

# Developments in Foreseeability and Remoteness: The Limits of Contract Damages

---

Stephen WADDAMS\*

The leading case on remoteness of damages in contract law continues to be the 1854 decision of the Exchequer Court in *Hadley v. Baxendale*.<sup>1</sup> The plaintiff, who operated a grist mill, agreed with the defendant, a nation-wide carrier, to carry a broken mill shaft to serve as a pattern for the manufacture of a new shaft. The carrier's undue delay caused the mill to be stopped for longer than it would otherwise have been, and the mill-owner claimed compensation for the consequent loss of profits. The carrier was held not to be liable in the absence of knowledge of the probable consequences of the delay. In a well-known passage Baron Alderson said:

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.<sup>2</sup>

But, he went on to say, if the damage arose from special circumstances not known to the contract-breaker, there should be no liability, and for this reason a new trial was ordered in *Hadley v. Baxendale*.

Alderson B. referred to the propositions formulated by the court both as a "rule," and as "principles." The need, as he perceived it, to formulate such a rule or principle sprang from general considerations of

---

\* Goodman/Schipper Chair, Faculty of Law, University of Toronto, Toronto, Ontario, © 2009.

<sup>1</sup> (1854) 9 Ex 341.

<sup>2</sup> *Ibid.* at 354–5.

justice: “if the jury are left without any definite rule to guide them, it will, in such cases as these, manifestly lead to the greatest injustice.”<sup>3</sup> The underlying reason was that the extent of potential liability for breach of contract was relevant to other contractual terms, including price and agreed limitations on liability: “for, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to damages in that case; and of this advantage it would be very unjust to deprive them.”<sup>4</sup>

The tenor of the decision was very much in the direction of making the consequences of breach of contract predictable, as in another case decided two years later by the same court (including Alderson B.). This was *Hamlin v. Great Northern Railway Co.*, where, a traveller having been stranded by the absence of a connecting train, the court laid down a rule (which stood for many years) excluding damages for mental distress for breach of contract. Pollock C.B. said:

In actions for breaches of contract the damages must be such as are capable of being appreciated or estimated.... [I]t may be laid down as a rule, that generally in actions upon contracts no damages can be given which cannot be stated specifically, and that the plaintiff is entitled to recover whatever damages naturally result from the breach of contract, but not damages for disappointment of mind occasioned by the breach of contract.<sup>5</sup>

The rule in *Hadley v. Baxendale* quickly proved to be incomplete. As early as 1860, Wilde B. said, presciently:

I think that, although an excellent attempt was made in *Hadley v. Baxendale* to lay down a rule on the subject, it will be found that the rule is not capable of meeting all cases; and when the matter comes to be further considered, it will probably turn out that there is no such thing as a rule as to the legal measure of damages applicable in all cases.<sup>6</sup>

Later cases have indeed imposed liability for losses that could not readily have been foreseen, and have refused to impose liability for losses that could quite easily have been foreseen.

---

<sup>3</sup> *Ibid.* at 354.

<sup>4</sup> *Ibid.* at 355.

<sup>5</sup> 1 H & N 408, at 411.

<sup>6</sup> *Gee v. Lancashire and Yorkshire Railway Co.* (1860) 6 H & N 211, at 221.

A recent case of the latter kind is the decision of the House of Lords in *Transfield Shipping Inc v. Mercator Shipping Inc. (The Achilles)*.<sup>7</sup> In that case, the time charterer of a ship was nine days late in redelivering the ship to the owner's disposition. The owner had meanwhile made a very profitable contract to charter the ship to another charterer following on at the end of the defendant's charter. The consequence of the defendant's delay under the first charter was that the second charterer became entitled to cancel its contract because the ship could not be made available on the agreed date. A compromise settlement was made between the owner and the second charterer, but, freight rates having declined in the meantime, the owner lost a large part of the benefit of the very profitable follow-on contract. The arbitrators, by a majority, held that the rule in *Hadley v. Baxendale*, as interpreted in later cases,<sup>8</sup> entitled the owner to compensation for this loss. The decision was upheld in the High Court and in the Court of Appeal, but reversed in the House of Lords.

The reason for the conclusion in all the lower tribunals, imposing liability, was simply that it was readily foreseeable—indeed highly probable—that the owner would enter into a follow-on contract, since owners do not normally choose to keep their ships idle, and that such a contract would be lost if the delivery date was missed.<sup>9</sup> Against this it was alleged that there was a long-standing and general understanding in legal and business shipping circles that charterers in such circumstances never had paid, and were never expected to pay more than the market freight rates during the period of the delay. The majority arbitrators admitted that there was such a general understanding, but they held it to be legally irrelevant.<sup>10</sup>

The law lords gave separate reasons. Lord Hoffmann, appealing to “principle” said that “all contractual liability is voluntarily undertaken,” concluding that “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.”<sup>11</sup> The underlying reason for the conclusion was, as in *Hadley v. Baxendale*

---

<sup>7</sup> [2009] 1 AC 61.

<sup>8</sup> Particularly *Heron II* [1969] 1 AC 350 (HL).

<sup>9</sup> It was conceded, perhaps unwisely, before the arbitrators by counsel for the charterer that these consequences were ‘not unlikely.’ *Ibid.* at para. 28.

<sup>10</sup> *Ibid.* at para. 7.

<sup>11</sup> *Ibid.* at para. 12.

itself, the desire to make the probable cost of breach predictable at the time of contract formation, and for much the same reasons as given there. Lord Hoffmann said:

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 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.<sup>12</sup>

Lord Hoffmann added that the risk sought to be imposed on the charterer “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.”<sup>13</sup>

Lord Hope agreed in substance with Lord Hoffmann’s approach. Lord Rodger, however, though agreeing with the conclusion, rested it on the proposition that “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.”<sup>14</sup> He added that “he had not found it necessary to explore the issues concerning ... assumption of responsibility” raised by Lord Hoffmann.<sup>15</sup> Lord Walker agreed with all three preceding opinions.<sup>16</sup>

Baroness Hale came very close to dissenting. She was critical of an approach (i.e. that of Lords Hoffmann and Hope) that made the result depend on what risks the parties should be supposed to have assumed, describing it, very vividly, as a “deus ex machine,” by which she meant a device enabling the court to engineer the conclusion it thought appropriate without further explanation. However, she refrained from dissenting, saying “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.”<sup>17</sup> The net result is some uncertainty as to what reasons

---

<sup>12</sup> *Ibid.* at para. 13.

<sup>13</sup> *Ibid.* at para. 23.

<sup>14</sup> *Ibid.* at para 10.

<sup>15</sup> *Ibid.* at para. 63.

<sup>16</sup> *Ibid.* at para. 87.

<sup>17</sup> *Ibid.* at para. 93.

command majority support. Probably those of Lords Hoffmann and Hope do, because Lord Walker expressly agreed with them both, and even Lord Rodger (with whom Lord Walker also agreed) did not say expressly that he disagreed, or that he agreed with Baroness Hale, but only that he had “not found it necessary to explore” the issue of assumption of responsibility.

Will this case be followed in Canada? This is an interesting and important question, which may arise in many other contexts than international shipping. For example, if a tenant under a short lease overholds for a day, with the consequence that the owner loses a very long and profitable follow-on lease, would the tenant be liable for the full loss? On the one hand it could be argued that it is readily foreseeable that the owner will enter into a follow-on lease, that if the premises are not available on the agreed date the new tenant will have a right to cancel the lease, and that this is very likely to occur if market rental rates turn out to have declined significantly. On the other hand, the kinds of arguments that prevailed in the *Transfield Shipping* case also have cogency: the tenant has no means of knowing, predicting, or controlling the terms of the follow-on lease, and the potential liability might be enormous compared with the amount of the rent paid under the first lease, and far beyond the risks that most tenants would expect to be assuming at the time they entered into the contract. It would not be a risk that could readily be insured against, and the breach of contract (the one-day overholding in the example) might occur entirely without the tenant’s fault. But then, if no better reason can be given for denying liability than that it seems unreasonable in the circumstances to impose it, there is force in Baroness Hale’s vivid metaphor of the *deus ex machina*.

*Hadley v. Baxendale* was much discussed by the Supreme Court of Canada in *Fidler v. Sun Life Assurance Co of Canada*.<sup>18</sup> In this case the Court reversed the rule, mentioned earlier as having been established in 1856 in *Hamlin v. Great Northern Railway Co.*, that excluded damages for mental distress for breach of contract. The Supreme Court relied heavily on the concept of “principle,” (the word was used 19 times within a few paragraphs). *Hadley v. Baxendale* was invoked, not to restrict the defendant’s liability, but to enlarge it. The Supreme Court said that “in *Hadley v. Baxendale*, the court explained the principle of reasonable expectation as follows [the passage from Alderson B’s judgment, given in

---

<sup>18</sup> [2006] 2 SCR 3.

part above, was here quoted].”<sup>19</sup> The Supreme Court added that “damages for mental distress for breach of contract may, in appropriate cases, be awarded as an application of the principle in *Hadley v. Baxendale*,”<sup>20</sup> and concluded that “it follows that there is only one rule by which compensatory damages for breach of contract should be assessed: the rule in *Hadley v. Baxendale*.”<sup>21</sup>

These extracts suggest a very expansive view of liability, but some parts of the judgment sound a more restrained note:

It does not follow, however, that all mental distress associated with a breach of contract is compensable. In normal commercial contracts, the likelihood of a breach of contract causing mental distress is not ordinarily within the reasonable contemplation of the parties. It is not unusual that a breach of contract will leave the wronged party feeling frustrated or angry. The law does not award damages for such incidental frustration. The matter is otherwise, however, when the parties enter into a contract, an object of which is to secure a particular psychological benefit. In such a case, damages arising from such mental distress should in principle be recoverable where they are established on the evidence and shown to have been within the reasonable contemplation of the parties at the time the contract was made. The basic principles of contract damages do not cease to operate merely because what is promised is an intangible, like mental security. This conclusion is supported by the policy considerations that have led the law to eschew damages for mental suffering in commercial contracts. As discussed above, this reluctance rests on two policy considerations—the minimal nature of the mental suffering and the fact that in commercial matters, mental suffering on breach ‘is not in the contemplation of the parties as part of the business risk of the transaction’.... Neither applies to contracts where promised mental security or satisfaction is part of the risk for which the parties contracted.<sup>22</sup>

“Normal commercial contracts” are here distinguished from “a contract an object of which is to secure a particular psychological

---

<sup>19</sup> *Ibid.* at para. 29.

<sup>20</sup> *Ibid.* at para. 44.

<sup>21</sup> *Ibid.* at para. 54.

<sup>22</sup> *Ibid.* at paras. 45–46.

benefit.” In the *Fidler* case itself, the contract in question (disability insurance) was held to fall into the latter category and to justify an award for mental distress. But the boundaries between the categories will not always be so clear. Some contracts would seem to fall into neither category (for example a contract to provide telephone service<sup>23</sup>), and some into both. The latter possibility was illustrated by a case which came up very soon afterwards to the Supreme Court involving mental distress caused by seeing a dead fly in a bottle of drinking water.<sup>24</sup> In one sense this was a normal commercial contract (a sale of bottled water); in another sense a contract to sell bottled drinking water might well be taken to imply an assurance of purity of the water, for the psychological as well as for the physical well-being of the buyer. The buyer had succeeded in recovering a substantial award for mental distress at trial, but the Supreme Court dismissed the buyer’s claim, not only in tort, but also in contract:

Damages arising out of breach of contract are governed by the expectation of the parties at the time the contract was made (*Hadley v. Baxendale* ... applied with respect to mental distress in *Fidler v. Sun Life Assurance Co of Canada*), as distinguished from the time of the tort, in the case of tort. I have concluded that personal injury to Mr Mustapha was not reasonably foreseeable by the defendant at the time of the alleged tort. The same evidence suggests that Mr Mustapha’s damage could not be reasonably supposed to have been within the contemplation of the parties when they entered into their agreement.<sup>25</sup>

This decision might seem to suggest some move back toward restraint in awarding damages for mental distress, but the reasons for rejecting the contractual claim are very brief, and it is not intuitively clear why damages for mental distress could not reasonably be supposed to have been in the contemplation of the parties at the time of the contract. One might have supposed that any buyer of bottled drinking water would be distressed to some degree by seeing a dead fly in it, and it has been often held that if *some* damage of the kind suffered is foreseeable, all damage of that kind is recoverable. The venerable case of *Hadley v. Baxendale* is invoked more often than ever, but its actual operation remains in practice unpredictable, as indeed foretold in 1860 by Baron Wilde.

<sup>23</sup> *Kelly v. Alliant Telecom/Island Tel* (2008), 273 Nfld & PEIR 177 (PEISC) (damages awarded for mental distress on interruption of telephone service).

<sup>24</sup> *Mustapha v. Culligan of Canada Ltd.*, [2008] 2 S.C.R. 114.

<sup>25</sup> *Ibid.* at para. 20.

I would offer two concluding observations. The first is that the idea that it is beneficial to enable the parties to make the cost of breach predictable at the time of contract formation necessarily implies that breach of contract cannot be treated as equivalent in all respects to other legal wrongs. Breaches of contract are inevitable in any large enterprise, and in many contexts are tolerated both by business and by legal considerations, on payment of money compensation.

This leads to the second observation, which is that predicting the amount of money compensation payable on breach of contract depends not only on the rules relating to remoteness, but on several other legal questions, on all of which the level of uncertainty has increased recently in Canadian law. These questions include the availability of punitive damages for breach of contract, the availability of damages for mental distress, the failure of the appellate courts to set any predictable money limit on awards for intangible losses, the increasing use of jury trials in contract cases combined with repeated statements from the appellate courts that the assessment of damages is a proper and desirable function of the jury, the growth of class actions, and uncertainty on the extent of the ability of parties to exclude or limit damages even by express agreement.