CASE NOTE

CONTRACT

FUNDAMENTAL BREACH AGAIN

Wathes (Western) Ltd. v. *Austins (Menswear) Ltd.*
[1976] 1 Ll.L. Rep. 14.

The Court of Appeal[1] decision in *Wathes (Western) Ltd.* v. *Austins (Menswear) Ltd.*[2] raises the question, in the context of an affirmed contract, when can the rule that a protective condition[3] cannot be construed so as to cover fundamental breaches be displaced by words to the contrary. The question is undoubtedly of importance for contract draftsmen[4] who no doubt would be aware of the intense judicial dislike of protective clauses, and correspondingly, an intense desire to restrict them as much as possible. This dislike is again apparent in *Wathes* v. *Austin*[5]

The facts[6] of the case were straightforward: Wathes contracted with Austins for the supply and installation of an air-conditioning plant in the latter's shop. The outside unit of the plant emitted a great deal of noise when operated in warm weather. This led to a series of complaints by Austins neighbours, Just Jane, Ld. and culminated in an action for nuisance which was settled at a cost of £1323.61. The plaintiffs did nothing to help Austins in this matter, but they sued for the price £1338.50. In defence, Austins pleaded that they were entitled to set-off or recover by counter-claim the costs they incurred as a result of the breach of contract by the plaintiffs, namely, the plaintiff's failure to remedy the defect in the outside unit which gave rise to the nuisance action. There was no dispute that the plaintiffs were entitled to the price for work done; the only question was whether the defendant were entitled to succeed on their counterclaim. The plaintiffs relied on Clause 14 of their Standard Conditions of Sale to defeat the counter-claim. Clause 14 states:

> *Consequential Damages.* The Company shall be under no liability for any consequential loss damage claims or liabilities of any kind arising from any cause whatsoever.

[1] The Appeal Court consisted of Megaw L.J., Stephenson L.J. and Sir John Pennycuick.

[2] [1976] 1 Ll.L. Rep. 14.

[3] The term is that of Donaldson's J. in *Kenyon Ltd.* v. *Baxter Hoare* [1971] 1 W.L.R. 519 at p. 522.

[4] Exemption clauses in contracts covered by the Sale of Goods Act 1893 are substantially curtailed by the Supply of Goods (Implied Terms) Act 1973, s. 55. But, of course, in hire-purchase agreements and other agreements not within the ambit of the Sale of Goods Act 1893, the common law still applies. See generally, Benjamin's Sale of Goods (A.G. Guest, ed. 1974) Ch. 13; Atiyah, Sale of Goods (5 ed. 1975) Ch. 14.

[5] [1976] 1 Ll.L. Rep. 14.

[6] As described by Megaw L.J., *ibid.,* at pp. 15-17.

The trial judge held that this clause did not protect the plaintiffs but that the amount of counter-claim would be reduced by 60% in view of the defendants' failure to mitigate the damage. The plaintiff appealed, arguing that there was no fundamental breach or that as the defendants had affirmed the contract, the protective clause was operative. The defendant cross-appealed on the deduction made of the counter-claim. Common grounds between the two parties were that firstly, in the absence of fundamental breach, the counter-claim must fail, and secondly, had the breach been accepted by the defendants so as to rescind the contract, clause 14 would not have availed the plaintiffs.

The Court of Appeal first dealt with the question of whether or not there was a fundamental breach. The three Judges agreed that the time in which to decide whether a breach is fundamental or not in the case of a rescinded contract is the date in which the innocent party claims to rescind the contract. But a difficulty arises in the case of an affirmed contract in that a fundamental breach may, at any time before the action is commenced, have been substantially ameliorated: should this be taken into account in deciding whether or not a protective clause should be applicable? Megaw L.J. did not decide this question as, on the facts of the case, it was found that at no time was there an amelioration of the breach.[7] Stephenson L.J. pointed out that if the breach was remedied, it would no longer be considered fundamental;[8] clearly inferring, therefore, that such amelioration could be taken into account. Sir John Pennycuick on the other hand, seems to be of the view that if at any time during the currency of the contract, a fundamental breach occurred, then "it is no answer that an effective remedy was afterwards found."[9] There is no doubt that general exception clauses such as the one contained in clause 14 would be valid in covering liability for breaches which were not fundamental and it seems right, on principle, that the fact that the fundamental breach had, to a certain extent, been ameliorated should be taken into account. Stephenson L.J.'s approach is to be preferred if one were to be entirely consistent in giving effect to such clauses to limit or exempt the liability of guilty parties for breaches which are not fundamental when the action is commenced. To hold that such a clause is not applicable in such circumstances seems to ignore the reasonable intentions of the parties: it is a reasonable inference, in the case of minor or serious (but not fundamental) breaches, that the parties could have contemplated the protective clauses to cover them, if such clauses were not to be totally devoid of effect. In any event, the Appeal Judges found that there was here a fundamental breach which was not ameliorated.

The next question concerns the effect of the fundamental breach on the exemption clause, where the contract had been affirmed. The Court was unanimous in deciding that the clause could not apply to the breach in question. Implicit in all the judgements was a recognition that the plaintiffs had failed to show that there was a different intention sufficient to rebut the *prima facie* presumption that an exemption clause is not ordinarily intended by the parties to cover fundamental breaches. But the judgements on this point merit analysis.

[7] *Ibid.,* at p. 20.
[8] *Ibid.,* at p. 24.
[9] *Ibid.,* at p. 25.

Megaw L.J. regarded himself bound by *Charterhouse Credit Co.* v. *Tolly,*[10] notwithstanding that it was disapproved by the House of Lords in *Suisse Atlantique.*[11] At any rate, he considered that insofar as *Charterhouse Credit*[10] was an authority to the effect that an exemption clause did not survive where there was a fundamental breach in the case of an affirmed contract, at least where it was accepted that had the contract been rescinded, the clause would not have availed the guilty party, it was still good law. This line of reasoning was also apparent in Stephenson's L.J. judgement:

> The innocent party cannot alter the meaning of a clause in a contract by affirming it: if the clause did not apply to what the guilty party has done and the damage which he has caused, it cannot be made to apply by the innocent party going on with the contract — or with another contract which appears to be regarded... as the same contract, though varied in a fundamental respect.[12]

The difficulty in this reasoning is enhanced by the decision in *Harbutts Plasticine.*[13] There, it was decided that where a contract has been rescinded or becomes incapable of performance, exemption clauses can never apply. If that is the case, the question of construing the clause never arises whereas it does in the case of an affirmed contract — at any rate, before this decision. The concession made by the plaintiffs that if the contract had been rescinded, the exemption clause could not have availed them can be taken to refer to the effect of *Harbutts Plasticine,*[14] and not to the construction of clause 14. It is submitted that the reasoning in Stephenson L.J.'s judgment is now suspect. In effect, it would mean that protective clauses can not be applied in a situation where although the contract had been affirmed, if the clause could not have been applied had the contract been rescinded, it could not be applied here, even though it could be construed to cover the type of breach in question. This is surely to return to the substantive law doctrine. Sir John Pennycuick seems to say as much when he said,

> The current of authority has now set, as I read the cases, in favour of the view that where a contract is affirmed after fundamental breach an exemption clause is treated as inapplicable to liability resulting from that breach, not upon a substantive principle of law, but upon construction, the clause being construed, in the absence of some plain indication of a different intention, as by implication inapplicable to such liability. *The distinction between the two grounds of inapplicability can, so far as I can see, make no difference to the result where there is no such indication of intention.*[15]

This strongly suggests that there is a need to construe exemption clauses only where a "different intention" has been indicated. This decision thus goes further than *Harbutts Plasticine* [13] insofar as it is authority for the proposition that in the case of an *affirmed* contract, the exemption clause cannot be construed to apply to a fundamental breach, at any rate, if there is no evidence of a "different intention". This, in effect, would mean that general clauses of the type found in this case can *never* be effective, no matter how widely they are phrased,

[10] [1963] 2 Q.B. 683.
[11] *Suisse Atlantique Societe D'Armament Maritime S.A.* v. *N.V. Rotterdamsche Kolen Centrale* [1967] 1 A.C. 361.
[12] [1976] 1 Ll.L. Rep. 14, 24.
[13] *Harbutt's "Plasticine" Ltd.* v. *Wayne Tank and Pump. Co. Ltd.* [1970] 1 Q.B. 449.
[14] *Ibid.*
[15] [1976] 1 Ll.L. Rep. 14, 25. (*italics mine*).

in covering fundamental breaches. A premium is placed on the sophistry and minutiae of drafting. The type of fundamental breach must be clearly indicated. This case is yet another illustration of the observation that "[t]he general trend of subsequent decisions has been to reach, as a matter of construction, much the same results that were formerly reached under the substantive doctrine."[16] Much can be said for the view that the doctrine of fundamental breach should be reconsidered, or better still, replaced by other devices of legislative and judicial control, namely, the specifying of types of exemption clauses that will be invalid, and the conferring to the courts of a discretion to strike down harsh and unconsionable clauses.[17]

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[16] Treitel, The Law of Contract, (4th ed. 1975), p. 152 *et. seq.*
[17] See, for instance, Supply of Goods (Implied Terms) Act 1973, s. 55.