The rule in Hadley v Baxendale (1854) and its place in the standard form of contract

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Abstract

The English Standard forms of Building and Engineering Contracts make complex provisions for dealing with delay and the management of its financial consequences. Similar provisions are found in many countries where the general structure of these contracts has been adopted. Analyses of these indicate that by approaching their application from the common law rules concerning damages for breach of contract provide a clearer rationale for explaining what these clauses set out to do. This enables users in countries outside the common law jurisdictions to gain a clearer means of adapting or using them.

Research into the earlier versions of the standard forms indicates that the relationship between the common law and the standard forms appear to be drafting accidents. Later judicial analyses of the common law identified the relationship between primary and secondary obligations. Clauses in the standard forms allocate these expressly. Only by examining the scope of the rule in Hadley v Baxendale (1854) in a construction setting, is it possible to identify the practical solutions the standard forms provide.

By analysing a variety of clauses in different standard forms of contract, it is possible to identify a common thread running through these clauses. These indicate that in order to understand the drafting, a clear appreciation of the rules about the right to damages at common law is essential. Only then is it possible to understand why these clauses were drafted and how they may be adapted and used in other jurisdictions.

Keywords: Risks, damages, secondary obligations, delay, liquidated damages, direct and indirect loss.

1. Introduction

There is wide range of contractual provisions dealing with delay and its consequence in the English Standard form of construction contracts. The paper analyses the legal interpretation of a number of such contractual provisions. The wording of earlier forms reflect their history, and in

1 My thanks to Andre De Wet (Quantity Surveyor and Project Manager for Transnet South Africa) for the idea of this paper
the older forms, by the manner in which the courts have interpreted them. Newer forms contain
different wording but their aims are the same; to allocate the risk arising in these contracts in a
clear and efficient manner. Contractors can as a result, price their tenders clearly knowing what
their risks are. As a consequence price comparisons between tenders can be managed in a
straight-forward manner. These principles were emphasised by the Privy Council in *Phillips HK
Ltd v AG of HK* [1] that ‘parties…should be able to know with a reasonable degree of certainty
the extent of their liability and the risks which they run as a result of entering into contracts.
This was ‘particularly true in the case of building contracts and engineering contracts’. Quantifying
delay in completion and its consequences is particularly important in situations
where it is difficult for the employer to prove its actual losses. It then makes commercial sense
for parties to agree the actual losses recoverable beforehand so as to reduce this uncertainty.
This paper analyses these provisions in the context of JCT05 [2], the NEC3 [3] and the PFI4 [4]
standard form contracts. Their relationship with the case law on damages for breach of contract
is evaluated in the context of these.

2. The common law

2.1 The significance of Hadley v Baxendale in English Law

In *Photo Production Ltd v Securicor Transport Ltd* [5] Lord Diplock giving the opinion of the
House of Lords, observed that it was a characteristic feature of commercial contracts that parties
promise each other that things will be done. Two examples he gave are (a) that a building would
be constructed in accordance to plans agreed and (b) that services of a particular kind would be
provided. So where one party fails to deliver what has been promised, the ‘promisor has failed
to fulfil [its] own primary obligation’. This failure amounts to a breach of the contract. The main
remedy under English law is damages i.e. monetary compensation which aims ‘to put innocent
party in the place they would have been had the contract been completed’. This is called its
reliance loss. *Hadley v Baxendale* (1854) [6] established the rules for deciding whether the
defaulting party was liable for all the damage caused by their breach. This is commonly
described under the rules of ‘remoteness of damage’. English law this rule to decide whether a
particular loss in the circumstances of the case is too remote to be recovered. There are two
limbs to the Rule (Anderson B):

‘Where two parties have made a contract, which one of them has broken, the damages the other
ought to receive in respect of such breach of such a contract should be such as may:

(a) fairly and reasonably be considered as either arising naturally, i.e., from the
usual course of things, from the breach of contract itself, or

(b) such as may reasonably be supposed to have been in contemplation of both
parties, at the time they made the contract, as the probable result of breach of it.’

Such is the importance of this case to Anglo-American Law that 26 academics contributed
papers to the 150th anniversary of *Hadley v Baxendale* [7]. Now whether there are two rules or
simply two different aspects of the same rule has caused much academic and judicial debate.
Lord Hope in *Jackson v Royal Bank of Scotland* (2005) [8] observed that what was in the
contemplation of the parties was in fact, the principle underlying both. Lord Walker of Gestingthor too, stressed the importance of that underlying principle of what the contract breaker knew or was taken to know, ‘so as to bring the loss within the reasonable contemplation of the parties’ (at para 48). From a strictly legal perspective therefore, there may well be only one rule but from the practical point of the clauses in contracts dealing with these, the courts treat it as of consisting of two different rules. In Hotel Services Ltd v Hilton Int Hotels (UK) Ltd [9], the Court of Appeal, in relation to the need for special knowledge [the what was in the contemplation of the parties] found that ‘authority dictates that the line between direct and indirect and consequential losses is drawn along the boundary between the first and second limbs of Hadley v Baxendale’ (at para. 18).

2.2 Remoteness of damage

The rules established Hadley v Baxendale, were explained by Lord Hope at para 26 in Jackson (2005), a case concerning the sale of dog chews. In the process he explained that the court of appeal misunderstood the effect of the case. In fact the crucial date for determining what ‘may reasonably be supposed to have been in the contemplation of both parties’ was the date of the contract, not the date of the breach. Why this matters is because it is then that the parties could limit their liability under the contract. So while the rules are 150 years old, three eminent Lord Justices misapplied them, which illustrates that applying them are in practice not at all easy. If the rules are so easily misunderstood, allocating damages through the contract itself is from any perspective, the better way to manage commercial relationships.

2.3 Application in construction contracts

Before the decision in Balfour Beatty Construction (Scotland) Ltd v Scottish Power plc [10], it was quite difficult to imagine a scenario where the rule would be applied in a construction context. Or that the point would be of such importance that it would reach the House of Lords. During construction of an aqueduct, the batching plant broke down due to the rupturing of the fuses provided by the supplier. Since watertight construction required a continuous pour of concrete, this came to an end with the power failure. Once it was restored, attempts were made to continue the work by cutting back the old concrete and adding fresh concrete. The contractor was unable to meet the specification for a watertight aqueduct and the engineer instructed the demolition and rebuilding of the structure. In an action against the supplier the contractor won damages for breach of contract. On appeal by the supplier against damages of £229,102.53 plus interest, the Lords confirmed that: damages should either arise naturally from the breach or have been in the contemplation of the parties at the time they made the contract. What one party knew about the other’s business was a question of fact. The demolition and reconstruction of the aqueduct was not in the contemplation of the supplier [since they did not know, and were unlikely to know, that a continuous pour was required make the structure water-tight].

The answer is of course to ensure that the supplier is aware of the consequences of a breach. Note though that damages were awarded under the first limb of Hadley v Baxendale for the damages that arose naturally when the fuses failed. An example of this was the costs of cutting
back unsuccessfully the concrete in an abortive attempt to restart the work. In Stuart Pty Ltd v Condor Commercial Insulation Pty Ltd [11] too, the court of appeal found that the event giving rise to the loss (a fire due to faulty workmanship of the sub-contractor) was not within reasonable contemplation of parties under the second limb. The relevance of the second limb is that the parties can limit their liability at the time of contracting for what would otherwise be a breach of contract. For instance, had the supplier known what damage might result, it could have stipulated that they were not liable for any damage resulting from a failure of their fuses. Would they not then also have raised the matter of a back-up generator if a continuous supply was so vital to the operation? After all, in Hadley v Baxendale itself, the claim for loss of profits caused by delay in the delivering of the broken mill shaft to the repairers, failed under the second limb precisely for that reason. How were the couriers to know that the mill would have no back-up shaft (which was after all central to their business)?

It should be borne in mind that even if the tests in Hadley v Baxendale are satisfied, the quantification of the loss has to be made. In this respect English law takes a reasonable approach. In Electronics and Construction Ltd v Forsyth [12] the House of Lords was held that where the costs of repair were disproportionate to the benefit to be gained, the winning party was only entitled to nominal damages. To demonstrate the difficulty of deciding damages at common law, it should be pointed out that 9 judges at three different judicial levels were eventually split 5:4 in the same case. Thus demonstrating that deciding whether a swimming pool had to be constructed to its specified depth, where there was no benefit to be gained by doing so, was no easy matter. The case was not a commercial one as it involved a builder and a home owner. The principle has however, been applied in commercial contracts. For an example see Birse Construction Ltd v Eastern Telegraph Co Ltd [13]. Damages of £2 were awarded to the winning party, because it was selling the defective premises without repairing it. A further illustration of the principle at work is Shepherd Homes Ltd v Encia Remedation Ltd [14]. It took a 5-week trial for the claimant to prove that a failure to carry out the work with reasonable care and skill had resulted in the damage. Even then though the claimant succeeded on all points of claim, for 40 of the 94 of the houses damaged by subsidence only nominal damages was awarded of £2 per house.

3. Contractual provisions

What these cases show is the difficulty, uncertainty and costs of successfully proving damages at common law. For this reason, avoiding the application of rule is a much the wiser option. Construction contracts therefore, make specific provisions for the payment of damages, to achieve the ‘certainty’ referred to in Phillips. These were emphasised in Photo Production Ltd v Securicor Transport Ltd [15] where the House of Lords distinguished between the primary and secondary obligations of the parties. Where there is a failure to perform those primary obligations (i.e., the performance obligations in the contract), there is a breach of contract. Lord Diplock observed that: ‘The secondary obligation on the part of the contract breaker…is to pay monetary compensation to the other party for the loss sustained by him as a consequence of the breach.’ Parties are free to decide for themselves how to allocate those secondary obligations. The approach of the courts to such allocation of risk was described by Chadwick LJ in Watford
Electronics Ltd v Sanderson [16] (with whom LJ Gibson and Mr Justice Buckley agreed) at 55 as accepting that:

‘Where experienced businessmen [and women] representing substantial companies of equal bargaining power negotiate an agreement, they may be taken to have regard to matters known by them…They should be taken to be the best judge on the question whether the terms of the agreement are reasonable.’

Gibson LJ too went on to say that a court should not assume that either party is likely to commit their company to unfair or unreasonable terms. So where they have agreed the allocation of risk, the price must be taken as reflect that allocation and that therefore there would be little scope for a court to unmake the bargain of commercial people. He adopted the observation of Forbes J in the Salvage Association v CAP Financial Services [17] at p. 656 to the effect that: ‘where a party well able to look after itself enters into a commercial contract and, with full knowledge of all relevant circumstances, willingly accepts the terms of the contract which provides for the apportionment of financial risks of that transaction, I think the court should be slow to interfere’.

The apportionment of financial risks include the provision of LD for delay, inserting exclusion or limiting clauses, and making provision for loss and/or expense to be paid in certain defined circumstances. Consequential losses are also excluded or limited to the value of the contract. Termination clauses too, fall in this category for they contain provisions that are in fact much wider than the position at common law. Again, what has to be borne in mind is that by so doing, the parties are in effect allocating risk between themselves.

The primary obligation of the contractor is to carry out the work required to prescribed standards in a specified time. That of the employer is to pay for the work. Provision is then made for a starting and a completion date. Any construction contract will contain other obligations, but the primary purpose of this paper is analyse the provision of secondary obligations only.

4. Secondary obligations

The early versions of the JCT standard form of contract had limited provisions for the payment of extra money (now called ‘loss and/or expense’). It appears that before JCT 63, there was no provision for the payment of extra money arising out of a delay caused by the employer [18]. However, the contractor had at common law, a claim for damages arising out of the delay. Such a clause was introduced in JCT 63 contract but was limited scope. These were substantially expanded in subsequent editions in 1980 and in 1998. The latest version, the JCT 05 has simplified these clauses. This contract too introduces provisions dealing with consequential loss [19] as does the NEC3.
4.1 Liquidated Damages

The object of LD is to fix the compensation resulting from delay in completing the contract. The advantage of doing so is to escape the uncertainty and costs of suing at common law. The sum so fixed is a pre-estimate of damages. The figure consists of the estimated costs arising out of any delay. This will usually be direct costs only and falls into the first limb of Hadley v Baxendale. For commercial reasons, the resulting sum may not always amount to the true value of the loss. Bath and Somerset [20] provides an example of the kind of losses (or costs) that can be incurred. The employer successfully proved that the LD’s was not the only damages it was likely to suffer if the project was delayed and that it was likely to incur other heads of damage too.

The actual sum need not be accurate as it is only an estimate at the time of the invitation to tender. In what circumstances if it was not ‘correct’ would it amount to a penalty? This question arose in McAlpine Capital Projects Ltd v Tile Box Ltd [21] where the law was extensively reviewed. Mr Justice Jackson proposed a test for discriminating between a LD clause and a penalty. It was his view was that: ‘a pre-estimate of damages does not have to be right in order to be reasonable. There must be a substantial discrepancy between the level of damages stipulated in the contract and the level of damages which is likely to be suffered before it can be said that the agreed pre-estimate is unreasonable’ (at para 20). Note that LD was £45,000 per week and at trial it was claimed that the work 2.5 years late (at para 25), however the employer was able to prove that its actual losses exceeded the sum allowed. The effect of this judgment is that is difficult to conceive of a situation where a sum expressed as LD will be held to be a penalty in a construction contract.

As always, the parties are free to choose whether or not their contract should make provision for fixed payments to be paid in the event of delay. Under NEC 3, Liquidated Damages are provided for in the optional clauses rather than in its core clauses. Option X7 requires the contractor to pay damages for delay from the completion date until the date the employer takes over the works. Should the option not be adopted, the employer is left to recover damage for delay at common law. In the light of the difficulties of proving loss at common law, this is not a particularly wise choice, especially since in a construction contract, the effect of delay is often difficult to quantify afterwards.

4.2 The relation between Liquidated Damages and extensions of time

Where the employer is wholly or partially responsible for an act of prevention that for prevents the contractor from completing on time, the employer cannot recover LD unless the contract provides otherwise. As Phillomere LJ observed in Peak Construction (Liverpool) Ltd v McKinney Foundation Ltd [22], ‘a clause providing for LD are closely linked to one providing for an extension of time.’ The parties agree that were delay is due to the employer; such a provision cures the default. Note though that where the employer issues a notice of intention to
deduct LD, the sum crystallises at that date and the employer can deduct LD despite an extension of time being granted [23].

The JCT 05 calls these provisions ‘relevant events’: clause 2.29. In practice, these are risk allocating measures. As the contractor does not have to include a price in its tender for these possibilities, the tender price should reflect this. In addition the contract contains provisions for loss and expense: clause 4.29 (discussed below). There is not necessarily a connection between the two in JCT contracts: *H. Fairweather & Co Ltd v LB of Wandsworth* [24]. This is emphasised in the JCT 05 contract which widely separates a claim for an extension of time from a claim for loss and expense. The NEC3 by contrast, treats these together in clause 60 where they are called ‘compensation events’. Clause 61 requires the contractor to give notice of compensation events. Where the project manager accepts that’s such an event has occurred, the project manager may instruct the contractor under clause 62 to provide a quotation for extra time and compensation. Note that the NEC also uses a system of early warnings in clause 16.1. This requires the contractor and project manager to notify each other of matters that could increase prices, delay the works or the meeting of key dates.

The PFI 4 allows for Supervening events in clause 5. These are three kinds: 5.2.1: (a) Compensation events which are at the Authority’s risk and for which the contractor receives compensation (b) Relief events which the contractor is best able to manage, but receives no compensation and (c) Force Majeure events. These arise through neither party’s fault, but provide ground for the contractor to terminate its employment under the contract. Clause 5.1.3 provides that Compensation events entitle the contractor to more money and extra time and relief events only extra time to complete.

It is clear from precedent how the court will approach the meaning of the clauses in JCT 05. In *Beaufort Developments (NI) Ltd v Gilbert-Ash*, Lord Hoffman said of the process at p. 784 that legal documents often contain superfluous words. He gave two reasons for this: (i) clumsy draftsmanship and (ii) the lawyer’s desire to cover every conceivable point. Of the JCT standard form of contract he said that it is periodically renegotiated, amended, and added to over many years. It would be unreasonable to expect there to be no redundancies or loose ends. It was therefore important that that earlier judicial authority and practice on the construction of similar contracts be examined to discover the true meanings of the words used. He added that standard forms of contract evolve and reflect the interaction between the draftsmen and the court. These could not be understood without referring to the meanings the judges gave to previous versions of the contract.

The guidance notes to the NEC 3 make clear that this contract is radically different from other existing standard form contracts, and that in should be used in a different manner. Admirable as this view is, common law judges do not make decisions in isolation. In *Costain Ltd & Ors v Bechtel Ltd & Anor* (2005) [25], the court had to interpret the duty of the project manager in certifying payment where the contract required the exercise of good faith. The clause was similar to that contained in NEC 3 where clause 10.1 requires the employer, the contractor, the project manager and the supervisor to ‘act…in a spirit of mutual trust and co-operation’. To
decide what the words meant the court looked at previous precedents dealing with the duties of a certifier. It concluded that in those cases involving other forms of contract, the certifying role required the exercise of fairness and impartiality. Having decided that, there was no need to decide what the clause actually meant in the context of the contract. It is therefore suggested that in interpreting expressions such as compensating events or relief events, the courts are likely to look at the interpretation of similar provisions in other contracts. It is therefore important when using new forms of contract to be aware of the way in which the courts have interpreted other contracts dealing with the same matters.

4.3 Direct loss and/or expense

Clause 4.23 of JCT 05 allows the contractor to claim ‘loss and/or expense’ caused by matters materially affecting the regular progress of the works. It requires the contractor to make written application to the Architect/Contract Administrator stating that it has incurred or is likely to incur direct loss and/or expense in the execution of this contract for which it would not be reimbursed by payment under any other provision of this contract. This is an important proviso because the granting of an extension of time does not automatically trigger a claim for loss and expense. Only when ‘the Architect is of the opinion that the direct loss and/or expense has been incurred...by matters referred to in clause 4.23...then the Architect shall ascertain or shall instruct the Quantity Surveyor to ascertain, the amount of such loss and/or expense.’ Such claims for delay and disruption may include (apart from additional project specific costs: (a) loss of profit (b) finance charges such as interest on borrowed capital (c) head office overheads (d) loss of productivity or uneconomic working (e) idle plant or machinery and (f) increased costs resulting from inflation.

4.4 The meaning of direct loss and/or expense

The words direct loss and/or expense were considered in Wraight Ltd v PH &T (Holdings) Ltd [26]. It was held to mean that the sums recoverable are equivalent to damages at common law. Megaw J said at p 34 that there was no other meaning to be given to the phrase other than what it would have in relation to a breach of contract: see Hadley v Baxendale, thought it must be stressed that at no point does he refer to that case itself. The Court of Appeal in FC Minter v WHTSO [27] considered the phrase in relation to the JCT 1963 contract. It held that direct loss and/or expense is loss that arises naturally, and in the ordinary course of things, as stated in the first limb of Hadley v Baxendale. It defined ‘direct damage’ as ‘that which flows naturally from the breach without any other intervening cause and independently of any special circumstances whereas indirect damage does not so flow.’ Any claim put by a contractor is therefore subject to the question of whether it falls within the first limb of Hadley v Baxendale. Keating [28] considers that the use of other formulae by contractors does not displace or detract from this principle. These formulae are based on the theory that where the period of delay is uncertain and hence the contractor cannot take steps to reduce its head office expenditure or other overheads by obtaining additional work, an approximation of the damages supposedly incurred by the contractor can be made [29].
In *FC Minter* finance charges were claimed as direct loss and/or expense. In holding that the JCT terms contained an implied term to pay interest as a constituent part of direct loss and/or expense, Stephenson LJ added that in the context of the building contract involved and ‘the accepted “cash flow” procedure and practice’, he had no doubt that the sums claimed was direct loss and/or expense. See also *Tate & Lyle Food & Distribution Ltd v GLC* [30] where it was decided that an interest claim for direct loss and/or expense should be calculated at a rate equivalent to the rate of borrowing.

A further detailed analyses of the phrase was carried out in *Robertson Group (Construction) Ltd v Amey-Miller (Edinburgh) JV* [31]. Lord Drummond Young had to construe the meaning of the phrase ‘all direct costs and directly incurred losses’ in a letter of intent. The employer argued that the expression limited the contractor to the cost of labour, plant and materials used on the contract. It excluded head office overheads and any profit element. The contractor claimed that it was entitled to recover not only the cost of labour and materials plus the cost of plant and sums paid to subcontractors but also an appropriate sum to cover their head office overheads plus an appropriate element of profit. The judge considered to the case law on the expression loss and/or expense in the JCT forms. These could ‘be summarised in two propositions. First, the word "direct" in the expression "direct loss and/or expense" is concerned with remoteness of loss…Second, the word denotes that the loss or expense in question must flow naturally from the contractual event relied on by the claimant, in the sense of the first [limb] in *Hadley v Baxendale*. It is worth remembering that in the JCT contract, the costs of disruption of the regular progress of the work is not a breach of contract but a specific contractual entitlement to compensation for loss and expense. Hence it is an example of a secondary obligation fixing the likely damages and circumstances where it will arise. Lord Drummond Young concluded that the phrase included profit and overheads.

### 4.5 Provisions excluding indirect and consequential losses

Making provision in traditional contracts for contractor design elements has led to standard form contracts containing provisions dealing with consequential losses. JCT 05 now has such a provision in clause 2.19.3. This is due to the inclusion of a ‘Contractor’s Design Portion’. The clause limits the liability of the contractor for loss of use, loss of profit or other consequential loss arising from a design failure. This is limited to the amount stated in the appendix. The NEC 3 too in Option X18 ‘Limitation of liability’ in Clause X18.1 states that ‘the Contractor’s liability to the Employer for the Employer’s indirect and consequential loss is limited to the amount stated in the Contract Data.

Clauses of this type are commonly found in contracts for the supply and installation of goods and materials. In *British Sugar plc v NEI Power Projects Ltd* [32] for example the clause provided that: ‘The Seller will be liable for any loss, damage, cost or expense incurred by the Purchaser arising from the supply by the Seller of any such faulty goods or materials …save that the Seller’s liability for any consequential loss is limited to the value of the contract.’
The importance of the clause for the parties is shown in sharp relief when the facts of the case are considered. The contract between the parties was for the design, supply, delivery, testing and commissioning of electrical equipment at a final price of £106,585. The buyer claimed that the equipment was poorly designed and badly installed and caused the power supply to break down. Damages of over £5 million were claimed for the increase in production cost and the losses of profits resulting from the breakdown.

The recent case of Shepherd Homes Ltd v Enica Remediation Ltd (2007) [33] demonstrates principle in operation in a construction setting. The preliminary issue for the court was whether a limiting term had been incorporated into a piling sub-contract. The value of a contract for the design and installation of ground beams on a site where the underlying soil was peat was £100K. Within a year of completion properties on the site showed signs of cracking due to settlement with a potential liability of £10m. The sub-contractor had included a term clause with their offer stating that ‘our maximum liability is limited to the Contract price; whether in contract or in tort, for any damage or loss whatsoever, including all direct, indirect or consequential loss’ Clarke J decided that the clause was a fair and reasonable one in the circumstances.

The meaning of the phrase is much clearer by a series of cases. In British Sugar and also Deepak Fertilisers & Petroleum Corp v. Davy McKee (London) (1999) [34] the Court of Appeal had once again to consider the formulation adopted in pervious cases. This was that the phrase ‘consequential loss’ did not exclude losses arising naturally from the breach of contract. In each case the Court of Appeal concluded that ‘consequential loss’ and ‘indirect and consequential loss’ refer to damages falling into the second limb of Hadley v Baxendale. In British Sugar it also did two other things: (a) It adopted the view that once a court has in a similar context, authoritatively construed the phrase, the ‘reasonable businessman’ must intend the phase to bear that meaning and (b) it confirmed that the phrase is concerned with damages that are too remote unless they are within the actual contemplation of the parties at the time they made the contract. The result of this approach is that a party intending to exclude categories of foreseeable loss, would be better off specifying what is included rather than specifying what is excluded. Examples are loss of profit, overheads, additional costs required to bring the project back to the level contracted for and loss of revenue.

5. Termination clauses

Lubenham Fidelities & Investments Co Ltd v. South Pembrokeshire DC [35] illustrates clearly the difference and risks between termination clauses and the right to repudiate at common law. Termination clauses terminate the employment of the contractor and not the contract. In Lubenham the contractor abandoned the contract because of what it considered an under-valuation of an interim certificate of payment. The employer determined the employment of the contractor under an express provision. In leaving the site, the contractor was in breach of the obligation to proceed with work regularly and diligently. It was held that no right to suspend the work for underpayment existed at common law. The contractor had repudiated the contract and
was liable in damages to the employer. The employer in following the procedures laid down by
the contract had lawfully determined the contractor’s employment.

Repudiating (and effectively terminating the contract) is therefore fraught with risk. This is
because having done so, the party who has chosen to do this, will only later find out whether it
was lawfully entitled to do so. In *Alkok v Grymek* [36] for example, the contractor having
repudiated the contract was found by the Court of Appeal to have had no grounds for
repudiating their contract. So too did the contractor in *Lubenham Fidelities*. The result was that
in both cases the contractors were held liable for all the damage resulting from their breach of
contract. Similarly in *Rheidwood (2007)* [23], the contractor thinking it had the right to
determine its employment was found to have repudiated the contract instead.

The JCT 05 contains two types of termination clauses. One deals with the effect of insolvency
(clause 8.1) and the other with defaults under the contract. Clause 8.4.1 deals with defaults by
the contractor and clause 8.9.1 with those by the employer. These rights are wider than those at
common law and in addition, the contract has accounting provisions dealing with the
consequences. The NEC 3 deals with the right to terminate in clause 90. Clause 91.1 entitles
either party to terminate on insolvency. Clause 91.2 deals with defaults by the contractor, clause
91.4 allows the contractor to terminate for non-payment and clause 91.5 allows either party to
terminate. Clause 92 contains the procedures to be followed upon termination. The PF1
Contract in clause 21.1 allows the contractor to terminate on authority default and clause 21.2
allows for termination due to contractor defaults.

6. Conclusion

The primary interpretation of contractual clauses dealing with delay and its consequences have
been made in the earlier cases on the JCT form of contract. It can therefore be concluded that in
interpreting expressions such as compensating events or relief events, the courts are likely to
look at the interpretation of similar provisions in other contracts.

By adopting the analyses made by the House of Lords in *Photo Production* it is possible to
demonstrate the close relationship between the standard forms of contract and the common law.
Construction contracts expressly allocate secondary obligations which arise as a consequence of
a failure to carry out primary obligations. By doing so, contractual parties avoid the difficulty,
costs and uncertainty of proving damages at common law. Where the courts have to decide what
these clauses which allocate secondary obligations mean, they in fact, return to the common law
principles to decide this. The question of how the parties have allocated risk then depends on
whether the loss falls into the two limbs of *Hadley v Baxendale*. This is the very thing that
secondary obligations are meant to avoid. The result is that contractual provisions such as
liquidated damages fall into the first limb because it is a direct loss. The same applies to
provisions for loss and/or expense (and probably for compensating events or relief events) as
well. Consequential losses fall into the second limb unless they are in fact direct loss and for this
reason the wording of the clause is crucial. Termination clauses, while not strictly within the
rule, avoid the application of the rule, since they too eliminate the uncertainty of damages at
common law and the further risks of unlawfully terminating a contract. What all these express secondary obligations do is to allocate risks between the parties, which ultimately is the purpose of a construction contract.

Therefore, in dealing with the English standard forms of contract and their meaning, it is vital to understand the relationship between the contractual provisions and the common law. Only then is it possible to decide how risk is allocated and how the clauses may in turn be modified to reflect the legal position in other jurisdictions.

References

[3] The Engineering and Construction Contract NEC3 Thomas Telford Ltd and the ICE


[19] Clause 2.19.3 the Contractor’s liability for loss of use, loss of profit or any other consequential loss …shall be limited to the amount, if any stated in the Contract Particulars


[23] Reinwood Ltd v. L Brown & Sons Ltd [2007] EWCA Civ 601


[26] Wraight Ltd v. PH &T (Holdings) Ltd (1968) 13 BLR 26

[27] FC Minter v. WHTSO (1980) 13 BLR 1

[28] Saint Line Ltd v. Richardson [1940] KB 99 at 103


[33] British Sugar plc v. NEI Power Projects Ltd (1997) 87 BLR 87

[34] Shepherd Homes Ltd v. Enica Remediation Ltd and another [2007] EWHC 70 (TCC)

[35] Lubenham Fidelities & Investments Co Ltd v. South Pembrokeshire DC & Wigley Fox Parts (1986) 33 BLR 39

[36] Alkok v Grymek (1986) 67 DLT (2d) 718, Supreme Court of Canada