HOUSE OF LORDS SESSION 2007–08

[2008] UKHL 48

on appeal from: [2007] EWCA Civ 901

OPINIONS
OF THE LORDS OF APPEAL
FOR JUDGMENT IN THE CAUSE

Transfield Shipping Inc (Appellants) *v* Mercator Shipping Inc (Respondents)

Appellate Committee

Lord Hoffmann
Lord Hope of Craighead
Lord Rodger of Earlsferry
Lord Walker of Gestingthorpe
Baroness Hale of Richmond

Counsel

Appellant:
Dominic Kendrick QC
Benjamin Parker

(Instructed by Swinnerton Moore LLP)

Respondent:
Simon Croall QC
Ruth Hosking

(Instructed by Bentleys Stokes & Lowless)

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HOUSE OF LORDS

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LORD HOFFMANN

My Lords,

1. The *Achilleas* is a single-decker bulk carrier of some 69,000 dwt built in 1994. By a time charter dated 22 January 2003 the owners let her to the charterers for about five to seven months at a daily hire rate of US$13,500. By an addendum dated 12 September 2003 the parties fixed the vessel for a further five to seven months at a daily rate of US$16,750. The latest date for redelivery was 2 May 2004.

2. By April 2004, market rates had more than doubled compared with the previous September. On 20 April 2004 the charterers gave notice of redelivery between 30 April and 2 May 2004. On the following day, the owners fixed the vessel for a new four to six month hire to another charterer, following on from the current charter, at a daily rate of US$39,500. The latest date for delivery to the new charterers, after which they were entitled to cancel, was 8 May 2004.

3. With less than a fortnight of the charter to run, the charterers fixed the vessel under a subcharter to carry coals from Quingdao in China across the Yellow Sea to discharge at two Japanese ports, Tobata and Oita. If this voyage could not reasonably have been expected to allow redelivery by 2 May 2004, the owners could probably have refused to perform it: see *Torvald Klaveness A/S v Arni Maritime Corpn* (*The Gregos)* [1995] 1 Lloyd's Rep 1. But they made no objection. The vessel completed loading at Quingdao on 24 April. It discharged at

Tobata, went on to Oita, but was unfortunately delayed there and not redelivered to the owners until 11 May.

4. By 5 May it had become clear to everyone that the vessel would not be available to the new charterers before the cancelling date of 8 May. By that time, rates had fallen again. In return for an extension of the cancellation date to 11 May, the owners agreed to reduce the rate of hire for the new fixture to $31,500 a day.

5. The owners claimed damages for the loss of the difference between the original rate and the reduced rate over the period of the fixture. At US$8,000 a day, that came to US$1,364,584.37. The charterers said that the owners were not entitled to damages calculated by reference to their dealings with the new charterers and that they were entitled only to the difference between the market rate and the charter rate for the nine days during which they were deprived of the use of the ship. That came to $158,301.17.

6. The arbitrators, by a majority, found for the owners. They said that the loss on the new fixture fell within the first rule in *Hadley v Baxendale* (1854) 9 Exch 341, 354 as arising "naturally, ie according to the usual course of things, from such breach of contract itself". It fell within that rule because it was damage "of a kind which the [charterer], when he made the contract, ought to have realised was not unlikely to result from a breach of contract [by delay in redelivery]": see Lord Reid in *C Czarnikow Ltd v Koufos* (*The Heron II)* [1969] 1 AC 350, 382-383. The dissenting arbitrator did not deny that a charterer would have known that the owners would very likely enter into a following fixture during the course of the charter and that late delivery might cause them to lose it. But he said that a reasonable man in the position of the charterers would not have understood that he was assuming liability for the risk of the type of loss in question. The general understanding in the shipping market was that liability was restricted to the difference between the market rate and the charter rate for the overrun period and "any departure from this rule [is] likely to give rise to a real risk of serious commercial uncertainty which the industry as a whole would regard as undesirable."

7. The majority arbitrators, in their turn, did not deny that the general understanding in the industry was that liability was so limited. They said (at para 17):

> "The charterers submitted that if they had asked their lawyers or their Club what damages they would be liable for if the vessel was redelivered late, the answer would have been that they would be liable for the difference between the market rate and the charter rate for the period of the late delivery. We agree that lawyers would have given such an answer".

8. But the majority said that this was irrelevant. A broker "in a commercial situation" would have said that the "not unlikely" results arising from late delivery would include missing dates for a subsequent fixture, a dry docking or the sale of the vessel. Therefore, as a matter of law, damages for loss of these types was recoverable. The understanding of shipping lawyers was wrong.

9. On appeal from the arbitrators, Christopher Clarke J [2007] 1 Lloyd's Rep 19 and the Court of Appeal (Ward, Tuckey and Rix LJJ) [2007] 2 Lloyd's Rep 555 upheld the majority decision. The case therefore raises a fundamental point of principle in the law of contractual damages: is the rule that a party may recover losses which were foreseeable ("not unlikely") an external rule of law, imposed upon the parties to every contract in default of express provision to the contrary, or is it a prima facie assumption about what the parties may be taken to have intended, no doubt applicable in the great majority of cases but capable of rebuttal in cases in which the context, surrounding circumstances or general understanding in the relevant market shows that a party would not reasonably have been regarded as assuming responsibility for such losses?

10. Before I come to this point of principle, I should say something about the authorities upon which the understanding of shipping lawyers was based. There is no case in which the question now in issue has been raised. But that in itself may be significant. This cannot have been the first time that freight rates have been volatile. There must have been previous cases in which late redelivery caused the loss of a profitable following fixture. But there is no reported case in which such a claim has been made. Instead, there has been a uniform series of dicta over many years in which judges have said or assumed that the damages for late delivery are the difference between the charter rate and the market rate: see for examples Lord Denning MR in *Alma Shipping Corpn of Monrovia v Mantovani* (*The Dione*) [1975] 1 Lloyd's Rep 115, 117-118; Lord Denning MR in *Arta Shipping Co Ltd v Thai Europe Tapioca Service Ltd* (*The Johnny)* [1977] 2 Lloyd's Rep 1, 2; Bingham LJ in

Hyundai Merchant Marine Co Ltd v Gesuri Chartering Co Ltd (*The Peonia*) [1991] 1 Lloyd's Rep 100, 118. Textbooks have said the same: see Scrutton on *Charterparties* 20th ed (1996), pp 348-349; Wilford and others *Time Charters* 5th ed (2003), at para 4.20. Nowhere is there a suggestion of even a theoretical possibility of damages for the loss of a following fixture.

11. The question of principle has been extensively discussed in the literature. Recent articles by Adam Kramer ("An Agreement-Centred Approach to Remoteness and Contract Damages") in *Cohen and McKendrick (ed), Comparative Remedies for Breach of Contract* (2004) pp 249-286 Andrew Tettenborn ("Hadley v Baxendale Foreseeability: a Principle Beyond its Sell-by Date") in (2007) 23 Journal of Contract Law 120-147) and Andrew Robertson ("The basis of the remoteness rule in contract") (2008) 28 Legal Studies 172-196) are particularly illuminating. They show that there is a good deal of support in the authorities and academic writings for the proposition that the extent of a party's liability for damages is founded upon the interpretation of the particular contract; not upon the interpretation of any particular language in the contract, but (as in the case of an implied term) upon the interpretation of the contract as a whole, construed in its commercial setting. Professor Robertson considers this approach somewhat artificial, since there is seldom any helpful evidence about the extent of the risks the particular parties would have thought they were accepting. I agree that cases of departure from the ordinary foreseeability rule based on individual circumstances will be unusual, but limitations on the extent of liability in particular types of contract arising out of general expectations in certain markets, such as banking and shipping, are likely to be more common. There is, I think, an analogy with the distinction which Lord Cross of Chelsea drew in *Liverpool City Council v Irwin* [1977] AC 239, 257-258 between terms implied into all contracts of a certain type and the implication of a term into a particular contract.

12. It seems to me logical to found liability for damages upon the intention of the parties (objectively ascertained) because all contractual liability is voluntarily undertaken. It must be in principle wrong to hold someone liable for risks for which the people entering into such a contract in their particular market, would not reasonably be considered to have undertaken.

13. The view which the parties take of the responsibilities and risks they are undertaking will determine the other terms of the contract and in particular the price to be paid. Anyone asked to assume a large and

unpredictable risk will require some premium in exchange. A rule of law which imposes liability upon a party for a risk which he reasonably thought was excluded gives the other party something for nothing. And as Willes J said in *British Columbia Saw Mill Co Ltd v Nettleship* (1868) LR 3 CP 499, 508:

> "I am disposed to take the narrow view, that one of two contracting parties ought not to be allowed to obtain an advantage which he has not paid for."

14. In their submissions to the House, the owners said that the "starting point" was that damages were designed to put the innocent party, so far as it is possible, in the position as if the contract had been performed: see *Robinson v Harman* (1848) 1 Exch 850, 855. However, in *Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd (sub nom South Australia Asset Management Corpn v York Montague Ltd*) [1997] AC 191, 211, I said (with the concurrence of the other members of the House):

> "I think that this was the wrong place to begin. Before one can consider the principle on which one should calculate the damages to which a plaintiff is entitled as compensation for loss, it is necessary to decide for what kind of loss he is entitled to compensation. A correct description of the loss for which the valuer is liable must precede any consideration of the measure of damages."

15. In other words, one must first decide whether the loss for which compensation is sought is of a "kind" or "type" for which the contract-breaker ought fairly to be taken to have accepted responsibility. In the *South Australia* case the question was whether a valuer, who had (in breach of an implied term to exercise reasonable care and skill) negligently advised his client bank that property which it proposed to take as security for a loan was worth a good deal more than its actual market value, should be liable not only for losses attributable to the deficient security but also for further losses attributable to a fall in the property market. The House decided that he should not be liable for this kind of loss:

> "In the case of an implied contractual duty, the nature and extent of the liability is defined by the term which the law implies. As in the case of any implied term, the process is one of construction of the agreement as a whole in its commercial setting. The contractual duty to provide a valuation and the known purpose of that valuation compel the conclusion that the contract includes a duty of care. The scope of the duty, in the sense of the consequences for which the valuer is responsible, is that which the law regards as best giving effect to the express obligations assumed by the valuer: neither cutting them down so that the lender obtains less than he was reasonably entitled to expect, nor extending them so as to impose on the valuer a liability greater than he could reasonably have thought he was undertaking." (p 212)

16. What is true of an implied contractual duty (to take reasonable care in the valuation) is equally true of an express contractual duty (to redeliver the ship on the appointed day). In both cases, the consequences for which the contracting party will be liable are those which "the law regards as best giving effect to the express obligations assumed" and "[not] extending them so as to impose on the [contracting party] a liability greater than he could reasonably have thought he was undertaking".

17. The effect of the *South Australia* case was to exclude from liability the damages attributable to a fall in the property market notwithstanding that those losses were foreseeable in the sense of being "not unlikely" (property values go down as well as up) and had been caused by the negligent valuation in the sense that, but for the valuation, the bank would not have lent at all and there was no evidence to show that it would have lost its money in some other way. It was excluded on the ground that it was outside the scope of the liability which the parties would reasonably have considered that the valuer was undertaking.

18. That seems to me in accordance with the careful way in which Robert Goff J stated the principle in *Satef-Huttenes Albertus SpA v Paloma Tercera Shipping Co SA* (*The Pegase*) [1981] Lloyd's Rep 175, 183, where the emphasis is upon what a reasonable person would have considered to be the extent of his responsibility:

> "The test appears to be: have the facts in question come to the defendant's knowledge in such circumstances that a reasonable person in the shoes of the defendant would, if he had considered the matter at the time of making the contract, have contemplated that, in the event of a breach by him, such facts were to be taken into account when considering his responsibility for loss suffered by the plaintiff as a result of such breach."

19. A similar approach was taken by the Court of Appeal in *Mulvenna v Royal Bank of Scotland plc* [2003] EWCA Civ 1112, mentioned by Professor Robertson in the article to which I have referred. This was an application to strike out a claim for damages for the loss of profits which the claimant said he would have made if the bank had complied with its agreement to provide him with funds for a property development. The Court of Appeal held that even on the assumption that the bank knew of the purpose for which the funds were required and that it was foreseeable that he would suffer loss of profit if he did not receive them, the damages were not recoverable. Sir Anthony Evans said:

> "The authorities to which we were referred…demonstrate that the concept of reasonable foreseeability is not a complete guide to the circumstances in which damages are recoverable as a matter of law. Even if the loss was reasonably foreseeable as a consequence of the breach of duty in question (or of contract, for the same principles apply), it may nevertheless be regarded as 'too remote a consequence' or as not a consequence at all, and the damages claim is disallowed. In effect, the chain of consequences is cut off as a matter of law, either because it is regarded as unreasonable to impose liability for that consequence of the breach (*The Pegase* [1981] 1 Lloyd's Rep 175 Robert Goff J), or because the scope of the duty is limited so as to exclude it (*Banque Bruxelles SA v. Eagle Star* [1997] AC 191), or because as a matter of commonsense the breach cannot be said to have caused the loss, although it may have provided the opportunity for it to occur…"

20. By way of explanation for why in such a case liability for lost profits is excluded, Professor Robertson (at p 183) offers what seem to me to be some plausible reasons:

> "It may be considered unjust that the bank should be held liable for the loss of profits simply because the bank knew of the proposed development at the time the refinancing agreement was made. The imposition of such a burden on the bank may be considered unjust because it is inconsistent with commercial practice for a bank to accept such a risk in a transaction of this type, or because the quantum of the liability is disproportionate to the scale of the transaction or the benefit the bank stood to receive."

21. It is generally accepted that a contracting party will be liable for damages for losses which are unforeseeably large, if loss of that type or kind fell within one or other of the rules in *Hadley v Baxendale*: see, for example, Staughton J in *Transworld Oil Ltd v North Bay Shipping Corpn* (*The Rio Claro*) [1987] Lloyd's Rep 173, 175 and *Jackson v Royal Bank of Scotland plc* [2005] 1 WLR 377. That is generally an inclusive principle: if losses of that type are foreseeable, damages will include compensation for those losses, however large. But the *South Australia* and *Mulvenna* cases show that it may also be an exclusive principle and that a party may not be liable for foreseeable losses because they are not of the type or kind for which he can be treated as having assumed responsibility.

22. What is the basis for deciding whether loss is of the same type or a different type? It is not a question of Platonist metaphysics. The distinction must rest upon some principle of the law of contract. In my opinion, the only rational basis for the distinction is that it reflects what would have been reasonable and have been regarded by the contracting party as significant for the purposes of the risk he was undertaking. In *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528, where the plaintiffs claimed for loss of the profits from their laundry business because of late delivery of a boiler, the Court of Appeal did not regard "loss of profits from the laundry business" as a single type of loss. They distinguished (at p 543) losses from "particularly lucrative dyeing contracts" as a different type of loss which would only be recoverable if the defendant had sufficient knowledge of them to make it reasonable to attribute to him acceptance of liability for such losses. The vendor of the boilers would have regarded the profits on these contracts as a different and higher form of risk than the general risk of loss of profits by the laundry.

23. If, therefore, one considers what these parties, contracting against the background of market expectations found by the arbitrators, would

reasonably have considered the extent of the liability they were undertaking, I think it is clear that they would have considered losses arising from the loss of the following fixture a type or kind of loss for which the charterer was not assuming responsibility. Such a risk would be completely unquantifiable, because although the parties would regard it as likely that the owners would at some time during the currency of the charter enter into a forward fixture, they would have no idea when that would be done or what its length or other terms would be. If it was clear to the owners that the last voyage was bound to overrun and put the following fixture at risk, it was open to them to refuse to undertake it. What this shows is that the purpose of the provision for timely redelivery in the charterparty is to enable the ship to be at the full disposal of the owner from the redelivery date. If the charterer's orders will defeat this right, the owner may reject them. If the orders are accepted and the last voyage overruns, the owner is entitled to be paid for the overrun at the market rate. All this will be known to both parties. It does not require any knowledge of the owner's arrangements for the next charter. That is regarded by the market as being, as the saying goes, *res inter alios acta*.

24. The findings of the majority arbitrators shows that they considered their decision to be contrary to what would have been the expectations of the parties, but dictated by the rules in *Hadley v Baxendale* as explained in *The Heron II* [1969] 1 AC 350. But in my opinion these rules are not so inflexible; they are intended to give effect to the presumed intentions of the parties and not to contradict them.

25. The owners submit that the question of whether the damage is too remote is a question of fact on which the arbitrators have found in their favour. It is true that the question of whether the damage was foreseeable is a question of fact: see *Monarch Steamship Co Ltd v Karlshamns Oljefabriker (A/B)* [1949] AC 196. But the question of whether a given type of loss is one for which a party assumed contractual responsibility involves the interpretation of the contract as a whole against its commercial background, and this, like all questions of interpretation, is a question of law.

26. The owners say that the parties are entirely at liberty to insert an express term excluding consequential loss if they want to do so. Some standard forms of charter do. I suppose it can be said of many disputes over interpretation, especially over implied terms, that the parties could have used express words or at any rate expressed themselves more clearly than they have done. But, as I have indicated, the implication of

a term as a matter of construction of the contract as a whole in its commercial context and the implication of the limits of damages liability seem to me to involve the application of essentially the same techniques of interpretation. In both cases, the court is engaged in construing the agreement to reflect the liabilities which the parties may reasonably be expected to have assumed and paid for. It cannot decline this task on the ground that the parties could have spared it the trouble by using clearer language. In my opinion, the findings of the arbitrators and the commercial background to the agreement are sufficient to make it clear that the charterer cannot reasonably be regarded as having assumed the risk of the owner's loss of profit on the following charter. I would therefore allow the appeal.

LORD HOPE OF CRAIGHEAD

My Lords,

27. My initial impression at the end of the excellent argument with which we were presented by counsel on both sides was that, on the facts found proved by the majority arbitrators, this appeal must fail. But, having had the benefit of reading in draft the opinions of my noble and learned friends Lord Hoffmann, Lord Rodger of Earlsferry and Lord Walker of Gestingthorpe, I have come to the conclusion that their decision was based on an error of law and that the view of this case that was taken by the minority arbitrator was right.

28. The majority arbitrators based their approach on their understanding of the test of remoteness as explained in *The Heron II* [1969] 1 AC 350, and in particular by Lord Reid at pp 382-383, as being to ask whether the loss in question was

> "of a kind which the defendant, when he made the contract, ought to have realised was not unlikely to result from [the] breach."

This had the result, as they put it, that the parties' knowledge of the markets within which they operated at the date of the addendum which extended the original charter period was more than sufficient for the loss claimed to be within their contemplation. Counsel for the charterers had agreed in exchanges with members of the tribunal that the "not unlikely"

results arising from the late delivery of the vessel would include missing dates for a subsequent fixture. The majority then asked themselves what was within the contemplation of the parties as a not unlikely result of a breach which resulted in missing such a date, bearing in mind that it was agreed that the market rates for tonnage go up and down, sometimes quite rapidly. They answered this question in the owners' favour. On the facts, they said, the need to adjust the relevant dates for the subsequent employment of the vessel through the revised terms agreed with the new charterers was within the contemplation of the parties as a not unlikely result of the breach. It might be that the precise amount of the loss could be seriously affected by market factors such as a sharp drop of the rate for the particular type of vessel during the relevant period. But the type of loss was readily identifiable.

29. The minority arbitrator pointed out that this would be to impose on the charterers a completely unquantifiable risk in what is a relatively common situation – late delivery under a time charter – given the exigencies of the shipping industry. If the test was what a reasonable man in the position of the charterers would have understood at the time of entering into the charter, it was impossible to conclude that they would or should have understood that they were assuming responsibility for the risk of loss of a particular follow-on fixture concluded by the owners. They had no knowledge of or control over the duration of any follow-on fixture which the owners might conclude. The fundamental problem that he had with the owners' argument was that if damages of this type were recoverable without particular knowledge sufficient to justify an assumption of risk it was difficult to see where a line was to be drawn, and there was a real risk of serious commercial uncertainty which the industry as a whole would regard as undesirable.

30. Both approaches share a common, and as it seems to me an entirely orthodox, starting point. They ask what should fairly and reasonably be regarded as having been in the contemplation of the parties at the time when the contract was entered into. The refinement that, on the facts of this case, the relevant date was the date of the addendum is not of any practical significance. Both parties were experienced in the market within which they were operating. Late delivery under a time charter is a relatively common situation, and it is not difficult to conclude that the parties must have had in contemplation when they entered into the contract that this might occur. Nor it is difficult to conclude – indeed this was conceded by counsel for the charterers – that in a market where owners expect to keep their assets in continuous employment dates late delivery will result in missing the date for a subsequent fixture. The critical question however is whether

the parties must be assumed to have contracted with each other on the basis that the charterers were assuming responsibility for the consequences of that event. It is at this point that the two approaches part company.

31. Assumption of responsibility, which forms the basis of the law of remoteness of damage in contract, is determined by more than what at the time of the contract was reasonably foreseeable. It is important to bear in mind that, as Lord Reid pointed out in *The Heron II* [1969] 1 AC 350, 385, the rule that applies in tort is quite different and imposes a much wider liability than that which applies in contract. The defendant in tort will be liable for any type of loss and damage which is reasonably foreseeable as likely to result from the act or omission for which he is held liable. Reasonable foreseeability is the criterion by which the extent of that liability is to be judged, and it may result in his having to pay for something that, although reasonably foreseeable, was very unusual, not likely to occur and much greater in amount than he could have anticipated. In contract it is different and, said Lord Reid, at p 386, there is good reason for the difference:

> "In contract, if one party wishes to protect himself against a risk which to the other party would appear unusual, he can direct the other party's attention to it before the contract is made, and I need not stop to consider in what circumstances the other party will then be held to have accepted responsibility in that event."

32. The point that Lord Reid was making here was that the more unusual the consequence, the more likely it is that provision will be made for it in the contract if it is to result in liability. Account may be taken of it in the rates that are provided for in the contract. Or terms may be written into the contract to provide for the extent, if any, of the liability. That is the way that commercial contracts are entered into. As Blackburn J said in *Cory v Thames Ironworks Co* (1868) LR 3 QB 181, 190-191, if the damage were exceptional and unnatural it would be hard on a party to be made liable for it because, had he known what the consequences would be, he would probably have stipulated for more time or made greater exertions if he had known the extreme mischief that would follow from the non-fulfilment of his contract. The fact that the loss was foreseeable – the kind of result that the parties would have had in mind, as the majority arbitrators put it – is not the test. Greater precision is needed than that. The question is whether the loss was a

type of loss for which the party can reasonably be assumed to have assumed responsibility.

33. How then is this question to be addressed? The statement of principle by Robert Goff J in *The Pegase* [1981] 1 Lloyd's Rep 175, 183 asks whether, if he had considered the matter, at the time of making the contract, the defendant would have contemplated that, in the event of a breach by him, the facts in question would be taken into account in considering his responsibility for loss suffered as a result of the breach. This depends on the degree of relevant knowledge held by him at the time of entering into the contract. Alderson B in *Hadley v Baxendale* (1854) 9 Exch 341, 354-355, distinguished between special circumstances that were wholly unknown to the party breaking the contract and the amount of injury which would arise generally and in the great multitude of cases not affected by any special circumstances. Losses in the latter category are losses which the parties may be taken to have in contemplation and to make provision for, in one way or another, in their contract. Losses in the former are losses which the party in breach was unable to contemplate when considering the terms on which he could agree to enter into the contract. These statements direct attention to the extent of the charterer's knowledge of the facts that are in question in this case.

34. In this case it was within the parties' contemplation that an injury which would arise generally from late delivery would be loss of use at the market rate, as compared with the charter rate, during the relevant period. This something that everybody who deals in the market knows about and can be expected to take into account. But the charterers could not be expected to know how, if – as was not unlikely – there was a subsequent fixture, the owners would deal with any new charterers. This was something over which they had no control and, at the time of entering into the contract, was completely unpredictable. Nothing was known at that time about the terms on which any subsequent fixture might be entered into – how short or long the period would be, for example, or what was to happen should the previous charter overrun and the owner be unable to meet the new commencement date. It is true that neither party had any control over the state of the market. But in the ordinary course of things rates in the market will fluctuate. So it can be presumed that the party in breach has assumed responsibility for any loss caused by delay which can be measured by comparing the charter rate with the market rate during that period. There can be no such presumption where the loss claimed is not the product of the market itself, which can be contemplated, but results from arrangements entered into between the owners and the new charterers, which cannot.

35. In the Court of Appeal [2007] 2 Lloyd's Rep 555, para 117 Rix LJ observed that the doctrine of remoteness is ultimately designed to reflect the public policy of the law. Developing this theme, he said in para 119 that it would be undesirable and uncommercial for damages for late delivery to be limited to the period of the overrun unless the owners could show that they had given their charterers special information of their follow-on fixture. It was undesirable, he said because this would put the owners too much at the mercy of their charterers at time of raised market rates. That seems to me, with respect, to overstate the position. The owners too are in the market and can at least expect to be compensated at market rates for the period of any delay. But he also said that it was uncommercial, because a new fixture would in all probability not be fixed until at or about the time of the redelivery. So the demand would be for information that the owner could not provide when entering into the contract.

36. In my opinion the commercial considerations point the other way. This was the crucial point in the case which led the minority arbitrator to dissent from the majority. As he pointed out, a party cannot be expected to assume responsibility for something that he cannot control and, because he does not know anything about it, cannot quantify. It is not enough for him to know in general and on open-ended terms that there is likely to be a follow-on fixture. This was the error which lies at the heart of the decision of the majority. What he needs is some information that will enable him to assess the extent of any liability. The policy of the law is that effect should be given to the presumed intention of the parties. That is why the damages that are recoverable for breach of contract are limited to what happens in ordinary circumstances – in the great multitude of cases, as Alderson B put it in *Hadley v Baxendale* – where an assumption of responsibility can be presumed, or what arises from special circumstances known to or communicated to the party who is in breach at the time of entering into the contract which because he knew about he can be expected to provide for. This is a principle of general application. We are dealing in this case with a highly specialised area of commercial law. But the principle by which the issue must be resolved is that which applies in the law of contract generally.

37. For these reasons, which owe much to my noble and learned friends' careful review of the authorities, I too would allow the appeal.

LORD RODGER OF EARLSFERRY

My Lords,

38. Mercator Shipping Inc, the respondents in this appeal, were at all material times the owners of the bulk carrier "Achilleas". In January 2003 they entered into a time charter-party in terms of which they let the Achilleas to the appellants, Transfield Shipping Inc ("the charterers"). On 12 September 2003 the charter period was extended for a further five-seven months, the exact period in charterers' option. In terms of the addendum, the terminal date for redelivery of the vessel to the owners was midnight on 2 May 2004.

39. In the event, the charterers did not redeliver the Achilleas to the owners until 0815 on 11 May 2004. It is common ground that, by failing to return the vessel by midnight on 2 May, the charterers were in breach of contract and are accordingly liable in the appropriate sum of damages for that breach. The dispute is about what constitutes the appropriate sum of damages. As a result of an agreement between the parties, the arbitrators and the courts have been faced with a stark choice between two fixed figures.

40. The charterers contend that their liability in damages is confined to the difference between the market rate of hire and the charter-party rate for the period from midnight on 2 May till 0815 on 11 May. That would amount to US$158,301.17. The owners contend that in the circumstances the charterers' liability extends further, however, so as to include the owners' loss of profit under a follow-on fixture.

41. On a date which is not identified by the arbitrators in their award, the charterers sub-chartered the vessel for a final voyage. She was to load a cargo of coal at Quingdao in China for discharge at Tobata and Oita in Japan. There is nothing in the findings made by the arbitrators to suggest that, if all had gone to plan, this final voyage would have prevented the charterers from redelivering the vessel, in accordance with their contractual obligation, by 2 May. In these circumstances, it must be presumed that the final voyage was legitimate.

42. On 20 April the charterers gave a 10 day estimated notice of redelivery between 30 April and 2 May. After receiving that notice, on

or about 21 April the owners fixed a follow-on time charter for about four-six months with Cargill International SA ("Cargill"). Cargill was entitled to cancel that charter-party if the Achilleas had not arrived at the delivery point by 8 May.

43. By 24 April the vessel had finished loading the coal at Quingdao. On 30 April she reached Oita, having discharged the relevant part of her load at Tobata. At Oita she experienced delays. Previously, on 27 April the charterers had given a revised notice of redelivery on 4/5 May – which, though involving a breach of contract, would still have been in time for the vessel to be delivered to Cargill within the laycan.

44. By 5 May the owners had recognised, however, that the vessel was going to be redelivered too late for her to be delivered to Cargill by 8 May. They therefore entered into discussions with Cargill to obtain an extension of the cancelling date under their charter. Cargill agreed to extend it to 11 May. At some point between the date when the Cargill charter was fixed (on or about 21 April) and 5 May, the market rate of hire for such vessels had fallen sharply, however. Therefore, in return for the extension of the cancelling date, Cargill insisted on the original rate of US$39,500 per day being reduced to US$31,500 per day. The charterers make no criticism of the steps taken by the owners.

45. At 0815 on 11 May, when Transfield redelivered the vessel to the owners at Oita, the owners immediately delivered her to Cargill under their charter. Cargill redelivered the vessel to the owners at 0815 on 18 November 2004.

46. In these circumstances the owners claim damages (agreed at US$1,364,584.17) for their loss of profit as a result of having to reduce the daily rate of hire under the Cargill fixture by US$8,000, when they obtained the extension of the cancelling date which they needed in order to accommodate the charterers' delay in redelivering the vessel. Clearly, the owners incurred that loss in the wake of the charterers' breach of contract. Nevertheless, in respectful disagreement with Christopher Clarke J and the Court of Appeal, I have come to the conclusion that the charterers are not liable in damages for the owners' loss of profit.

47. Today, as for more than 150 years, the starting-point for determining the measure of damages for breach of contract is the

judgment of Alderson B in *Hadley v Baxendale* (1854) 9 Exch 341. The story is well known. The plaintiff owners of a flour mill in Gloucester arranged for the defendant common carriers (the firm of Pickfords) to take their broken mill shaft to a firm in Greenwich which was to use it as a pattern to produce a new shaft. Unknown to the defendants – as the court held - the plaintiffs had no other shaft and so could not operate their mill until they got the new one. In breach of contract, the defendants delayed in transporting the broken shaft. The plaintiffs sued the defendants for the profits which they lost from being unable to operate their mill during the period of delay. The Court of Exchequer held that they could not recover the loss of profits.

48. Frequently only one sentence from the judgment of Alderson B is quoted as enshrining the principle with which the case is synonymous. But it is preferable to have regard to slightly more of what Alderson B said, at pp 354-355:

> "Now we think the proper rule in such a case as the present is this: Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i e, 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. Now the above principles are those by which we think the jury ought to be guided in estimating the damages arising out of any breach of contract."

It was by referring back to the language of the third sentence in this passage that Alderson B went on to hold, at p 356, that, in the circumstances, the defendants were not liable for the loss of profits:

> "But it is obvious that, in the great multitude of cases of millers sending off broken shafts to third persons by a carrier under ordinary circumstances, such consequences would not, in all probability, have occurred, and these special circumstances were here never communicated by the plaintiffs to the defendants. It follows, therefore, that the loss of profits here cannot reasonably be considered such a consequence of the breach of contract as could have been fairly and reasonably contemplated by both the parties when they made this contract."

49. The entire passage containing the applicable principles was quoted with approval by Viscount Sankey LC in *Banco de Portugal v Waterlow & Sons Ltd* [1932] AC 452, 474-475. In *Monarch Steamship Co Ltd v Karlshamns Oljefabriker (A/B)* [1949] AC 196, 221, Lord Wright identified the distinction drawn by Alderson B as being "between damages arising naturally (which means in the normal course of things), and cases where there were special and extraordinary circumstances beyond the reasonable prevision of the parties..." Like Lord Hodson in *C Czarnikow Ltd v Koufos (The Heron II)* [1969] 1 AC 350, 411A-C, I find guidance in Alderson B's use of the expression "in the great multitude of cases". In the words of Lord Hodson, it indicates

> "that the damages recoverable for breach of contract are such as flow naturally in most cases from the breach, whether under ordinary circumstances or from special circumstances due to the knowledge either in the possession of or communicated to the defendants. This expression throws light on the whole field of damages for breach of contract and points to a different approach from that taken in tort cases."

50. The same idea is, of course, to be found, more compactly, in other well-known statements by celebrated commercial judges. For

example, in *Horne v Midland Railway Co* (1872) LR 7 CP 583, 590, Willes J said that, in contract, "damages are to be limited to those that are the natural and ordinary consequences" of the breach, while in *Cory v Thames Ironworks Co* (1868) LR 3 QB 181, 190, Blackburn J said that the measure of damages is "what might be reasonably expected in the ordinary course of things to flow from the non-fulfilment of the contract, not more than that …"

51. In *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528, 539-540, Asquith LJ explained that "Everyone, as a reasonable person, is taken to know the 'ordinary course of things' and consequently what loss is liable to result from a breach of contract in that ordinary course." He went on to say that, for loss to be recoverable, the defendant did not need to foresee that a breach must necessarily result in that loss: "It is in enough if he could foresee it was likely so to result. It is indeed enough, to borrow from the language of Lord du Parcq in the [*Monarch Steamship*] case, at p 158, if the loss (or some factor without which it would not have occurred) is a 'serious possibility' or a 'real danger.' For short, we have used the word 'liable' to result."

52. As Lord Reid pointed out in *The Heron II* [1969] 1 AC 350, 389E-G, by referring to foreseeability, Asquith LJ cannot have been intending to assimilate the measure of damages in contract and tort. Moreover, there might appear to be a certain tension between the idea that, to be recoverable, a loss must be something which would result from the breach in the ordinary course and the idea that it is enough that the loss is just something which is liable to result. Lord Reid therefore surmised that Asquith LJ might have meant that the loss was foreseeable as a likely result. That appears to be an appropriate way of reconciling the two aspects of Asquith LJ's opinion. In any event, amidst a cascade of different expressions, it is important not to lose sight of the basic point that, in the absence of special knowledge, a party entering into a contract can only be supposed to contemplate the losses which are *likely* to result from the breach in question – in other words, those losses which will generally happen in the ordinary course of things if the breach occurs. Those are the losses for which the party in breach is held responsible – the stated rationale being that, other losses not having been in contemplation, the parties had no opportunity to provide for them.

53. In the present case, the arbitrators found that - as conceded by counsel then acting for the charterers – missing a date for a subsequent fixture was a "not unlikely" result of the late redelivery of a vessel.

That concession has been criticised elsewhere, but the House must proceed on the basis that, when they entered into the addendum, the parties could reasonably have contemplated that it was not unlikely that the owners would miss a date for a subsequent fixture if the Achilleas were redelivered late. The majority of the arbitrators also found that, at the time of contracting, the parties, who were both engaged in the business of shipping, would have known that market rates for tonnage go up and down, sometimes quite rapidly. Nevertheless, as Rix LJ himself pointed out [2007] 2 Lloyd's Rep 555, 577, para 120 - when seeking to combat any criticism that the Court of Appeal's decision would throw the situation in general into confusion because late redelivery and changing market conditions are common occurrences - "It requires extremely volatile market conditions to create the situation which occurred here." In other words, the extent of the relevant rise and fall in the market within a short time was actually unusual. The owners' loss stemmed from that unusual occurrence.

54. The obligation of the charterers was to redeliver the vessel to the owners by midnight on 2 May. Therefore, the charterers are taken to have had in contemplation, at the time when they entered into the addendum, the loss which would generally happen in the ordinary course of things if the vessel were delivered some nine days late so that the owners missed the cancelling date for a follow-on fixture. Obviously, that would include loss suffered as a result of the owners not having been paid under the contract for the charterers' use of the vessel for the period after midnight on 2 May. So, as both sides agree, the owners had to be compensated for that loss by the payment of damages. But the parties would also have contemplated that, if the owners lost a fixture, they would then be in a position to enter the market for a substitute fixture. Of course, in some cases, the available market rate would be lower and, in some cases, higher, than the rate under the lost fixture. But the parties would reasonably contemplate that, for the most part, the availability of the market would protect the owners if they lost a fixture. That I understand to be the thinking which lies behind the dicta to the effect that the appropriate measure of damages for late redelivery of a vessel is the difference between the charter rate and the market rate if the market rate is higher than the charter rate for the period between the final terminal date and redelivery: *Hyundai Merchant Marine Co Ltd v Gesuri Chartering Co Ltd* (*The Peonia*) [1991] 1 Lloyd's Rep 100, 108. In that passage Bingham LJ was adopting the approach which had been indicated in earlier authorities: *Alma Shipping Corpn of Monrovia v Mantovani (The Dione)* [1975] 1 Lloyd's Rep 115, 117-118, per Lord Denning MR, and *Arta Shipping Co Ltd v Thai Europe Tapioca Service Ltd (The Johnny)* [1977] 2 Lloyd's Rep 1, 2, per Lord Denning MR.

55. More particularly, this understanding of the general position lies behind the observations of Lord Mustill in *Torvald Klaveness A/S v Arni Maritime Corpn* (*The Gregos*) [1995] 1 Lloyd's Rep 1. In that case, when the charterers insisted on proceeding with a voyage which had become illegitimate by the time it was due to commence, the owners refused. The owners began to negotiate a replacement fixture with a concern named Navios, involving a higher rate of freight plus a bonus. In the event, the parties to the original charter-party reached a without prejudice agreement under which the owners would perform the voyage and, if in subsequent proceedings it were held that they had been justified in refusing to perform it, they would be entitled to a sum reflecting the difference between the chartered rate of hire and the more advantageous terms of the proposed substitute fixture with Navios. The sum in question was roughly US$300,000.

56. In these circumstances the House did not need to deal with the measure of damages in a case of late redelivery. Nevertheless, Lord Mustill said that the obligation of the charterers was to redeliver the vessel on or before the final date or to pay damages for breach of contract. He added [1995] 1 Lloyd's Rep 1, 5, "On damages, see ... *The Peonia*...." – so endorsing, en passant, what Bingham LJ had said in that case.

57. In the Court of Appeal in *The Gregos* Hirst LJ had drawn attention to what he described as "the charterers' windfall damages" under the without prejudice agreement by comparison with the damages which would have been awarded simply in respect of a few days' late redelivery: [1993] 2 Lloyd's Rep 335, 348. Lord Mustill said this [1995] 1 Lloyd's Rep 1, 10:

> "At first sight, this apparently anomalous result is a good reason for questioning whether the claim for repudiation was soundly based. On closer examination, however, the anomaly consists, not so much in the size of the damages, but in the fact that damages were awarded at all. Imagine that the without prejudice agreement had not been made, and that the owners, having treated the charter as wrongfully repudiated, had accepted a substitute fixture with Navios. If one then asked what loss had the repudiation caused the owners to suffer, the answer would be – None. On the contrary, the charterers' wrongful act would have enabled the owners to make a profit. Even if they had not accepted the substitute employment they

> might very well have suffered no loss, since they would have been in the favourable position of having their ship free in the right place at the right time to take a spot fixture on a rising market. In neither event would the owners ordinarily recover any damages for the wrongful repudiation."

The implication from this passage is that, ordinarily, the appropriate measure of damages will be that set out by Bingham LJ in *The Peonia*, since owners will be able to obtain substitute employment for their vessel.

58. I would enter two caveats. First, it may be that, at least in some cases, when concluding a charter-party, a charterer could reasonably contemplate that late delivery of a vessel of that particular type, in a certain area of the world, at a certain season of the year would mean that the market for its services would be poor. In these circumstances, the owners might have a claim for some general sum for loss of business, somewhat along the line of the damages for the loss of business envisaged by the Court of Appeal in *Victoria Laundry (Windsor)Ltd v Newman Industries Ltd* [1949] 2 KB 528, 542-543. Because of the agreement on figures, the matter was not explored in this case and I express no view on it. But, even if some such loss of business could have been reasonably contemplated, as *Victoria Laundry* shows, this would not mean that the owners' particular loss of profit as a result of the re-negotiation of the Cargill fixture should be recoverable. To hold otherwise would risk undermining the first limb of *Hadley v Baxendale*, which limits the charterers' liability to "the amount of injury" that would arise "ordinarily" or "generally".

59. Secondly, the position on damages might also be different, if, for example - when a charter-party was entered into - the owners drew the charterers' attention to the existence of a forward charter of many months' duration for which the vessel had to be delivered on a particular date. The charterers would know that a failure to redeliver the vessel in time to allow the owners to deliver it under that charter would be liable to result in the loss of that fixture. Then the second rule or limb in *Hadley v Baxendale* might well come into play. But the point does not arise in this case.

60. Returning to the present case, I am satisfied that, when they entered into the addendum in September 2003, neither party would reasonably have contemplated that an overrun of nine days would "in

the ordinary course of things" cause the owners the kind of loss for which they claim damages. That loss was not the "ordinary consequence" of a breach of that kind. It occurred in this case only because of the extremely volatile market conditions which produced both the owners' initial (particularly lucrative) transaction, with a third party, and the subsequent pressure on the owners to accept a lower rate for that fixture. Back in September 2003, this loss could not have been reasonably foreseen as being likely to arise out of the delay in question. It was, accordingly, too remote to give rise to a claim for damages for breach of contract.

61. Rix LJ objects, [2007] 2 Lloyd's Rep 555, 577, para 119, that such an approach is uncommercial because to demand that, before the charterers are held liable, they would need to know more than they already do in the ordinary course of events, is to demand something that cannot be provided. But that is simply to criticise the long-standing rule of the English law of contract under which a party is not liable for this kind of loss, precisely because it arises out of unusual circumstances which are not – indeed, cannot be - within the contemplation of the parties when they enter into the contract. In any event, it would not, in my view, make good commercial sense to hold a charterer liable for such a potentially extensive loss which neither party could quantify at the time of contracting.

62. Rix LJ also describes the charterers as "happily [draining] the last drop and more of profit at a time of raised market rates": [2007] 2 Lloyd's Rep 555, 577, para 119. But, in reality, at the outset the sub-contract and the final voyage amounted to nothing more than a legitimate use of the vessel which the charterers had hired until 2 May and for which they were paying the owners the agreed daily rate. The delay which led to the breach of contract was caused by supervening circumstances over which the charterers had no control. The charterers' legitimate actions under their contract provide no commercial or legal justification for fixing them with liability for the owners' loss of profit, due to the effects of an "extremely volatile market" in relation to an arrangement with a third party about which the charterers knew nothing.

63. I have not found it necessary to explore the issues concerning *South Australia Asset Management Corpn v York Montague Ltd* [1997] AC 191 and assumption of responsibility, which my noble and learned friend, Lord Hoffmann, has raised. Nevertheless, I am otherwise in substantial agreement with his reasons as well as with those to be given by Lord Walker of Gestingthorpe. I would allow the appeal.

LORD WALKER OF GESTINGTHORPE

My Lords,

Introduction

64. In *James Finlay & Co Ltd v Kwik Hoo Tong HM* [1929] 1 KB 400, 417 Sankey LJ (echoing a submission of counsel) said of the decision of this House in *Re Hall Limited's & Pim (Jr) & Co's arbitration* (1928) 139 LT 30, that it had

> "astonished the Temple and surprised St Mary Axe."

It is now generally regarded as a sound decision on its special facts (see for instance Sir Roy Goode, *Commercial Law*, 3rd ed (2004) pp 385-386).

65. In this appeal your Lordships are faced with concurrent judgments of judges of great commercial experience (Christopher Clarke J at first instance and Rix LJ with the agreement of Ward LJ and Tuckey LJ in the Court of Appeal, upholding a majority award by experienced arbitrators) which are said to have upset an old and well-established commercial understanding (see John Weale, [2008] LMCLQ 6; the author suggests that the outcome of the case was influenced by the charterers' concessions, and the dissenting arbitrator seems to have taken a similar view). The charterers have been the appellants at every stage of the appeal process. While conceding that the point is not squarely covered by precedent, they urge your Lordships to restore the general understanding which has prevailed in the shipping world, so as to uphold commercial certainty. The respondent shipowners concede that there is no clear precedent in their favour, but put this down to the comparatively recent clarification (in *Hyundai Merchant Marine Co Ltd v Gesuri Chartering Co Ltd (The Peonia)* [1991] 1 Lloyd's Rep 100) of the law as to a charterer's liability for damages for delay after a "legitimate last voyage". The shipowners say that the judgments below were correct applications of the general principles laid down in *Hadley v Baxendale* (1854) 9 Exch 341 and later decisions refining those principles, including *Victoria Laundry (Windsor) Ltd v Newman*

Industries Ltd [1949] KB 528 and *C Czarnikow Ltd v Koufos (The Heron II)* [1969] 1 AC 350.

The rule in Hadley v Baxendale

66. In these circumstances your Lordships have to revisit some important general issues. These are all aspects of how the rule in *Hadley v Baxendale* has been developed or modified by 150 years of case law. This topic was reviewed by Robert Goff J in *Satef-Huttenes Albertus SpA v Paloma Tercera Shipping Co SA (The Pegase)* [1981] 1 Lloyd's Rep 175, 181-183. He observed (at p181)

> "Although the principle stated in *Hadley v Baxendale* remains the fons et origo of the modern law, the principle itself has been analysed and developed, and its application broadened, in the 20th century."

After referring to the *Victoria Laundry* case and to *The Heron II*, Robert Goff J stated (at p 182):

> "The general result of the two cases is that the principle in *Hadley v Baxendale* is now no longer stated in terms of two rules, but rather in terms of a single principle—though it is recognised that the application of the principle may depend on the degree of relevant knowledge held by the defendant at the time of the contract in the particular case. This approach accords very much to what actually happens in practice; the courts have not been over-ready to pigeon-hole the cases under one or other of the so-called rules in *Hadley v Baxendale*, but rather to decide each case on the basis of the relevant knowledge of the defendant."

67. The recognition of the rule as a single principle accords with the reality that even under the first limb, the defendant often needs some particular knowledge (for instance Mr Baxendale's firm had to know, as Lord Pearce pointed out in *The Heron II*, at p 416, that the article accepted for carriage from Gloucester to Greenwich was a broken millshaft). The degree of knowledge assumed under the first limb depends on the nature of the business relationship between the contracting parties. The different outcomes of *Hadley v Baxendale* and the *Victoria Laundry* case depended in part (though only in part) on the

fact that the defendant in the latter case was an engineering company supplying a specialised boiler, and not merely a carrier of goods with which it had no particular familiarity.

68. Another consequence of the (at least partial) assimilation of the two limbs is to raise doubt as to whether the notion of assumption of responsibility (as a precondition for liability for a larger measure of damages) is necessarily confined to second limb cases. That notion appears to be a watered-down version of the proposition (originating in *British Columbia Saw Mill Co v Nettleship* (1868) LR 3 CP 499, 509 and rejected by Lord Upjohn in *The Heron II* [1969] 1 AC 350, 422) that the defendant is liable for a larger measure of damages only if that has been made a term of the contract. Diplock LJ in *Robophone Facilities Ltd v Blank* [1966] 1 WLR 1428, 1448 described this as an implied undertaking given by the defendant to the plaintiff to bear the larger measure of loss, derived from (a) the defendant's knowledge of special circumstances and (b) the further factor

> "that he should have acquired this knowledge from the plaintiff, or at least that he should know that the plaintiff knew that he was possessed of it at the time the contract was entered into and so could reasonably foresee at that time that an enhanced loss was liable to result from a breach."

69. It may be that this rather precise formulation of the notion of assumption of responsibility applies (if at all) only to what are recognisably second limb cases. But the underlying idea—what was the common basis on which the parties were contracting?—seems to me essential to the rule in *Hadley v Baxendale* as a whole. Businessmen who are entering into a commercial contract generally know a fair amount about each other's business. They have a shared understanding (differing in precision from case to case) as to what each can expect from the contract, whether or not it is duly performed without breach on either side. No doubt they usually expect the contract to be performed without breach, but they are conscious of the possibility of breach. These points are repeatedly made in the authorities: it is sufficient to refer to the much-quoted speech of Lord Wright in *Monarch Steamship Co Ltd v Karlshamns Oljefabriker (A/B)* [1949] AC 196, 220-223, and to Robert Goff J in *The Pegase* at pp 182-183 (part of this passage is quoted by my noble and learned friend Lord Hoffmann in para 16 of his opinion).

70. The consequence is that although the fundamental principle in *Hadley v Baxendale* applies to contracts of every sort (at any rate since the abolition in 1989 of the rule in *Bain v Fothergill* (1874) LR 7 HL 158) particular types of contract in regular use in different areas of commercial, industrial and financial life (such as charterparties, construction contracts, and agreements for the sale and purchase of a controlling shareholding in a large company) have inevitably become specialised subjects. They are dealt with by specialist lawyers acting for well-informed businessmen. Anything that causes surprise in Essex Court is likely to cause surprise in St Mary Axe also. When the majority arbitrators stated in para 17 of their reasons, that a lawyer and "a broker in a commercial situation" would have given different answers to the same question they were in my opinion assuming, incorrectly, that two different questions were the same. I shall come back to this point.

The Heron II

71. *The Heron II* [1969] 1 AC 350 calls for close attention because, although decided over 40 years ago, it is the most recent full discussion of *Hadley v Baxendale* in your Lordships' House. It was concerned with a charterparty for the carriage of sugar from the Black Sea port of Constanza to the Iraqi port of Basrah, where there was a sugar market. The cargo was delivered late and the charterers claimed (and were awarded) damages for their market loss of about £1.40 per ton on about 3,000 tons of sugar. In dismissing the appeal the Court declined to follow *The Parana* (1877) 2 PD 118, a decision from what "was still the golden age of sail" (Lord Upjohn, at p 428). But the real importance of the case is in its discussion of general principles.

72. The House's decision was unanimous but each member of the Appellate Committee gave a full opinion, and unfortunately none of them in terms expressed either agreement or disagreement with any of the others. Their Lordships treated the decision of the Court of Appeal in the *Victoria Laundry* case with "varying degrees of enthusiasm" (Donaldson J in *Aruna Mills Ltd v Dhanrajmal Gobindram* [1968] 1 QB 655, 668). They themselves expressed differing views as to the requisite degree of probability of loss if it was to be recoverable following a breach of contract.

73. Lord Reid observed, at p 385:

> "I am satisfied that the court [in *Hadley v Baxendale*] did not intend that every type of damage which was reasonably foreseeable by the parties when the contract was made should either be considered as arising naturally, ie in the usual course of things, or be supposed to have been in the contemplation of the parties. Indeed the decision makes it clear that a type of damage which was plainly foreseeable as a real possibility but which would only occur in a small minority of cases cannot be regarded as arising in the usual course of things or be supposed to have been in the contemplation of the parties: the parties are not supposed to contemplate as grounds for the recovery of damage any type of loss or damage which on the knowledge available to the defendant would appear to him as only likely to occur in a small minority of cases.
>
> In cases like *Hadley v Baxendale* or the present case it is not enough that in fact the plaintiff's loss was directly caused by the defendant's breach of contract. It clearly was so caused in both. The crucial question is whether, on the information available to the defendant when the contract was made, he should, or the reasonable man in his position would, have realised that such loss was sufficiently likely to result from the breach of contract to make it proper to hold that the loss flowed naturally from the breach or that loss of that kind should have been within his contemplation."

Here, Lord Reid saw the law as applying an objective test, and one which reflects the realities of the business transaction entered into by the contracting parties.

74. Lord Reid then considered the *Victoria Laundry* case and disapproved of it so far as what Asquith LJ had said went beyond previous authorities. Lord Reid stated, at p 389:

> "To bring in reasonable foreseeability appears to me to be confusing measure of damages in contract with measure of damages in tort. A great many extremely unlikely results are reasonably foreseeable: it is true that Lord Asquith may have meant foreseeable as a likely result, and if that is all he meant I would not object further than to say that I think that the phrase is liable to be misunderstood. For the same reason I would take exception to the phrase 'liable to

> result' in paragraph (5). Liable is a very vague word but I think that one would usually say that when a person foresees a very improbable result he foresees that it is liable to happen."

75. Lord Reid also disapproved of the expressions "a serious possibility", "a real danger" and "on the cards". He said, at p 390:

> "If the tests of 'real danger' or 'serious possibility' are in future to be authoritative then the *Victoria Laundry* case would indeed be a landmark because it would mean that *Hadley v Baxendale* would be differently decided today. I certainly could not understand any court deciding that, on the information available to the carrier in that case, the stoppage of the mill was neither a serious possibility nor a real danger. If those tests are to prevail in future then let us cease to pay lip service to the rule in *Hadley v Baxendale*. But in my judgment to adopt these tests would extend liability for breach of contract beyond what is reasonable or desirable. From the limited knowledge which I have of commercial affairs I would not expect such an extension to be welcomed by the business community and from the legal point of view I can find little or nothing to recommend it."

76. Their Lordships were unanimous in disapproving the expression "on the cards" but Lord Morris of Borth-y-Gest, Lord Pearce and Lord Upjohn (at pp 400, 415 and 425 respectively) approved the expressions "real danger" and "serious possibility". Lord Hodson preferred the expression "liable to result". Lord Pearce and Lord Upjohn both expressed the view that *Hadley v Baxendale* would have been decided the same way on a "real danger" or "serious possibility" test.

77. The diversity of opinion in the House as to the most appropriate language is no doubt partly a matter of linguistic taste. Lord Reid's apparent preference for "not unlikely" as against "likely" cannot be ascribed to an uncharacteristic preference for a double negative rather than a simple word. A few years later he made some famous observations in *Davies v Taylor* [1974] AC 207, 213 (a case concerned with quantification of damages under the Fatal Accidents Acts):

> "You can prove that a past event happened, but you cannot prove that a future event will happen and I do not think that the law is so foolish as to suppose that you can. All you can do is to evaluate the chance. Sometimes it is virtually 100 per cent: sometimes virtually nil. But often it is somewhere in between. And if it is somewhere in between I do not see much difference between a probability of 51 per cent and a probability of 49 per cent."

It would not be a normal use of English to say that an eventuality with a probability of 51 per cent is likely and one with a probability of 49 per cent is unlikely (although in other fields, notably in connection with the civil standard of proof of past events, the law does make such a distinction). In ordinary discourse, there is a middle ground (say, for illustration, between 60 per cent and 40 per cent probability) within which an event would not normally be described as either likely or unlikely. Lord Reid's choice of language reflects his view (shared by the rest of the House) that the outcome need not be an odds-on chance.

78. To my mind, however, the diversity of opinion in *The Heron II* has another and more important significance. Other passages in the speeches show that their Lordships had well in mind (but did not, perhaps, spell out at length) that it is not simply a question of probability. It is also a question of what the contracting parties must be taken to have had in mind, having regard to the nature and object of their business transaction. If a manufacturer of lightning conductors sells a defective conductor and the customer's house burns down as a result, the manufacturer will not escape liability by proving that only one in a hundred of his customers' buildings had actually been struck by lightning. The need to take account of the nature and object of the contract is recognised, I think, in the passage (at p 385) from Lord Reid's speech which I have already quoted; in Lord Morris's speech at pp 398-399; in Lord Pearce's speech at pp 416-417 (with the example of the court ceiling collapsing during a sitting); and in Lord Upjohn's speech at pp 424-425. The need for the loss suffered to be within the horizon of the parties' contemplation (Lord Pearce at p 416) makes it less important to define its degree of probability with any precision. Arguably a vague expression (such as "real possibility") is actually preferable, because it is more flexible, once it is understood that what is most important is the common expectation, objectively assessed, on the basis of which the parties are entering into their contract.

79. My Lords, I had reached this point in drafting my opinion when my noble and learned friend Lord Hoffmann drew to my attention the articles by Adam Kramer, Professor Tettenborn, and Professor Robertson, not cited in argument, that are mentioned in Para 11 of Lord Hoffmann's opinion. These scholars develop ideas about *Hadley v Baxendale* which, although differently formulated, share some common ground. They demonstrate that foreseeability by itself is not a satisfactory test, and Kramer and Tettenborn emphasise the importance of what I have rather imprecisely referred to as the nature and object of the contract entered into by the parties. Both refer to a possible analogy with the restriction of damages in tort under the *SAAMCO principle* (see *South Australia Asset Management Corpn v York Montague Ltd* [1997] AC 191). Robertson is against approaching allocation or assumption of risk as a matter of contractual interpretation. I have found all these materials very helpful.

The majority arbitrators' decision

80. The arbitrators took seriously their task as the fact-finding tribunal, recognising (at the outset of the majority's reasons) that there were issues of law which might be taken to appeal. The majority identified (para 7) a difference between the parties as to whether, and how far, *The Heron II* had reformulated the rule in *Hadley v Baxendale*. The majority did not in terms resolve that difference, but seem to have adopted the "not unlikely" test. In para 8 they stated:

> "As [counsel for the charterers] agreed in exchanges with members of the Tribunal the "not unlikely" results arising from the late redelivery of a vessel were not numerous, but would include missing dates for (a) a subsequent fixture, (b) a dry docking and (c) a sale of the vessel."

They then carried this forward, to my mind out of context, to the discussion in para 17 of the answers that would have been given by a lawyer or by a broker.

81. In para 9, after a reference to *The Rio Claro* [1987] 2 Lloyd's Rep. 173, 175, they continued:

> "We consider on the facts that the type or kind of loss suffered by the Owners, i.e. the need to adjust relevant dates for the subsequent employment of the vessel through the revised Cargill terms, was within the contemplation of the parties as a not unlikely result of the breach. The fact that the extent of the loss was greater than anticipated is not relevant: see *Hill v Ashington Piggeries* [1969] 3 All ER 1496 (Davies LJ at p 1524 F)."

82. I have some difficulties with these passages. There seems to be a gap in reasoning between the bare fact of missing a fixture (an eventuality which would not, in a rising market, occasion any financial loss) and the very heavy financial loss for which the owners claimed (and recovered) damages in this case. *Ashington Piggeries* was a case of physical damage (the claimant's pigs died from disease caused by mouldy feed, which was in turn caused by defective feed hoppers). A much closer authority would have been the *Victoria Laundry* case, in which the Court of Appeal declined to award damages for the loss of unusually profitable dyeing contracts, but indicated that recovery for some loss of profition such contracts would be possible ([1949] 2 KB 528, 543):

> "We agree that in order that the plaintiffs should recover specifically and as such the profits expected on these contracts, the defendants would have had to know, at the time of their agreement with the plaintiffs, of the prospect and terms of such contracts. We also agree that they did not in fact know these things. It does not however, follow that the plaintiffs are precluded from recovering some general (and perhaps conjectural) sum for loss of business in respect of dyeing contracts to be reasonably expected, any more than in respect of laundering contracts to be reasonably expected."

The loss of unusually profitable contracts, unknown to the vendor of specialised equipment at the time of the sale contract, will often be a "serious possibility" or "real danger"; but it was held not to be within the reasonable contemplation of the parties to the sale contract.

83. So in this case it was open to the arbitrators to conclude that for the owners to miss a fixture was a "not unlikely" result of the delay, but it did not follow from that the charterers were liable for an exceptionally large loss (measured by the entire term of the fixture) when the market

fell suddenly and sharply (apparently, from the rates renegotiated with Cargill, by about 20%) between 21 April and 8 May 2004. As Rix LJ said in the Court of Appeal (para 120), "It requires extremely volatile conditions to create the situation which occurred here".

84. The majority arbitrators referred to a number of authorities, cited by the charterers, to the effect that the normal measure of damages for late delivery is the market rate (if higher than the charter rate) for the period from the latest date for re-delivery under contract until the date of actual re-delivery. They made a passing reference to the discussion of this point by Lord Mustill in *Torvald Klaveness AS v Arni Maritime Corpn, (The Gregos)* [1995] 1 Lloyd's Rep 1, 10, on which Rix LJ commented in paras 58-59 of his judgment. The majority regarded these authorities as giving the charterers only very limited assistance. Ultimately they accepted and applied the owners' submission that "what mattered was that the type of loss claimed was foreseeable" (para 18 of the majority reasons). That was in my opinion too crude a test, and it was an error of law to adopt it. What mattered was whether the common intention of reasonable parties to a charterparty of this sort would have been that in the event of a relatively short delay in re-delivery an extraordinary loss, measured over the whole term of renewed fixture, was, in Lord Reid's words,

> "sufficiently likely to result from the breach of contract to make it proper to hold that the loss flowed naturally from the breach or that loss of that kind should have been within [the defaulting party's] contemplation."

Lord Mustill's dictum in *The Gregos* indicates that that would not have been the common intention of reasonable contracting parties, and I respectfully agree.

85. In the Commercial Court Christopher Clarke J relied on the *Ashington Piggeries* case and (though he made a passing reference to *Victoria Laundry*) did not consider what was said in that case about loss of extraordinary profit. He found no error in the "foreseeable" test stated in para 18 of the majority arbitrators' reasons.

86. Rix LJ did refer to what was said in the *Victoria Laundry* case about extraordinary profit. In para 89 he cited the passage which I have set out above. But in a later passage he seems to have discounted it, either because the arbitrator had been faced with a choice between two

agreed figures (para 106) or because the owners made the Cargill fixture "at an appropriate time" (para 107- the reference to *The Pegase* should, I think, be to *Koch Marine Inc v D'Amica Societa Di Navigazione ARL* (*The Elena d'Amico*) [1980] 1 Lloyd's Rep 75). No doubt the fixture was made at an appropriate time (Rix LJ did not say of the owners, as he chose to say of the charterers, at para 96, that they were "keen to squeeze the last drop of profit … from what was a particularly strong market": see also para 119, referred to by my noble and learned friend Lord Rodger of Earlsferry). But it was contrary to the principle stated in the *Victoria Laundry* case, and reaffirmed in *The Heron II*, to suppose that the parties were contracting on the basis that the charterers would be liable for any loss, however large, occasioned by a delay in re-delivery in circumstances where the charterers had no knowledge of, or control over, the new fixture entered into by the new owners.

87. For these reasons, and for the further reasons given by my noble and learned friend Lord Hoffmann, Lord Hope and Lord Rodger, whose opinions I have had the advantage of reading in draft, I would allow this appeal.

BARONESS HALE OF RICHMOND

My Lords,

88. Ship-owners let out their ship for a period of five to seven months, to end no later than midnight on 2 May 2004. The charterers notified the ship-owners that the ship would be back no later than then. The ship-owners therefore contracted to let the ship to new charterers for a period of about four to six months, promising that they could have the ship no later than 8 May 2004. The agreed price of hire was $39,500 a day. The ship was delayed on its last voyage and the owners did not get their ship back until 11 May 2004. The new charterers agreed to take the ship, but by then the market had fallen and they would only take it at a reduced price of $31,500 a day. Are the first charterers liable to pay only for the use of the ship for the number of days that they were late at the market rate then prevailing? Or are they liable to pay the difference between what the owners would have got from the new charter had the ship been returned in time and what the owners in fact got?

89. My Lords, this could be an examination question. Although the context is a specialised one, the answer has mainly to be found in the general principles to be derived from the well-known authorities to which your Lordships have all referred, principally *Hadley v Baxendale* (1854) 9 Exch 341, *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528 and, above all, *C Czarnikow Ltd v Koufos (The Heron II)* [1969] 1 AC 350. There is no obviously right answer: two very experienced commercial judges have reached one answer, your lordships have reached another. There is no obviously just answer: the charterer's default undoubtedly caused the owner's loss, but a loss for which no-one has ever had to pay before. The examiners would surely have given first class marks to all the judges who have answered the question so far.

90. In common with my noble and learned friend, Lord Hope of Craighead, I was at first inclined to agree with the very full and thoughtful judgments in the courts below which arrived at the second answer. Their careful reviews of the shipping cases show that, although the normal measure of damages is undoubtedly the first, there is no case in which a claim to the second has been rejected. The fact that no-one has thought to make such a claim before now does not mean that it is unfounded. The question was unlikely to arise if the last voyage on which the charterer wished to send the ship was illegitimate, because the owner could then refuse to undertake it and the first charter would come to a premature end (or he might undertake it without prejudice as happened in *The Gregos* [1995] 1 Lloyd's Rep 1). And until the decision in *The Peonia* [1991] 1 Lloyd's Rep 100 it would not arise if the last voyage was legitimate, because the charterer was not liable at all for delay which was not his fault. So the novelty of the claim is no answer. It is not novel in principle. The object of damages for breach of contract is to put the claimants in the position in which they would have been had the contract been properly performed. Had this contract not been broken in the way that it was, the claimants would have had the benefit of the next fixture at the original rate. Putting them in the position in which they would have been had the contract been performed in accordance with its terms entails paying them the difference. No-one has suggested that it was at all unusual or unlikely for the owners to commit their ship to a new fixture to begin as soon as possible after the ship was free from the first. It was conceded before the arbitrators that missing dates for a subsequent fixture was a "not unlikely" result of late redelivery. Both parties would have been well aware of that at the time when the contract was made. They would also have been well aware that a new charter was likely to commit that particular ship rather than to allow the ship-owner to go into the market and find a substitute to fulfil his next commitment if his ship was late back. Charterparties allowing the owner

to substitute a different vessel are unusual. Above all, if the parties wish to exclude liability for consequential loss of this kind then it will be very simple to insert such a clause into future charterparties. It would take a much more complicated piece of drafting, following some complicated negotiations, to impose liability for this sort of loss. To rule out a whole class of loss, simply because the parties had not previously thought about it, risks as much uncertainty and injustice as letting it in.

91. That argument cuts both ways. We are looking here at the general principles which limit a contract breaker's liability when the contract itself does not do so. The contract breaker is not inevitably liable for all the loss which his breach has caused. Loss of the type in question has to be "within the contemplation" of the parties at the time when the contract was made. It is not enough that it should be foreseeable if it is highly unlikely to happen. It would not then arise "in the usual course of things": see *The Heron II* [1969] 1 AC 350, 385, per Lord Reid. So one answer to our question, given as I understand it by my noble and learned friend, Lord Rodger of Earlsferry, is that these parties would not have had this particular type of loss within their contemplation. They would expect that the owner would be able to find a use for his ship even if it was returned late. It was only because of the unusual volatility of the market at that particular time that this particular loss was suffered. It is one thing to say, as did the majority arbitrators, that missing dates for a subsequent fixture was within the parties' contemplation as "not unlikely". It is another thing to say that the "extremely volatile" conditions which brought about this particular loss were "not unlikely".

92. Another answer to the question, given as I understand it by my noble and learned friends, Lord Hoffmann and Lord Hope, is that one must ask, not only whether the parties must be taken to have had this *type of loss* within their contemplation when the contract was made, but also whether they must be taken to have had *liability for this type of loss* within their contemplation then. In other words, is the charterer to be taken to have undertaken legal responsibility for this type of loss? What should the unspoken terms of their contract be taken to be? If that is the question, then it becomes relevant to ask what has been the normal expectation of parties to such contracts in this particular market. If charterers would not normally expect to pay more than the market rate for the days they were late, and ship-owners would not normally expect to get more than that, then one would expect something extra before liability for an unusual loss such as this would arise. That is essentially the reasoning adopted by the minority arbitrator.

93. My Lords, I hope that I have understood this correctly, for it seems to me that it adds an interesting but novel dimension to the way in which the question of remoteness of damage in contract is to be answered, a dimension which does not clearly emerge from the classic authorities. There is scarcely a hint of it in *The Heron II*, apart perhaps from Lord Reid's reference, at p 385, to the loss being "sufficiently likely to result from the breach of contract *to make it proper* to hold that the loss flowed naturally from the breach or that loss of that kind should have been within his contemplation" (emphasis supplied). In general, *The Heron II* points the other way, as it emphasises that there are no special rules applying to charterparties and that the law of remoteness in contract is not the same as the law of remoteness in tort. There is more than a hint of it in the judgment of Waller LJ in *Mulvenna v Royal Bank of Scotland plc* [2003] EWCA Civ 1112, but in the context of the "second limb" of *Hadley v Baxendale* where knowledge of an unusual risk is posited. To incorporate it generally would be to introduce into ordinary contractual liability the principle adopted in the context of liability for professional negligence in *South Australia Asset Management Corpn v York Montague Ltd* [1997] AC 191, 211. In an examination, this might well make the difference between a congratulatory and an ordinary first class answer to the question. But despite the excellence of counsels' arguments it was not explored before us, although it is explored in academic textbooks and other writings, including those cited by Lord Hoffmann in paragraph 11 of his opinion. I note, however, that the most recent of these, Professor Robertson's article on "The basis of the remoteness rule in contract" (2008) 28 Legal Studies 172 argues strongly to the contrary. I am not immediately attracted to the idea of introducing into the law of contract the concept of the scope of duty which has perforce had to be developed in the law of negligence. The rule in *Hadley v Baxendale* asks what the parties must be taken to have had in their contemplation, rather than what they actually had in their contemplation, but the criterion by which this is judged is a factual one. Questions of assumption of risk depend upon a wider range of factors and value judgments. This type of reasoning is, as Lord Steyn put it in *Aneco Reinsurance Underwriting Ltd v Johnson & Higgins Ltd* [2002] 1 Lloyd's Rep 157, para 186, a "deus ex machina". Although its result in this case may be to bring about certainty and clarity in this particular market, such an imposed limit on liability could easily be at the expense of justice in some future case. It could also introduce much room for argument in other contractual contexts. Therefore, if this appeal is to be allowed, as to which I continue to have doubts, I would prefer it to be allowed on the narrower ground identified by Lord Rodger, leaving the wider ground to be fully explored in another case and another context.