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## Commercial litigation

### Transfield Shipping Inc V Mercator Shipping Inc

#### Introduction

The House of Lords decision in *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] 4 All ER 159 (the *Transfield* decision) is significant for two reasons: first, its potential introduction of an “assumed responsibility test” into the law of remoteness of damage for breach of contract and, secondly, for confirming the diminishing relevance of the concept of “reasonable foreseeability” in assessing whether damages are too remote.

#### The Transfield decision in its historical context

In order to analyse the significance of the *Transfield* decision, it is necessary to refer briefly to the leading cases relating to “remoteness of damage” for breach of contract.

The renowned decision in the area is that of *Hadley v Baxendale* (1854) 9 Ex 341. In that decision, the Court of Exchequer held that damages must either arise naturally from the breach (the “first limb of the test”) or must reasonably be supposed to have been in the contemplation of both parties, at the time they entered the contract, as the probable result of the breach (the “second limb of the test”).<sup>1</sup>

Following on from *Hadley v Baxendale*, the courts have commonly inferred a “foreseeability test” into both limbs of *Hadley v Baxendale* – although the courts have been far from consistent in their preference as to how to word the “foreseeability test”.<sup>2</sup> In *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528, the English Court of Appeal held that the loss must be “reasonably foreseeable” under both limbs of the *Hadley v Baxendale* test.<sup>3</sup> Asquith LJ referred to the loss as needing to be a “serious possibility”, a “real danger” or “on the cards”.<sup>4</sup>

However, in *Koufos v C Czarnikow Ltd* [1969] 1 AC 350 (*Koufos*), the House of Lords held that a “reasonable foreseeability test” was more appropriate in tort cases rather than contract cases. Each of the Law Lords in *Koufos* had differing opinions as to the test which should apply instead of the “foreseeability test”, although the consensus was that the damage must arise with a high degree of probability from the breach.<sup>5</sup>

#### The Transfield decision, the “assumed responsibility test” and the “contemplation test”

As referred to above, the significance of the *Transfield* decision is its apparent authority for an “assumed responsibility test”.

The “assumed responsibility test”, as proposed by Lords Hoffman and Hope in *Transfield*, provides that, in assessing whether damages should be awarded, the court must look, from an objective viewpoint, at the parties’ understanding when entering the contract as to the types of losses each party would bear in the event of a breach.<sup>6</sup> This will involve an examination of the knowledge held by the parties.<sup>7</sup>

In *Transfield*, Lord Rodger and Baroness Hale did not either expressly affirm or reject the “assumed responsibility test”, but instead applied the first limb of the *Hadley v Baxendale* test to determine whether the parties would have “contemplated” that the breach would “in the ordinary course of things” cause the loss.<sup>8</sup> In this regard, Lord Rodger and Baroness Hale applied a “contemplation test” rather than an “assumed responsibility test”.

Lord Walker’s decision focused on what the parties “had in mind having regard to the nature and object of the business transaction”.<sup>9</sup> This would seem to be supportive of the “contemplation test”, and not the “assumed responsibility” test proposed by Lords Hoffman and Hope. However, in the final paragraph of his decision, Lord Walker stated that he agreed with the reasons given by Lords Hoffman and Hope.<sup>10</sup> This lends weight to the argument that the *Transfield* decision is authority for the “assumed responsibility test” (and not the “contemplation test”) because three out of the five members of the House of Lords supported the “assumed responsibility test”.

### **The effectiveness of an “assumed responsibility test”**

The question then arises as to whether the “assumed responsibility test” is an effective test which should be applied generally in the law of remoteness for breach of contract. Quite obviously, the “assumed responsibility test” introduces an additional hurdle for plaintiffs to overcome in establishing their entitlement to recover their loss. However, apart from the additional hurdle, what Lords Hoffman and Hope do not explore in the *Transfield* decision are the difficulties, from an evidentiary point of view, in determining what were the “assumed responsibilities” of the parties in relation to the types of losses which might arise.

When parties enter contracts, their focus is on the performance of the particular contract, not the types of loss they are assuming responsibility for if there were to be a breach. In the absence of express provisions in the contract relating to the types of losses the parties will assume responsibility for in the event of a breach, in applying the “assumed responsibility test” a court will often be guessing as to the types of losses the parties assumed responsibility for. If this is the case, the court will inevitably look towards what a reasonable party would have *contemplated* (in line with Lord Rodger and Baroness Hale’s decision in *Transfield*) because of the difficulty in determining what losses the parties assumed responsibility for.<sup>11</sup>

Unless there is “special knowledge”, in line with the second limb of the *Hadley v Baxendale* test, or evidence relating to the commercial practices in a particular market (as there was in *Transfield*), it will generally be difficult for the courts to apply the “assumed responsibility test”. While, in the *Transfield* decision, Lords Hoffman and Hope seemingly applied the “assumed responsibility test” with relative ease in finding that the charterers did not assume responsibility for the owners’ loss relating to the new charter, the reasons given as to why the charterers did not assume responsibility are somewhat arbitrary. In this regard, Lord Hoffman cites, first, the “unquantifiable” nature of the loss claimed and, secondly, the capacity of the owners to decide whether or not to enter into a new charter prior to the vessel being returned.<sup>12</sup> Both reasons given by Lord Hoffman do not involve a detailed examination of the parties’ assumed responsibilities at the time of entering the contract, but instead involve a degree of arbitrariness on the part of the fact-finder in determining what were the assumed responsibilities of the parties.

This is not to say that the decision in *Transfield* was the wrong decision. What is being argued is that the “assumed responsibility test” could be a mechanism used by the courts to achieve what the courts consider a just outcome, rather than requiring the courts to engage in an analysis of what types of losses the parties actually assumed responsibility for.

## The Transfield decision and the “foreseeability test”

As referred to above, the House of Lords held in *Koufos* that the “reasonable foreseeability test” was more appropriate in tort cases than contract cases. Nevertheless, despite *Koufos*, the courts have, in applying *Hadley v Baxendale*, continued to refer to what types of losses are “foreseeable”.<sup>13</sup>

The *Transfield* decision suggests that the courts may be less willing to consider “foreseeability” as determinative. For Lord Hoffman in *Transfield*, the “reasonable foreseeability test” does not provide sufficient regard to “commercial practice”.<sup>14</sup> Lord Hope viewed the “reasonable foreseeability test” as being too imprecise.<sup>15</sup> Lord Walker spoke disapprovingly of the “reasonable foreseeability test” as not giving effect to “the nature and object of the contract entered into by the parties”.<sup>16</sup> Baroness Hale focused on what the parties contemplated, rather than what was foreseeable.<sup>17</sup> Lord Rodger was ambiguous in his references to the “reasonable foreseeability test” – at one point stating that the owners’ loss “could not have been reasonably foreseen as being likely to arise”,<sup>18</sup> but at another point referring to what types of losses the parties contemplated as “likely to result”.<sup>19</sup>

The *Transfield* decision highlights the inadequacies of referring to foreseeability in assessing whether damages arising out of breach of contract are too remote. Foreseeability does not examine the scope of the contractual duties, but instead superimposes the court’s view (often with very little evidence) as to what the parties considered the likely types of losses.<sup>20</sup> As can be seen from *Transfield*, the court upheld the charters’ appeal, not because the loss was unforeseeable, but because it was either not an “assumed responsibility” or within the “contemplation” of the parties.

However, despite its inadequacies, the “reasonable foreseeability test” is likely to linger on in breach of contract cases, despite *Transfield*. In circumstances where the courts are yet to discover a “fits-all” rule which determines whether the particular type of loss is too remote, the foreseeability test is likely to creep into judicial decision making on a case by case basis. This is because there is no entirely satisfactory “fits-all” test. For the reasons set out above, the “assumed responsibility test” does not provide a satisfactory alternative. The “contemplation test” will, to some extent, involve the court considering foreseeability in deciding what was in the parties’ contemplation. This means that the “reasonable foreseeability test” is likely to remain despite its deficiencies.

## Applicability of Transfield decision to Australia

The *Transfield* decision has not been considered in any detail by an Australian court. Interestingly, however, in a recent NSW Court of Appeal decision in *Robb Evans of Robb Evans & Associates v European Bank Ltd* [2009] NSWCA 67 at 58, Campbell JA referred approvingly, in obiter, to the “assumed responsibility test”.

In *Russell v The Trustee of the Roman Catholic Church for the Archdiocese of Sydney*, Basten JA of the NSW Court of Appeal referred with approval to Lord Hoffman’s view that liability should be restricted for breach of contract to that which the parties can “reasonably be considered to have undertaken”.<sup>21</sup>

The “assumed responsibility test” is not Australian law. In saying that, the High Court of Australia has generally followed the English courts in developing the common law relating to breach of contract. Almost certainly, when the High Court next considers a case involving remoteness of damage for breach of contract, it will need to express an opinion regarding the *Transfield* decision and the “assumed responsibility test”. In light of the fact that only Lords Hoffman and Hope expressed clear approval for the “assumed responsibility test”, the High Court may well chose not to apply the “assumed responsibility test” and instead continue to apply the “contemplation test” which has generally been adopted by Australian courts.

The “contemplation test” was applied in *Burns v Man Automotive (Aust) Pty Ltd* (1986) 161 CLR 653 where the High Court looked at what was “within the reasonable contemplation of the parties at the time when the contract was made”. In *Castle Constructions Pty Ltd v Fekala Pty Ltd* [2006] NSWCA 133, the NSW Court of Appeal examined what was “within the parties’ common contemplation”. The Australian courts are more aligned with Lord Rodger and Baroness Hale’s decisions in *Transfield* – although if the factual circumstances arose, the High Court may well re-examine this area of the law.

## Conclusion

The *Transfield* decision illustrates the difficulties the courts face in formulating a “fits-all” rule in the law of remoteness for breach of contract. In the absence of a “fits-all” rule, the court’s decisions will be open to criticism because of a perception that different tests are being applied to similar factual circumstances. It is beyond the scope of this paper to consider an alternate rule. However, it is suggested that any such rule must focus first, on the intentions of the parties and the circumstances in which the contract arose and secondly, the scope of duty which the contract provides as being applicable to the parties.

<sup>1</sup> *Hadley v Baxendale* (1854) 9 Ex 341 at 354. <sup>2</sup> See eg, *Monarch SS Co Ltd v A/B Karlshamns Oljefabriker* [1949] AC 196. <sup>3</sup> *Victoria Laundry (Windsor) v Newman Industries Ltd* [1949] 2 KB 528 at 539. <sup>4</sup> *Victoria Laundry (Windsor) v Newman Industries Ltd* [1949] 2 KB 528 [1949] 2 KB 528 at 540. <sup>5</sup> Carter J W, Peden E and Tolhurst G J, *Contract Law in Australia* (LexisNexis Butterworths, 2007) p 822.

<sup>6</sup> *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] 4 All ER 159 at 167, 172. <sup>7</sup> *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] 4 All ER 159 at 172.

<sup>8</sup> *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] 4 All ER 159 at 178, 188. <sup>9</sup> *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] 4 All ER 159 at 184. <sup>10</sup> *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] 4 All ER 159 at 187. <sup>11</sup> See Robertson A, “The Basis of the Remoteness Rule in Contract” (2008) 28 *Legal Studies* 172. <sup>12</sup> *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] 4 All ER 159 at 169.

<sup>13</sup> See also *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64. <sup>14</sup> *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] 4 All ER 159 at 168. <sup>15</sup> *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] 4 All ER 159 at 172. <sup>16</sup> *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] 4 All ER 159 at 184-185. <sup>17</sup> *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] 4 All ER 159 at 188. <sup>18</sup> *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] 4 All ER 159 at 179. <sup>19</sup> *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] 4 All ER 159 at 177. <sup>20</sup> Tettenborn A, “Hadley v Baxendale Foreseeability: A Principle Beyond Its Sell-by Date?” (2007) 23 *Journal of Contract Law* 120 at 124. <sup>21</sup> *Russell v Trustees of the Roman Catholic Church, Archdiocese of Sydney* [2008] NSWCA 217 at 61; *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] 4 All ER 159 at 166; see also *Dome Resources NL v Silver* [2008] NSWCA 322 at 68 where the NSW Court of Appeal at 68 referred to the *Transfield* decision as making reference to the “expectations of the scope of loss for breach”.