defender to prove that the contract would have been loss-making. This places an unreasonable burden on the defender who cannot be expected to have details of the pursuer's business practices or opportunities. It also enables pursuers in certain cases to recover damages for unreasonable risks voluntarily taken.

Example. A landowner enters into a contract with a treasure hunter. The contract grants the treasure hunter permission to excavate an ancient burial site on the land. The landowner warrants that there is a burial site but does not warrant that it contains anything of value or interest. In fact there is no site – just natural features

⁶⁹ Paras 8.15 – 8.22.

⁷⁰ We have already noted that the pursuers in *Daejan Developments v Armia Ltd* 1981 SC 48 and *Dawson International plc v Coats Paton plc* 1993 SLT 80 chose to restrict the damages claimed.

⁷¹ See eg *Morrison v Main* (1895) SLR (Sh Ct) 16.

which look remarkably like the normal indications of a site. The treasure hunter has spent money assembling equipment and experts for the excavation and claims damages for this abortive expenditure.⁷²

If the onus is on the pursuer to prove that the expenditure would have been covered by returns from the excavation if there had been a burial site on the land then the claim for damages fails. That cannot possibly be proved. If, however, the onus is on the defender to prove that the expenditure would not have been covered by returns if there had been a burial site on the land then the claim for damages succeeds. That cannot be proved either. It seems to us that the important point is that the treasure hunter took the risk of there being nothing to recover. At most damages should be awarded for the loss of a chance.⁷³ A mere chance of gain is all that the treasure hunter would demonstrably have received if the contract had been fulfilled. Damages for the loss of the chance of recovering something in excess of expenditure would place the treasure hunter in the position he would have been in had the contract been fulfilled. The normal approach seems to us to produce better results than the reliance approach adopted in English law.

Request for views

8.36 We would welcome views on the following proposition.

27. **There is no need to introduce an alternative measure of damages, available at the pursuer's option and designed to restore the pursuer's position to what it would have been had the contract never been entered into.**

Unreasonable rectification costs

The problem

8.37 The problem is that in some cases it would be grossly unreasonable to base damages, in accordance with the normal rule, on the amount required to make the aggrieved party's position as nearly as possible what it would have been if the contract had been duly performed. In the case of defective work on property which is not intended for resale the best way of giving effect to the normal rule is usually to award the costs of rectification. However, that method sometimes produces absurd and unacceptable results.

The swimming pool case

8.38 The problem is well illustrated by the English case of *Ruxley Electronics and Construction Ltd. v Forsyth*.⁷⁴

The case concerned a contract between an individual proprietor and a construction company. The company was to excavate a swimming pool in the proprietor's garden. The diving area was to be seven feet, six inches deep. The pool when completed turned out to be only six feet deep at the relevant point. The proprietor refused to pay the outstanding balance of the price and, when the company sued for

⁷² The example is suggested by the Australian case of *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377 which concerned the right to salvage a non-existent oil tanker.

⁷³ The prospects of recovery would not be good, although much might depend on expert evidence. See McBryde, *Contract* 471 – 472.

⁷⁴ [1996] AC 344.

the outstanding balance,⁷⁵ counterclaimed for damages of £21,560 based on the cost of reconstructing the pool to the required depth. The case turned on this counterclaim. The trial judge awarded £2,500 in damages for "loss of amenity". The Court of Appeal awarded the full rectification cost of £21,560. The House of Lords restored the original award of £2,500 for non-monetary loss, there having been no argument before it as to the appropriateness of the amount awarded on that basis.

The main argument for the proprietor was that there were only two possible bases for an award of damages in such a case. One was the cost of rectification and the other was diminution in value due to the defective performance. Here the trial judge had found as a fact that there was no diminution of value. The pool as constructed was worth as much as a pool with a diving area of the depth required by the contract. So the only basis for damages was the cost of rectification. The House of Lords rejected the idea that there were only two possible bases.⁷⁶ The rectification basis would not be used where the cost of rectification would be "unreasonable"⁷⁷ or "out of all proportion to the benefit to be obtained".⁷⁸ At least two members of the court thought that damages could be awarded for non-monetary loss to reflect the fact that the aggrieved party had not received the performance contracted for.⁷⁹

Scottish law

8.39 It might be thought that the nearest Scottish equivalents to the *Ruxley* case are the cases involving claims by builders for payment for defective work which we have considered in the context of actions for payment.⁸⁰ However these were concerned with claims for payment and, hypothetically, with possible claims based on unjustified enrichment rather than with claims for damages. In relation to the claim for payment they give rise to problems, which we have discussed above.⁸¹ In relation to unjustified enrichment they have probably been overtaken by recent developments.⁸² They are of no help in the present context. They do not discuss the basis of a claim for damages far less provide authority for departing from the normal measure where to award the costs of rectification would be unreasonable.

⁷⁵ The contract had provided for payment in stages as the work progressed. The company was found entitled to the balance of the price. The circumstances were not such as to justify rescission (with restitution of instalments already paid) or suspension of performance. The trial judge found as a fact that the pool had been substantially completed. See [1996] AC 344 at 363.

⁷⁶ This is most clear in the speeches of Lord Mustill and Lord Bridge of Harwich. Lord Lloyd of Berwick recognised that an award for loss of amenity might be justified under the recognised exceptions to the rule established by *Addis v Gramophone Co Ltd* [1909] AC 488. Lord Jauncey of Tullichettle said (at 358) that it was "not the case" that "where the objective of a building contract involved satisfaction of a personal preference [ie a case where diminution of value was not available as a basis for damages] the only measure of damages...was the cost of reinstatement". However, he found it unnecessary to express any opinion on the award of £2500 for loss of amenity.

⁷⁷ [1996] AC 344 at 356 - 359, 361, 367, 371.

⁷⁸ [1996] AC 344 at 367.

⁷⁹ Lord Mustill and Lord Bridge of Harwich. Lord Lloyd also seemed to be favourably disposed to this idea although he did not wish to decide the matter as the award for loss of amenity could be fitted within existing exceptions to the rule established by *Addis v Gramophone Co Ltd* [1909] AC 488.

⁸⁰ *Ramsay v Brand* (1898) 25 R 1212; *Steel v Young* 1907 SC 360; *Forrest v Scottish County Investment Co* 1916 SC (HL) 28; *Spiers Ltd v Petersen* 1924 SC 428. See also *McMorran v Morrison & Co* (1906) 14 SLT 578.

⁸¹ Paras 5.23 - 5.28.

⁸² They appear to suggest that a claim based on unjustified enrichment would be available while the contract subsists unrescinded. That would now be regarded as unsound. A subsisting contract would provide a legal justification for the retention of any benefit conferred under it. See *Dollar Land (Cumbernauld) Ltd v CIN Properties Ltd* 1998 SLT 992 and *Shilliday v Smith* 1998 SC 725.

8.40 In a number of more recent Scottish cases the costs of rectification have been used as the basis of damages for loss caused by defective work in breach of contract but in all of them it was clear that this was a reasonable approach to take.⁸³

Assessment

8.41 Cases of the *Ruxley* type demonstrate that there is a need to recognise an exception to the normal rule for damages where the normal rule would suggest using the cost of rectification but where using the cost of rectification would be unreasonable. Even more dramatic examples could be given.⁸⁴ It is clear that it would be wrong to regard difference in the value of the property as the only alternative. In some cases, such as normal commercial sales of goods, difference in value will be appropriate⁸⁵ but it will not always be appropriate and will often be irrelevant. People can contract for a performance which decreases the value of their property if they so wish. They ought still to be entitled to damages for breach of contract. A clear recognition that damages can be awarded for non-patrimonial loss of any kind, including loss of the satisfaction of receiving what was contracted for, would help in this type of case. We have already raised that question.⁸⁶ Beyond that, what might be useful in Scotland would be a provision to the effect that the cost of rectification need not be used as the basis of assessing damages in any case where to do so would be unreasonable and that in such a case damages should be based on an assessment of the aggrieved party's loss, including non-patrimonial loss, in the absence of rectification. That would enable diminution of value to be taken into account, where appropriate, but would not limit damages to loss of value.

Request for views

8.42 We would welcome responses to the following question.

- 28. Should it be made clear that the cost of rectification need not be used as the basis of assessing damages in any case where to do so would be unreasonable and that in such a case damages should be based on an assessment of the loss, including non-patrimonial loss, sustained by the aggrieved party in the absence of rectification?**

Damages for loss or harm to third parties

8.43 The question for consideration under this head is whether there should be any further⁸⁷ exception to the normal, and understandable, rule that the aggrieved party cannot recover damages for a loss suffered by someone else.

⁸³ *Stewart Roofing Co Ltd v Shanlin* 1958 SLT (Sh Ct) 53; *Mills v Simpson* 1987 GWD 37-1322; *Chisolm v Gillespie* 1990 GWD 19-1042; *Cloggie v Savro Ltd* 1988 GWD 31-1301. See also *Stair Memorial Encyclopaedia*, Vol 3, *Building Contracts*, para 109. In some cases there has been a cross-check between difference in value and costs of rectification. *Prudential Assurance Co Ltd v James Grant & Co Ltd* 1982 SLT 423; *Black v Gibson* 1992 SLT 1076. See also *Martin v Bell-Ingram* 1986 SLT 575 (a delict case).

⁸⁴ Several are given in the speeches in *Ruxley*.

⁸⁵ Difference in value is the *prima facie* measure of loss when the breach of contract consists of the delivery of goods which are not of the quality required by the contract and the buyer retains the goods. Sale of Goods Act 1979 s 53A(2).

⁸⁶ Para 8.28.

⁸⁷ There is already a limited exception for some contracts for the carriage of goods by sea. See the Carriage of Goods by Sea Act 1924 s 2 (4). The effect is to enable, for example, the lawful holder of a bill of lading to sue the

The problem

8.44 The problem is that cases arise where it seems that the party who breaches a contract and thereby causes loss escapes all liability because the other contracting party does not suffer the loss and the party who suffers the loss is not a party to the contract. The contract breaker's liability appears to vanish "into some legal black hole".⁸⁸ Here are some examples.

1. A, a whisky manufacturer, sells some casks of whisky to C. Property passes immediately. A enters into a contract with a carrier, B, for the transport of the whisky to C. Due to a breach of contract by B, the whisky is lost.⁸⁹
2. A, a sugar merchant, enters into a contract with a carrier, B, for the transport of a cargo of sugar to Scotland. The cargo is to be delivered to A. Due to a breach of contract by B some of the sugar fails to arrive. The sugar at all times belongs to C.⁹⁰
3. A, a firm of shipbuilders, contracts with B, a firm of engineers, for the construction of engines for a ship. A sells the ship to C while it is still unfinished. C is caused loss by a subsequent breach of contract on the part of B.⁹¹
4. A, who run a fish farm, contract with B, who operate a neighbouring sawmill, that B will not engage in certain activities which might affect the purity of the water used by A. A sell the fish farm to C. B breaches the contract and causes loss to C.
5. A, wishing to give a present to C, enters into a contract with B for the construction of a greenhouse on C's property. There is a material breach of contract by B. The greenhouse is shoddily constructed and unacceptable.
6. A contracts with a tour operator, B, for a holiday for herself and her friend C. The tour operator repudiates the contract. A wishes to recover damages not only for her own loss but also for C's.⁹²
7. A, a firm of property developers, enter into a contract with B, a firm of builders, for the construction of buildings on A's property. A transfer the property to an associated company, C. They attempt to assign their rights under the contract but the assignation turns out to be ineffective. B, in breach of the contract, does defective work which has to be rectified by C.⁹³

In all of these cases A has the contractual rights, B is in breach of contract but C suffers the loss. Other similar cases can easily be imagined. The problem sometimes presents itself as one where A has title to sue, but no interest, and C has an interest to sue but no title; but this is not the real nature of the problem. A may well have some interest to sue. That will depend on the facts. The real problem is that A cannot normally recover damages for a loss suffered by C, and C does not normally have rights under a contract between A and B.

carrier for breach of contract causing damage to goods belonging to someone else. The holder sues for the benefit of the owner.

⁸⁸ *GUS Property Management v Littlewoods* 1982 SC (HL) 157 at 177.

⁸⁹ *Dunlop & Co v Lambert* (1839) 1 Macl & Rob 663.

⁹⁰ *Campbell v Tyson* (1840) 2 D 1215.

⁹¹ *Blumer & Co v Scott & Sons* (1874) 1 R 379.

⁹² Example suggested by *Jackson v Horizon Holidays Ltd* [1975] 1 WLR 1468.

⁹³ Example suggested by *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85.

Some possible solutions under the existing law

8.45 This problem has been known for a long time and there are various possible solutions to it under the existing law.

Agency. It may be possible to show that A was acting as C's agent in entering into the contract with B.⁹⁴

Assignment. A may be able to assign A's rights under the contract to C.⁹⁵ B's obligations under the contract would, from then on, be owed to C instead of to A.⁹⁶

Jus quaesitum tertio. In some cases C may have rights under the contract as a third party under the doctrine of *jus quaesitum tertio*. It is perfectly possible in Scotland for a contract between A and B to confer rights on C. However, the intention to confer rights on C must be clear and there must be at least intimation to C.⁹⁷

Delict. In some cases, for example where B has by negligent acts caused damage to C's property, C may be able to recover damages from B on the basis of delict rather than contract.⁹⁸

Claim by A for consequential loss to A. In some cases, for example where B's breach causes A to incur liability to C under a separate contract between A and C, A may be able to claim the amount of this liability from B as a consequential loss arising from B's breach of contract.⁹⁹

Ordinary claim by A for primary loss to A. In some cases A may be able to claim full damages on normal principles. For example, if A has contracted with B for a greenhouse to be built on C's ground and there is a material breach of contract by B, there would be nothing to stop A claiming damages from B based on the cost of

⁹⁴ A case like example 2 (sugar merchants shipping sugar belonging to a third party) might well lend itself to decision on this basis. Cases like example 6 (holiday booked for friend) might also lend themselves, depending on the exact facts, to decision on this basis.

⁹⁵ See MacQueen, "Assignment and Breach of Contract" 1997 SLPQ 114.

⁹⁶ In relation to a loss sustained after the assignment it would not matter that A would not have suffered any loss if the contract had not been assigned. A's losses are by that time irrelevant. C has stepped into A's place as the other party to the contract. C could not, for example, recover for a loss suffered by A after the date of the assignment. There may be less difficulty here for Scottish law than for English law because Scottish law concentrates on the transfer of substantive rights rather than rights of suit or rights to damages. On the English law see *Darlington Borough Council v Wiltshier Northern Ltd* [1995] 1 WLR 68 at 73 - 74.

⁹⁷ *Carmichael v Carmichael's Exrx* 1920 SC (HL) 195; *Cullen v McMennamin* 1928 SLT (Sh Ct) 2; *Scott Lithgow Ltd v GEC Electrical Projects Ltd* 1992 SLT 244. The Law Commission for England and Wales have recommended the introduction of rules to allow third parties to acquire rights under contracts in certain situations (*Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com No 242, 1996) and a Bill has now been introduced to implement these recommendations. One of the reasons for the reform is to deal with problems of the type under discussion here.

⁹⁸ See the analysis in *Scott Lithgow Ltd v GEC Electrical Projects Ltd* 1992 SLT 244 where, on the facts of that case, it was held that there was no liability in delict. The law on liability for delict in this type of situation has shown a remarkable tendency to fluctuate. See eg *Anns v Merton London Borough Council* [1978] AC 728; *D & F Estates Ltd v Church Commissioners for England* [1989] AC 177; *Murphy v Brentwood District Council* [1991] 1 AC 398; *Department of the Environment v Thomas Bates and Son Ltd* [1991] 1 AC 499. It does not matter for the purposes of this paper where the precise boundaries are at any given time. The point is simply that in certain cases the law of delict may provide a solution.

⁹⁹ This was the basis of the decision in *Dunlop & Co v Lambert* (1839) 1 Macl & Rob 663 where the key point was that, although property had passed, the risk of loss of the whisky casks had remained with A who had in fact reimbursed C. See Clive, "Jus Quaesitum Tertio and Carriage of Goods by Sea" in *Comparative and Historical Essays in Scots Law* (Carey Miller and Meyers, eds, 1992) 47.

rectification. A's primary loss is the loss of the contractual performance. A normal way of measuring that is by reference to the cost of rectification.¹⁰⁰

Real burden. If the parties exercise sufficient foresight it may be possible to constitute the obligation owed by B as a real burden on the land owned by B in favour of the land owned by A. The obligation would then run with the land. However the requirements for the constitution of a real burden are strict.¹⁰¹

Assessment

8.46 The first question is whether it necessarily matters that work to be done under a contract between A and B is to be done on property belonging to C. It seems clear on principle that it does not. It would be fallacious to suppose that only owners of property, or indeed only those with real rights in property, can suffer loss as a result of a breach of contract to do work on the property. A tenant can with the landlord's agreement have work carried out on the property for the improvement of the tenant's comfort. It cannot be doubted that the tenant, however short the tenancy, can recover damages for breach of the contract if the work is not done to the required standard.¹⁰² The cost of rectification is the normal, but not the only possible, way of measuring the loss.¹⁰³ The same argument applies where the contracting party does not even have a tenancy. The fundamental point is that a person who has contracted for a certain performance is entitled to damages if it is not provided in accordance with the contract. There is no obvious need for reform here, at least if our earlier suggestion on non-patrimonial loss is accepted.

8.47 The second question is whether the law on assignation of contractual rights is adequate to enable rights to be transferred when the property or enterprise to which they relate is transferred. We can see no reason to suppose that it is not, at least in most situations.¹⁰⁴ There may be cases where A and B agree that A's rights under the contract cannot be assigned. In such a case it would seem to be wrong on principle to override this agreement. C should simply pay less for property that does not have useful contractual rights assigned with it. There may also be cases where an attempted assignation turns out to be defective. In such a case the remedy ought to be sought against whoever was responsible for bungling the assignation. There may also be cases where A and C do not arrange an assignation until it is too late – that is, until after the loss or damage has been sustained by

¹⁰⁰ This was the basis of Lord Griffiths' decision in *St Martins Property Corporation Ltd v Sir Robert McAlpine Ltd* [1994] 1 AC 85. The other judges saw much force in the analysis but, as it had not been fully explored in argument, preferred to decide the case on a more narrow and technical ground. See also the comments in *Darlington Borough Council v Wiltshier Northern Ltd* [1995] 1 WLR 68. English cases in this area are not, however, a reliable guide in so far as they found on the special rule of English law developed in *The Albazero* [1977] AC 774 or on doctrines of constructive trust. It is possible that English law has been distorted because of the absence of a doctrine allowing rights to be conferred directly on third parties under contracts.

¹⁰¹ The leading case is *Tailors of Aberdeen v Coutts* (1840) 1 Rob 296. We have recently consulted on reform of the law relating to real burdens. See our discussion paper on *Real Burdens* (Scot Law Com DP No 106, 1998).

¹⁰² In *Steel Aviation Services Ltd v Allan & Son Ltd* 1996 GWD 28-1699 A claimed damages for breach of contract by B to do work, on C's land, in connection with a concession held by A to operate certain services on B's land. It was held that A had averred a sufficient interest as sub-tenants or licensees to entitle them to sue. A were suing for their own primary loss, not for any loss alleged to be sustained by C.

¹⁰³ See paras 8.37 – 8.42.

¹⁰⁴ One of the reasons for the Carriage of Goods by Sea Act 1924 was that assignation is not a satisfactory solution in contracts for the carriage of goods by sea where ownership may pass frequently during a voyage and where foreign parties may be involved. See the joint report of the English and Scottish Law Commission on *Rights of Suit in Respect of Carriage of Goods by Sea* (Law Com No 196; Scot Law Com No 130, 1991) at para 2.13.

C.¹⁰⁵ It is not obvious, however, that special rules, contrary to normal principles and likely to be productive of difficulty, are required merely because parties do not assign rights or bungle the attempt to assign rights.

8.48 There might also be questions as to whether the rules on the other possible solutions under the existing law – and, in particular, on delict and the *jus quaesitum tertio* – are adequate. However, an examination of these questions would take us far beyond the reasonable limits of this paper. The important point is that there is no reason on principle why these other rules of law, as they are or as they might be developed, should not provide acceptable solutions in a wide range of cases where a breach of contract causes loss or harm to a person who is not an original party to the contract.

Request for views

8.49 Our preliminary view is that it would be unnecessary and contrary to principle to introduce a special rule allowing the party aggrieved by a breach of contract to recover damages for losses suffered by third parties. We would welcome views on the following provisional proposition.

- 29. No new special rule is necessary to enable a party to a contract to recover damages for losses suffered by a third party.**

¹⁰⁵ The time when the loss or harm occurs is crucial in this type of case.

Part 9 Reducing Uncertainty

Introduction

9.1 One of the main practical difficulties in relation to remedies for breach of contract is uncertainty as to the true legal position. This is particularly acute in relation to rescission. A party faced with a breach of contract has to assess accurately, often within a very short time, whether the breach is material enough to justify rescission. A party who guesses wrongly and rescinds will be in breach of contract. The rescission will be treated as a repudiation. The consequences of a wrong assessment of materiality can be serious. The problem can be particularly acute in the case of anticipated breach. The party who suspects that there will be a material breach has to assess the likelihood of breach, taking the risk that the other party will be able to satisfy a court that performance would have been made when the time for performance arrived, and also has to assess how material the breach is likely to be.

Requiring adequate assurance of performance

9.2 One way of alleviating the position for the aggrieved party is to introduce a provision allowing that party to demand an assurance of due performance from the other party. Failure to provide the assurance will make it safer to rescind. This is not a complete answer to the problem but experience in the United States of America, where the Uniform Commercial Code contains a rule of this type, suggests that it is useful.¹ The idea has been adopted by both the European *Principles*² and the Unidroit *Principles*.³ The Unidroit *Principles*, for example, provide as follows.

"A party who reasonably believes that there will be a fundamental non-performance by the other party may demand adequate assurance of due performance and may meanwhile withhold its own performance. Where this assurance is not provided within a reasonable time the party demanding it may terminate the contract."

What constitutes an adequate assurance depends on the circumstances. In cases where there appears objectively to be a serious risk of non-performance only the provision of some security for performance might constitute an adequate assurance. The idea of seeking an adequate assurance of performance in order to fortify the position of the aggrieved party is not unknown in Scotland⁴ but it appears to be undeveloped. We would be interested to know whether consultees would consider a provision on these lines to be worth introducing in Scotland.

¹ See the Uniform Commercial Code s 2.609 and the commentary thereon.

² Art 3.105.

³ Art 7.3.4.

⁴ In *Rodger (Builders) Ltd v Fawdry* 1950 SC 483 at 494 Lord Sorn said that where there was reason to doubt that money would be forthcoming to settle a transaction the party in doubt could set a time limit for payment (a device discussed below). He continued "What will justify doubt must always be a question of circumstances, but there are recognised means of seeking assurance with regard to ultimate payment, and, if these means have been tried and found wanting, the seller will be in a strong position to take action."

30. Should a party who reasonably believes that there will be a material breach by the other party be entitled to demand an adequate assurance of due performance, the effect being that the party could withhold its own performance in the meantime and could rescind the contract if an adequate assurance were not given within a reasonable time?

An ultimatum procedure

9.3 Another way of reducing uncertainty for an aggrieved party faced with delay in performance is to have an ultimatum procedure whereby the aggrieved party can allow an additional time for performance, with the right to rescind if performance is not made within that time. In some cases the effect of the ultimatum is to convert a non-material breach into a material breach. In other cases the effect is to resolve a doubt as to the availability of rescission and other remedies. Both the European *Principles*⁵ and the Unidroit *Principles*⁶ have a rule allowing an additional time to be given for performance, with the remedy of termination of the contract being available if the ultimatum is not met. The Unidroit version is as follows.

"(1) In a case of non-performance the aggrieved party may by notice to the other party allow an additional period of time for performance.

(2) During the additional period the aggrieved party may withhold performance of its own reciprocal obligations and may claim damages but may not resort to any other remedy. If it receives notice from the other party that the latter will not perform within that period, or if upon expiry of that period due performance has not been made, the aggrieved party may resort to any of the remedies that may be available under this Chapter.

(3) Where in a case of delay in performance which is not fundamental the aggrieved party has given notice allowing an additional period of time of reasonable length, it may terminate the contract at the end of that period. If the additional period allowed is not of reasonable length it shall be extended to a reasonable length. The aggrieved party may in its notice provide that if the other party fails to perform within the period allowed by the notice the contract shall automatically terminate.

(4) Paragraph (3) does not apply where the obligation which has not been performed is only a minor part of the contractual obligation of the non-performing party."

9.4 There is a similar rule in Scotland⁷ but it rests on dubious foundations⁸ and it is not clear whether it is confined to the sale of land. Lord Sorn explained the rule as follows.

⁵ Art 3.106.

⁶ Art 7.1.5.

⁷ *Rodger (Builders) Ltd v Fawdry* 1950 SC 483 at 492; *Inveresk Paper Co Ltd v Pembry Machinery Co Ltd* 1972 SLT (Notes) 63; *Johnstone v Harris* 1977 SC 365; *Charisma Properties Ltd v Grayling (1994) Ltd* 1996 SC 556 at 558.

⁸ The modern rule was invented single-handedly by Lord Sorn in *Rodger (Builders) Ltd v Fawdry* 1950 SC 483 at 492. He based the rule on two earlier Scottish cases and one English House of Lords case. The first Scottish case was *Black v Dick* (1814) Hume 699. This involved an action for declarator that a sale of land was "void and null" because of non-payment of the price. The court gave the purchaser time to pay, saying that declarator would be granted if he did not. When payment was still not made after "two short indulgences more" declarator was granted. Clearly this is far removed from a private ultimatum procedure. The second Scottish case was *Burns v Garscadden* (1901) 8 SLT 321. Here after numerous delays and allowances of time to pay, the seller finally rescinded and sold the land to a third party. It was held that the seller was not entitled to rescind. Damages were awarded to the purchaser. This is not a good foundation for an ultimatum doctrine. The English case was *Stickney v Keeble* [1915] AC 386. It concerned a delay by the seller of land in providing a title. The buyer was held

"If there is unnecessary or unjustifiable delay on the part of the purchaser in paying the price, the seller may limit a time within which payment must be made, and, provided the time limited is a reasonable one in the circumstances, failure to pay within that time will be treated as breach of an essential condition entitling the seller to rescind."⁹

9.5 We would welcome views on whether it would be useful to set this ultimatum procedure on a firm base and make it clear that it is not confined to sales of land.

31. Should there be a general rule, not confined to sales of land, that a party faced by a delay in performance under a contract can give a reasonable additional time for performance under threat of rescission if the time limit is not met?

A summary declarator procedure

9.6 Yet another way of alleviating the difficulties of the aggrieved party faced with the uncertainty of knowing how to proceed would be to introduce a special summary declarator procedure which would enable a prompt decision to be obtained from a court as to the materiality of a breach or anticipated breach. We put this idea forward with some hesitation because we are aware that great efforts have already been made to improve the availability of judicial remedies to parties involved in commercial disputes.¹⁰ We are also aware that there are many competing demands for priority in court proceedings. There are also limits to the speed with which any court proceedings can be conducted, especially if disputed facts have to be investigated. For these reasons we are inclined to believe that procedures which can be operated by the parties themselves, such as the demand for an adequate assurance of performance or the ultimatum procedure described above, are likely to be more effective in the long run in reducing uncertainty. Nonetheless we would be interested to know whether consultees would consider that there would be advantages in a summary declarator procedure. One possible difficulty is that the declarator, to fulfil its function, would have to be final. There would be no advantage or sense in an interim declarator.

32. Would there be advantages in a summary declarator procedure to enable a prompt judicial decision to be obtained on such matters as the materiality of a breach of contract? Are there any comments on the practicability of, or constraints on, such a procedure?

Using replacement transaction as a basis for damages

9.7 Another technique to reduce the doubts of an aggrieved party as to the courses of action available on a breach of contract by the other party is to make it clear that the

entitled to give a period of notice setting a reasonable time for performance at the expiration of which he would treat the contract as at an end. The decision turned on principles of English equity and the effect of the Judicature Act 1873 and is again not a sound foundation for an ultimatum doctrine in Scotland.

⁹ *Rodger (Builders) Ltd v Fawdry* 1950 SC 483 at 492. Lord Sorn held that there was not in this case sufficient unnecessary or unjustifiable delay to entitle the seller to impose a time limit.

¹⁰ Rules of the Court of Session 1994, chap 47 – introducing a new commercial court with more flexible and rapid procedures. See the *Report of the Working Party on Commercial Causes*, Nov 1993; N Morrison, "Scotland's New Commercial Court," 1994 JLSS 354; Penrose, "Commercial Actions - First Thoughts," 1995 Greens Civil Practice Bulletin, Issue 1, p 3; J McNeill, "Commercial Actions in the Court of Session," 1995 Greens Civil Practice Bulletin, Issue 5, p 2; R McInnes, "Men Behaving Badly: The Commercial Court and the Ethics of Tactics," 1997 Greens Civil Practice Bulletin, Issue 13, p 4; R Clancy, A Murray & R Wadia, "The New Commercial Cause Rules" 1997 SLT (News) 45, 53.

aggrieved party can safely resort to a replacement transaction once a contract is rescinded, in the knowledge that if the transaction is reasonable it will be used as the basis for calculating the main head of damages. This is provided for by the Vienna Convention¹¹ and, in almost identical terms, by the European *Principles*¹² and the Unidroit *Principles*.¹³

"Where the aggrieved party has terminated the contract and has made a replacement transaction within a reasonable time and in a reasonable manner it may recover the difference between the contract price and the price of the replacement transaction as well as damages for any further harm."¹⁴

9.8 There are many ordinary situations where the comparative certainty of a rule on these lines could be useful.

Example. The organisers of a conference want to hire a bus to take participants on an excursion. They obtain quotations from five bus companies and accept the cheapest. On the day before the excursion the bus company telephones to say that it has no bus available for the contract. The organisers accept this repudiation, terminate the contract and contact the bus company which provided the next lowest estimate. It provides a bus for the price it originally quoted.

In this situation it is reasonable that the conference organisers should be able to claim the difference between the contract price and the higher price they had to pay for a bus. They acted reasonably. They should not have to meet arguments that they could have shopped around for a cheaper bus or that the market price for a bus for a day was slightly less than the price that they paid.

9.9 There is little doubt that sensible results could be reached under the existing rules on mitigation of loss.¹⁵ However, those rules give the appearance of being aimed at the aggrieved party rather than of being designed to help the aggrieved party. There could be some presentational advantage, and also perhaps some slight gain in certainty, in a rule like that quoted above.

9.10 We would welcome views.

33. Would there be any advantage in introducing a rule to the effect that where the aggrieved party has terminated the contract and has made a replacement transaction within a reasonable time and in a reasonable manner it may recover the difference between the contract price and the price of the replacement transaction as well as damages for any further harm?

Using current market price as the basis of damages

9.11 Where there is no replacement transaction, but there is a current market price for the performance contracted for, the European *Principles*¹⁶ and Unidroit *Principles*¹⁷ provide for

¹¹ Art 75.

¹² Art 4.505.

¹³ Art 7.4.5.

¹⁴ This is the Unidroit version.

¹⁵ See McBryde, *Contract* 454 – 462.

¹⁶ Art 4.506.

¹⁷ Art 7.4.6.

damages to be assessed by reference to the difference between the contract price and the current market price at the time when the contract was terminated, damages for any further loss also being available. The European *Principles*, for example, have the following rule.¹⁸

"Where the aggrieved party has terminated the contract and has not made a cover transaction but there is a current price for the performance contracted for, he may recover the difference between the contract price and the price current at the time the contract is terminated as well as damages for any further loss so far as these are recoverable ..."

9.12 A similar approach is adopted in Scotland, both at common law¹⁹ and under the Sale of Goods Act 1979,²⁰ although there are some differences. The most important difference is in relation to the time as at which market value is to be ascertained. Under the Sale of Goods Act this is normally the time when the goods ought to have been accepted or delivered. This does not always work well, particularly in the case of rescission for anticipatory breach. The aggrieved party is in a position to go into the market as soon as the contract is rescinded and the date of rescission would generally be a better date to take. The Scottish common law position was more flexible.²¹ Indeed even in the case of rescission for actual breach the date of rescission would often seem to be a better date. The aggrieved party is allowed a reasonable time to decide whether or not to rescind and may reasonably allow a further time for performance before rescinding. In the case of the person who is being supplied with goods or services there may be a need to examine the goods (or whatever else has been supplied) and conduct tests before deciding on rescission. That may take time. It is only at the date of rescission that the aggrieved party is freed from the contract and able to go into the market. If, therefore, the existing rules were applied rigidly there would, in our view, be a case for considering reform in the direction of a more flexible solution, perhaps making the date of rescission the normal date for the ascertainment of market value in any case where the contract was rescinded. However, the existing rules are only *prima facie* rules and the courts are able to depart from them when this would be reasonable.²² Some of the difficulties arising under the present law would in any event be eased if more attention were paid to a reasonable replacement transaction. We do not therefore consider that any recommendation for change in the underlying rules is necessary, although the question of date would be worthy of consideration if the rules were being reformulated anyway.

¹⁸ Art 4.506.

¹⁹ *Dunlop v Higgins* (1848) 6 Bell's App 195; *Duff & Co v The Iron and Steel Fencing and Buildings Co* (1891) 19 R 199.

²⁰ Ss 50 and 51.

²¹ See *Warin and Craven v Forrester* (1876) 4 R 190; *Duff & Co v The Iron and Steel Fencing and Buildings Co* (1891) 19 R 199; *Marshall and Co v Nicoll and Son* 1919 SC 244 and 1919 SC (HL) 129.

²² See eg *Radford v De Froberville* [1977] 1 WLR 1262; *Kaines v Osterreichische Warrenhandels-gesellschaft Austrowaren Gesellschaft mbH* [1993] 2 Lloyd's Rep 1 where the court took the day after the rescission as the relevant date.

Part 10 Miscellaneous

Interest

10.1 The law on the payment of interest on overdue contractual sums is far from satisfactory and we have received suggestions that we should examine it. There is, at common law, no general right to interest on sums overdue under a contract. Yet the loss of a reasonable return on money which ought to have been received is an obvious loss sustained by a person who is not paid money that is due under a contract. The hardship, worry and waste of time and effort caused by a culture of late payment of debt are considerable. A legal right to interest would not provide a complete answer. Economic power will always enable some persons to ignore their legal obligations. However, a legal right to interest would not do any harm and might do some good. It seems right in principle and potentially beneficial in practice. If the field was unoccupied we would be inclined to favour a general provision like that in article 4.507 of the European *Principles* which provides as follows.¹

"(1) If payment of a sum of money is delayed, the aggrieved party is entitled to interest on that sum from the time when payment is due to the time of payment at the average commercial bank short-term lending rate to prime borrowers prevailing for the contractual currency of payment at the place where payment is due.

(2) The aggrieved party may in addition recover damages for any further loss, so far as these are recoverable ..."

The field, however, is not unoccupied. After much discussion and consultation, legislation on this matter has been introduced. The Late Payment of Commercial Debts (Interest) Act 1998 provided for a statutory obligation to pay interest on certain commercial debts.² The Act provides for a high rate of interest³ which goes beyond compensation and is intended to have some penal effect. The obligation affects only debts due by large businesses or public sector bodies to small businesses.⁴ This appears to us to be unprincipled, as indeed does the limitation to commercial debts. The 1998 Act is, however, a major step in the right direction. It has provisions to prevent contracting out and other refinements not found in the European *Principles*. We hope that it will be possible to extend its application in a principled way. The matter is, however, in the political arena and is likely to be affected by a European Directive on the subject.⁵ In these circumstances we do not think it would be appropriate or productive for us to consult on it in this paper.

¹ The Unidroit *Principles* have a similar rule in art. 7.4.9. The Vienna Convention also provides, in arts 78 and 84 (1), for interest to be due on sums unpaid in breach of contract, but does not fix a rate. The English Law Commission recommended an obligation to pay interest on contract debts. See its report on *Interest* (Law Com No 88, 1978).

² See Macgregor, "A Statutory Right to Claim Interest on Late Commercial Debt" 1998 SLPQ 180.

³ Essentially base rate + 8%.

⁴ A small business is one with 50 or fewer full-time employees or part-time equivalents. The intention is to extend the Act, in time, to all businesses.

⁵ A proposal for a European Parliament and Council Directive combating late payment in commercial transactions was submitted to the Parliament and Council on 23 April 1998 and published in the Official Journal on 3 June 1998. See Lawson, "Late Payment: the Commission's latest proposals" 1999 Sol J 244.

Loss or harm attributable to aggrieved party⁶

10.2 In 1988 this Commission published a report⁷ noting that a plea of contributory negligence was not generally available in claims based on breach of contract⁸ and recommending that it should be available to a limited extent. The key recommendations were as follows.

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."⁹

These recommendations have not been implemented.

10.3 In 1993 the English Law Commission came to very similar conclusions.¹⁰ Like the Scottish Law Commission it drew short of recommending that contributory negligence should be generally available in breach of contract cases. It did recommend that it should be available whenever a plaintiff suffered damage as the result partly of the breach of a contractual duty to take reasonable care or exercise reasonable skill and partly of the plaintiff's own contributory negligence. These recommendations have not been implemented either.

10.4 The European *Principles* have an article headed "Loss Attributable to Aggrieved Party" which provides as follows.¹¹

"(1) The non-performing party is not liable for loss suffered by the aggrieved party to the extent that:

(a) the aggrieved party contributed to the non-performance or its effects..."¹²

⁶ The term "contributory negligence" is commonly used in this context but it is perhaps inappropriate. The important question is whether the aggrieved party contributed to the loss or its exacerbation. It does not matter whether that was done intentionally or negligently. Indeed there is a stronger argument for taking account of intentional conduct than there is for taking account of negligent conduct in this area.

⁷ Report on *Civil Liability – Contribution* (Scot Law Com No 115, 1988).

⁸ The Law Reform (Contributory Negligence) Act 1945 allowed damages to be apportioned to take account of the pursuer's contributory negligence. Its wording, using terms like "fault" and "damage", is such that it might be applicable in certain cases of breach of contract but it was intended for delict cases and, in practice, has not been used in contract cases. The point is considered in *Lancashire Textiles (Jersey) Ltd v Thomson Shepherd & Co Ltd* 1986 SLT 41 at 45. See also *Forsikringsaktieselskapet Vesta v Butcher* [1989] AC 852 and 880.

⁹ p 57 of Report. See also paras 4.15 to 4.26 of Report.

¹⁰ Report on *Contributory Negligence as a Defence in Contract* (Law Com No 219, 1993).

¹¹ At 4.504.

One criticism of this rule is that it is too mechanistic. It takes no account of degree of fault. The aggrieved party may have contributed accidentally or blamelessly to the non-performance or its effects. The Unidroit *Principles* are more subtle. They provide that¹³

"Where the harm is due in part to an act or omission of the aggrieved party or to another event as to which that party bears the risk, the amount of damages shall be reduced to the extent that these factors have contributed to the harm, having regard to the conduct of each of the parties."

10.5 We regard the earlier Commission recommendation as the minimum reform which should be considered in this area. The question for consideration now is whether it would be desirable to go beyond the Commission's earlier recommendation and introduce a wider provision. The main reason for the Commission's recommendation that contributory negligence should not be available to the defender where the defender's breach did not consist of negligence was that where the defender's fault was irrelevant to the breach, the pursuer's fault should also be irrelevant.¹⁴ This, however, does not necessarily follow. The fact that the party in breach cannot normally found on its own absence of fault does not necessarily mean that it should be liable to the full extent for loss or damage which was partly caused by the aggrieved party. In any event it could be provided, as in the Unidroit *Principles*, that the conduct of both parties can be taken into consideration where both have contributed to the loss or harm. There was also an argument that the parties should be free to contract for extensive liability, regardless of contributory fault, if they so wished.¹⁵ However, this argument loses much of its force if it is accepted that the parties can contract out of any rule on contributory fault. It was also said that to allow contributory negligence to operate in all contractual cases would weaken the position of consumers and give rise to unacceptable uncertainty in commercial dealings.¹⁶ It is, however, a question of policy whether consumers are to be protected and certainty achieved no matter how unjust and unreasonable the results. It is also open to argument how much additional uncertainty would be caused. Questions of causation, remoteness and mitigation are likely already to introduce uncertainty in cases involving joint fault. Allowing reasonable results, based on an apportionment of blame, to be reached at an early stage in a dispute can prevent litigation and appeals and reduce uncertainty in the end of the day. In making its modest and limited recommendations in 1988 the Scottish Law Commission was adopting a cautious approach which was not by any means unreasonable or unusual. A similar approach had been adopted in many common law jurisdictions and, as we have seen, was adopted, for substantially the same reasons, by the English Law Commission five years later. Nonetheless it is clear that there were, and are, arguments both ways on this question.

10.6 At our seminar on remedies for breach of contract the question of harm due in part to the conduct of the aggrieved party was raised as a matter deserving consideration. On principle it would seem to be desirable to take into account the conduct of the aggrieved party in contributing to the loss or harm. This is just an extension of the policy underlying

¹² The rest of the article deals with mitigation of loss. The party in breach is not liable to the extent that the loss could have been reduced by the aggrieved party's taking reasonable steps.

¹³ Art 7.4.7.

¹⁴ Scot Law Com No 115 (1988) para 4.18 – "The fault of the defender is irrelevant to liability: therefore any fault on the part of the pursuer should also be irrelevant."

¹⁵ Scot Law Com No 115 (1988) para 4.19 – "If [a person] agrees to be bound by the contract in all circumstances, even those involving carelessness by the other contracting party, he should not, as a matter of general law, be able to plead that party's conduct in answer to a claim for breach of contract."

¹⁶ Scot Law Com No 115 (1988) para 4.20.

the well-established rules on mitigation of loss. In cases where loss or damage is sustained as a result of breach of contract it will often be the case that the aggrieved party is partly to blame for the loss or harm. To force courts into an all or nothing choice is likely to produce unreasonable results.

Example. A contractor contracts with an electricity supply company for a continuous supply of electricity. The company, in breach of the contract, allows an interruption in the supply. This is one of the causes of an enormous loss to the contractor who has to re-lay a large volume of concrete. Another causal factor was that the contractor failed to take reasonable steps to see that a back-up system was available before beginning a task for which a continuous supply of concrete was indispensable.¹⁷

In a case like this, awarding the contractor full damages or no damages may be equally unattractive. The reasonable course may be to apportion the liability, taking the conduct of both parties into account.¹⁸ Other, more commonplace, examples could easily be imagined. For example, a party to a contract for the carriage of goods gives the carrier a wrong address and then claims damages for late delivery. Or a person who has bought sophisticated electronic equipment which is not in all respects conform to contract causes damage to it by ignoring the clear instructions supplied with it and taking foolish and unreasonable steps to remedy the small defect. Or a woman injures herself in foolishly and unreasonably attempting to climb over a high gate which ought, in terms of a contract, to have been left open.¹⁹

10.7 It is not entirely clear that it is justifiable to draw a distinction between contracts involving the exercise of care or skill and other contracts. The above examples are all ones where it would seem reasonable to take contributory fault into account but none of them involves a contract to exercise care or skill. It may be a matter of chance whether an obligation is expressed as an obligation to achieve a result or to use all reasonable care and skill to achieve a result.

10.8 We invite responses to the following questions.

34. (a) Is there a need for any new rule to deal with the situation where loss or harm caused partly by a breach of contract is also caused partly by the act or omission of the aggrieved party?

(b) If so, should it be provided that 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?

(c) Should it matter whether the defender's contractual obligation was one which involved the exercise of due care?

¹⁷ This is a hypothetical example suggested by the case of *Balfour Beatty Construction v Scottish Power* 1994 SLT 807 but not intended to reflect the actual facts in that case.

¹⁸ If the electricity company had caused the loss intentionally, having been warned, for example, that the operation was beginning and that there were no back-up arrangements, then their deliberate conduct would no doubt justify the conclusion that they should be wholly liable.

¹⁹ This is a less colourful version of the facts in *Sayers v Harlow UDC* [1958] 1 WLR 623 where the plaintiff injured herself in attempting to climb out of a locked toilet cubicle.

General request for views

10.9 We have tried in the preceding parts of this paper to identify those topics in the law on remedies for breach of contract where reform might be of practical benefit in filling gaps, removing anomalies or clarifying the law. We have invited views on possible solutions. However, there may be other and better solutions to the problems we have identified and there may be other problems causing difficulties in practice which we have not identified. We would be grateful for suggestions.

- 35. We would be grateful for views on other possible approaches to any of the problems we have identified and on other problems relating to remedies for breach of contract which we have not identified but which might merit legislative intervention.**

Part 11 Summary of Propositions and Questions

Remedies for breach in general

1. Should it be made clear that breach, in relation to contract, covers the situation where a contractual warranty, not involving any obligation to perform, proves to be untrue?
(Paragraph 2.4)
2. Should it be made clear that the aggrieved party's remedies for anticipatory breach arise not only when there is a total repudiation of the contract but also when it is clear that there will be a material breach of the contract?
(Paragraph 2.7)
3. Should it be made clear that the aggrieved party's remedies for anticipatory breach can arise in relation to an anticipatory breach of a severable part of the contract, the remedies being confined to that part of the contract?
(Paragraph 2.8)
4. (a) Would there be any advantage in having a statutory provision defining or explaining the type of breach which will justify rescission ?
(b) If so, what should be its essential features?
(Paragraph 2.17)
5. (a) Is the existing structure of remedies for breach of contract satisfactory?
(b) Are any additional remedies needed?
(Paragraph 2.19)
6. Would there be any advantage in a statutory provision making clear 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?
(Paragraph 2.20)
7. It should be made clear that a party to a contract is not disentitled, merely by being in breach of contract, from any available remedy for the other party's breach of contract.
(Paragraph 2.26)

Suspension of performance

8. Should it be made clear that suspension of performance is available where it is clear that there is going to be a material breach?

(Paragraph 3.10)
9. Should it be made clear that, where there has been an actual breach of contract, not being a trivial breach, the remedy of suspension of performance is available even if the breach was not material?

(Paragraph 3.11)
10. The remedy of suspension of performance should not be available where the other party has substantially performed but the performance is defective and it would be unreasonable to require the defects to be remedied.

(Paragraph 3.14)
11. As an alternative to the last two solutions, should it be provided that the remedy of suspension of performance must be exercised in good faith?

(Paragraph 3.15)

Rescission

12. It should be made clear that rescission is effected by intimation to the party in breach.

(Paragraph 4.6)
13. (1) In the case of a remediable material breach, should the basic rule be
 - (a) that the aggrieved party cannot rescind unless the other party has been given a reasonable opportunity to remedy the breach, or
 - (b) that the aggrieved party can rescind without giving the other party an opportunity to remedy the breach?(2) If (a) were adopted would the rules in article 7.1.4 of the *Unidroit Principles* (set out in paragraph 4.20) provide a suitable model for a provision which attempted to recognise the legitimate interests of the aggrieved party?

(Paragraph 4.22)
14. It should be made clear that if performance has been made or offered, but in a way which is a material breach of the contract, the right to rescind is lost after the lapse of a reasonable time from the date when the aggrieved party became, or could reasonably have been expected to become, aware of the breach.

(Paragraph 4.24)

15. Should the redressing of economic imbalances caused by rescission of a partly performed contract be
- (a) left to the law on unjustified enrichment, it being made clear that recourse to the law on unjustified enrichment is not precluded by the existence of a claim for damages and that a rescinded contract does not provide legal justification for the retention of benefits conferred in the expectation of a counter-performance lost by the rescission, or
 - (b) regulated in a statute dealing with reform of the law on remedies for breach of contract?

(Paragraph 4.52)

16. If the redressing of imbalances caused by rescission of a contract were to be regulated by statute, would articles 4.307 to 4.309 of the European *Principles* provide an appropriate model?

(Paragraph 4.52)

17. If either of the above solutions were adopted, should it be made clear that the so-called *quantum meruit* rule (that is, the rule to the effect that a person who has provided work or services under a rescinded contract is normally entitled to reasonable remuneration) is an example of the operation of the law on unjustified enrichment or of the new statutory rule, as the case may be, and is not an independent rule of law?

(Paragraph 4.52)

Decree for payment

18. Would there be any advantage in a provision, designed to solve the problem revealed by *White & Carter (Councils) Ltd v McGregor*, along the lines of Article 4.101(2) of the Principles of European Contract Law which provides as follows?

"Where the creditor has not yet performed his obligation and it is clear that the debtor will be unwilling to receive performance, the creditor may, nonetheless, proceed with his performance and may recover any sum due under the contract unless:

- (a) he could have made a reasonable cover transaction without significant effort or expense; or
- (b) performance would be unreasonable in the circumstances."

(Paragraph 5.22)

19. In order to remove doubts and difficulties caused by statements in *Ramsay v Brand* (1898) 25R 1212, would it be useful to provide that there is no rule of law that a party claiming payment under a contract which has been substantially performed, but with defects in performance which cannot reasonably be rectified, must necessarily have subtracted from the payment the cost of rectifying the work? (This would be without prejudice to any claim for damages the aggrieved party may have.)

(Paragraph 5.28)

Specific implement

20. Is there any need for greater clarity as to the circumstances in which a decree of specific implement will or will not be granted?

(Paragraph 6.13)

21. Should there be express provision enabling interim decrees of specific implement to be obtained?

(Paragraph 6.13)

Interdict

22. It should be competent to grant an interdict notwithstanding that in substance it compels performance of a contract. No such interdict should be granted, however, if a specific implement would not be granted in the same circumstances.

(Paragraph 7.22)

Damages

23. Do consultees agree that the purpose of damages for breach of contract should, in general, be compensation for loss or harm caused by the breach and that accordingly there is no need for the general law on damages to provide for restitutionary, disgorgement, punitive or nominal damages for breach of contract?

(Paragraph 8.5)

24. Would it be useful to provide that the party in breach of contract is liable only for loss or harm which it foresaw or could reasonably have foreseen at the time of conclusion of the contract as a likely result of the breach?

(Paragraph 8.20)

25. Should there be an exception to the preceding rule if the breach was intentional or grossly negligent?

(Paragraph 8.20)

26. Should it be made clear that, subject to the normal remoteness rule, the loss or harm for which damages may be recovered for breach of contract includes non-patrimonial loss or harm of any kind, and in particular includes loss of the satisfaction of obtaining what was contracted for and harm in the form of pain, suffering or mental distress?

(Paragraph 8.26)

27. There is no need to introduce an alternative measure of damages, available at the pursuer's option and designed to restore the pursuer's position to what it would have been had the contract never been entered into.

(Paragraph 8.34)

28. Should it be made clear that the cost of rectification need not be used as the basis of assessing damages in any case where to do so would be unreasonable and that in such a case damages should be based on an assessment of the loss, including non-patrimonial loss, sustained by the aggrieved party in the absence of rectification?

(Paragraph 8.40)

29. No new special rule is necessary to enable a party to a contract to recover damages for losses suffered by a third party.

(Paragraph 8.47)

Reducing uncertainty

30. Should a party who reasonably believes that there will be a material breach by the other party be entitled to demand an adequate assurance of due performance, the effect being that the party could withhold its own performance in the meantime and could rescind the contract if an adequate assurance were not given within a reasonable time?

(Paragraph 9.2)

31. Should there be a general rule, not confined to sales of land, that a party faced by a delay in performance under a contract can give a reasonable additional time for performance under threat of rescission if the time limit is not met?

(Paragraph 9.5)

32. Would there be advantages in a summary declarator procedure to enable a prompt judicial decision to be obtained on such matters as the materiality of a breach of contract? Are there any comments on the practicability of, or constraints on, such a procedure?

(Paragraph 9.6)

33. Would there be any advantage in introducing a rule to the effect that where the aggrieved party has terminated the contract and has made a replacement transaction within a reasonable time and in a reasonable manner it may recover the difference between the contract price and the price of the replacement transaction as well as damages for any further harm?

(Paragraph 9.10)

Miscellaneous

34. (a) Is there a need for any new rule to deal with the situation where loss or harm caused partly by a breach of contract is also caused partly by the act or omission of the aggrieved party?
- (b) If so, should it be provided that 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?
- (c) Should it matter whether the defender's contractual obligation was one which involved the exercise of due care?

(Paragraph 10.8)

35. We would be grateful for views on other possible approaches to any of the problems we have identified and on other problems relating to remedies for breach of contract which we have not identified but which might merit legislative intervention.

(Paragraph 10.9)