

**11-002 Common law and State Immunity Act 1978.** The law of sovereign immunity was largely placed on a statutory basis by the State Immunity Act 1978.<sup>8</sup> The 1978 Act is not, however, a complete code and matters which are excluded from its scope will be governed by the rules developed by the common law. Thus the 1978 Act excludes proceedings relating to anything done by or in relation to the armed forces of a state while in the United Kingdom.<sup>9</sup> Such cases are subject to immunity under the common law rules.<sup>10</sup>

**11-003 Sovereign immunity and human rights.** In *Holland v Lampen-Wolfe*<sup>11</sup> the House of Lords held that to accord sovereign immunity to the defendant did not deprive the claimant of a fundamental right of access to the English court under art.6 of the European Convention on Human Rights since the immunity of a state was an attribute of the state itself under international law which all other states are, by international law, obliged to accept. In a series of cases the European Court of Human Rights has also held that application of the principles of state immunity was compatible with art.6 of the Convention.<sup>12</sup> The court maintained that while a limitation on a right of access to a court must pursue a legitimate aim and must be proportionate, according immunity to a state in civil proceedings was designed to achieve the legitimate aim of complying with international law by promoting comity and good relations between states through mutual respect for the sovereignty of states. Immunity which reflected generally held rules of public international law did not amount to a disproportionate restriction on the right of access to a court since some such restrictions, including those generally accepted in international law, were inherent. But in *Cudak v Lithuania*<sup>13</sup> the European Court of Human Rights decided that the art.6 rights of a Lithuanian secretary and switchboard operator in Lithuania had been violated by the Lithuanian courts' refusal to exercise jurisdiction over Poland in her claim for unfair dismissal: although immunity pursued a legitimate aim, the grant of immunity was disproportionate in the light of growing agreement that there was no immunity for employment claims by non-nationals. In *Jones v Ministry of the Interior of the Kingdom of Saudi Arabia*<sup>14</sup> the House of Lords assumed that art.6

<sup>8</sup> See below, para.11-004.

<sup>9</sup> State Immunity Act 1978 s.16(2).

<sup>10</sup> *Littrell v Government of the United States (No.2)* [1995] 1 W.L.R. 82; *Holland v Lampen-Wolfe* [2000] 1 W.L.R. 1573. Since the 1978 Act is not retrospective (s.22(3)) it will only apply to matters which occurred after it entered into force (November 1978) but it is now most unlikely that matters which occurred before that date, which would be governed by the common law, will arise in practice. cf. *Plammont Ltd v Republic of Zaire* [1981] 1 All E.R. 1110; *Sengupta v Republic of India* [1983] I.C.R. 221.

<sup>11</sup> [2000] 1 W.L.R. 1573. See also *Matthews v Ministry of Defence* [2003] UKHL 4, [2003] 1 A.C. 1163.

<sup>12</sup> *Fogarty v United Kingdom* (2002) 34 E.H.R.R. 302; *Al-Adsani v United Kingdom* (2002) 34 E.H.R.R. 273, arising out of *Al-Adsani v Government of Kuwait*, *The Times*, March 29, 1995, 107 Int. L.R. 536; *McElhinney v Ireland* (2002) 34 E.H.R.R. 322, arising out of *McElhinney v Williams* [1996] 1 I.L.R.M. 276. See Kloth, *Immunities and the Right of Access to Court under Article 6 of the European Convention on Human Rights* (2010); Fox (2001) 117 L.Q.R. 10; Garnett (2002) 118 L.Q.R. 367; Voyiakis (2003) 52 I.C.L.Q. 297; Lloyd Jones (2003) 52 I.C.L.Q. 463; Yang (2003) 74 B.Y.L.L. 333; Garnett (2005) 54 I.C.L.Q. 705.

<sup>13</sup> (2010) 51 E.H.R.R. 15; see also *Sabah El Leil v France* [2010] ECHR 1055.

<sup>14</sup> [2006] UKHL 26, [2007] 1 A.C. 270. See Seymour [2006] C.L.J. 479.

of the Convention was engaged, as decided by the European Court of Human Rights in the above cases, but held that according sovereign immunity to the state and its servants, agents, officials or functionaries in respect of civil claims arising out of alleged acts of torture committed in the state was not disproportionate as inconsistent with a peremptory norm of international law. Lord Bingham of Cornhill, however, had reservations as to whether art.6 was engaged at all, since the rule of international law is not that a state should not exercise over another state a jurisdiction which it has, but that save in cases recognised by international law, of which this case was not an example, a state has no jurisdiction over another state: it was therefore difficult to accept that a state had denied access to its court if it had no access to give.<sup>15</sup>

**State Immunity Act 1978.** The Act<sup>16</sup> applies both to cases where the question of the immunity of a foreign state arises directly in the proceedings as where the state is named as a defendant, and also to the common case of "indirect impleading", as where an action between two other parties puts the title to the state's goods in issue.<sup>17</sup> The basic principle of the Act is that a foreign state is

<sup>15</sup> [2006] UKHL at [14]. See, to the same effect, Lord Hoffmann at [64] and *Holland v Lampen-Wolfe* [2000] 1 W.L.R. 1573, 1588, per Lord Millett. See also *AIG Capital Partners Inc v Republic of Kazakhstan* [2005] EWHC 2239 (Comm), [2006] 1 W.L.R. 1420 (restriction on the right of a party to enforce a judgment against a central bank (see State Immunity Act 1978 s.14(4)) is legitimate and proportionate); *Grovit v Nederlandsche Bank* [2005] EWHC 2944 (QB); [2006] 1 W.L.R. 3323 (according immunity to employees of immune central bank is legitimate and proportionate; affirmed on other grounds, [2007] EWCA Civ 712, [2008] 1 W.L.R. 51). cf. *Cudak v Lithuania* (2010) 51 E.H.R.R. 15, above. See also *Aziz v Aziz* [2007] EWCA Civ 712, [2008] 2 All E.R. 501. In *Lechouritou v Dimosio tis Omospondiakis Dimokratias tis Germanias* (C-282/05) [2007] E.C.R. I-1519 the European Court of Justice found it unnecessary to decide whether immunity was compatible with the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters 1968. In *Grovit v Nederlandsche Bank* it was held at first instance that immunity was compatible, but the point was not decided by the Court of Appeal. See also *Entico Corp Ltd v UNESCO* [2008] EWHC 531 (Comm), [2008] 1 Lloyd's Rep. 673 (immunity of international organisation).

<sup>16</sup> Implementing the 1972 European Convention on State Immunity: Cmnd.5081, though the Act is more extensive in scope. For discussion and references to relevant literature (which is copious) see *Dicey, Morris and Collins on the Conflict of Laws*, 14th edn (2006), paras 10-002-10-058; Cheshire, North and Fawcett, *Private International Law*, 14th edn (2008), pp.491-510; Fox, *The Law of State Immunity*, 2nd edn (2008). See also United Nations Convention on Jurisdictional Immunities of States and their Property (December 2004, not yet in force). For the text of the Convention see (2005) 44 Int. Leg. Mat. 803. Although not in force the Convention has been regarded as a strong indicator of international thinking on questions of sovereign immunity: see *AIG Capital Partners Inc v Republic of Kazakhstan* [2005] EWHC 2239 (Comm), [2006] 1 W.L.R. 1420; *Jones v Ministry of the Interior of the Kingdom of Saudi Arabia* [2006] UKHL 26, [2007] 1 A.C. 270; *Koo Golden East Mongolia v Bank of Nova Scotia* [2007] EWCA Civ 1443, [2008] Q.B. 717; *NML Capital v Argentina* [2011] UKSC 31, [2011] 2 A.C. 495; *Cudak v Lithuania* (2010) 51 E.H.R.R. 15; *Jurisdictional Immunities of the State (Germany v Italy: Greece intervening)* (International Court of Justice, February 3, 2012), available at <http://www.icj-cij.org>. For comment on the Convention, see Denza (2006) 55 I.C.L.Q. 395; Fox (2006) 55 I.C.L.Q. 399; Gardiner (2006) 55 I.C.L.Q. 407; Hall (2006) 55 I.C.L.Q. 411; Dickinson (2006) 55 I.C.L.Q. 427; McGregor (2006) 55 I.C.L.Q. 437.

<sup>17</sup> e.g. *The Parlement Belge* (1880) L.R. 5 P.D. 197; *United States of America and Republic of France v Dollfus Mieg et Cie SA and Bank of England* [1952] A.C. 582. On the scope of the Act in respect of immunity from taxation, see *R v IRC Ex p. Camaca Corp* [1990] 1 W.L.R. 191 and below, para.11-005.



immune from the jurisdiction of the English courts<sup>18</sup> whether or not it appears in the proceedings,<sup>19</sup> and the issue of immunity must be decided as a preliminary issue before the substantive action can proceed.<sup>20</sup> This immunity applies to any foreign or Commonwealth state, other than the United Kingdom, to the sovereign or other head of state in his public capacity and to the government or any department of that state.<sup>21</sup> It also applies to a "separate entity", such as a state corporation, not being a department of the state, where proceedings relate to something done by the separate entity in the exercise of sovereign authority and the state itself would have been immune.<sup>22</sup> It will be for the courts to develop criteria for determining what constitutes a separate entity. It is suggested, however, that the notion of separate entity does not extend to any agent of a foreign

<sup>18</sup> The principle of immunity also precludes registration in England of a foreign judgment against a foreign state under the Administration of Justice Act 1920: see *AIC Ltd v Federal Government of Nigeria* [2003] EWHC 1357 (QB). Civil Jurisdiction and Judgments Act 1982 s.31, as to which see *NML Capital Ltd v Argentina* [2011] UKSC 31, [2011] 2 A.C. 495.

<sup>19</sup> 1978 Act s.1. See *United Arab Emirates v Abdelghafar* [1995] I.C.R. 65; *Malaysian Industrial Development Authority v Jeyasingham* [1998] I.C.R. 307; *Military Affairs Office of the Embassy of the State of Kuwait v Caramba-Coker* (EAT/1054/02/RN, April 10, 2003); *Koo Golden East Mongolia v Bank of Nova Scotia* [2007] EWCA Civ 1443, [2008] Q.B. 717; *ETI Euro Telecom International NV v Republic of Bolivia* [2008] EWCA Civ 880, [2009] 1 W.L.R. 665. The burden of proof is upon the party asserting that the state is subject to the jurisdiction of the English court. *Donegal International Ltd v Zambia* [2007] EWHC 197 (Comm), [2007] 1 Lloyd's Rep. 397.

<sup>20</sup> *J.H. Rayner (Mincing Lane) Ltd v Dept of Trade and Industry* [1989] Ch. 72, 194–195, 252, affirmed without reference to this point, [1990] 2 A.C. 418; *A Co Ltd v Republic of X* [1990] 2 Lloyd's Rep. 520, 525; *Aziz v Republic of Yemen* [2005] EWCA Civ 754, [2005] I.C.R. 1391; *ETI Euro Telecom International NV v Republic of Bolivia* [2008] EWCA Civ 880, [2009] 1 W.L.R. 665. See also *Mauritius Tourism Promotion Authority v Wong Min* (UKEAT/0186/08/LA November 24, 2008) (EAT). A claim to immunity should be heard in public: *Harb v King Fahd Bin Abdul Aziz* [2005] EWCA Civ 632, [2006] 1 W.L.R. 578. See also *Aziz v Aziz* [2007] EWCA Civ 712, [2008] 2 All E.R. 501.

<sup>21</sup> s.14. See *Propend Finance Pty Ltd v Sing, The Times*, May 2, 1997, 111 Int. L.R. 111; *Bank of Credit and Commerce International (Overseas) Ltd v Price Waterhouse* [1997] 4 All E.R. 108. The immunity extends to servants or agents, officials and functionaries of a foreign state in respect of acts done by them as such in the foreign state: *Jones v Ministry of the Interior of the Kingdom of Saudi Arabia* [2006] UKHL 26, [2007] 1 A.C. 270; *Pocket Kings Ltd v Safenames Ltd* [2009] EWHC 2529 (Ch), [2010] Ch. 438 (Commonwealth of Kentucky, a constituent territory of the United States, not a "State" for the purposes of State Immunity Act 1978 s.14(1)); *R. (on the application of HRH Sultan of Pahang) v Secretary of State for the Home Department* [2011] EWCA Civ 616 (Sultanate of Pahang, Malaysia, not a "state" for the purposes of State Immunity Act 1978 and Sultan of Pahang not a "Head of State" for those purposes). See also *Grovit v Nederlandsche Bank* [2005] EWHC 2944 (QB), [2006] 1 W.L.R. 3323; affirmed on other grounds, [2007] EWCA Civ 953, [2008] 1 W.L.R. 51.

<sup>22</sup> s.14. See *Kuwait Airways Corp v Iraqi Airways Co* [1995] 1 W.L.R. 1147 (for further proceedings, see *Kuwait Airways Corp v Iraqi Airways Co (No.2)* [2001] 1 W.L.R. 430; *Kuwait Airways Corp v Iraqi Airways Co* [2003] EWHC 31 (Comm), [2003] 1 Lloyd's Rep. 448); *Propend Finance Pty Ltd v Sing, The Times*, May 2, 1997, 111 Int. L.R. 611; *Ministry of Trade of the Republic of Iraq v Tsavlis Salvage (International) Ltd* [2008] EWHC 612 (Comm), [2008] 2 Lloyd's Rep. 90; *Wilhelm Finance Inc v Ente Administrador del Astillero Rio Santiago* [2009] EWHC 1074 (Comm), [2009] 1 C.L.C. 867; *Pocket Kings Ltd v Safenames Ltd* [2009] EWHC 2529 (Ch), [2010] Ch. 438; *R. (on the application of HRH Sultan of Pahang) v Secretary of State for the Home Department* [2011] EWCA Civ 616; see also *Koo Golden East Mongolia v Bank of Nova Scotia* [2007] EWCA Civ 1443, [2008] Q.B. 717; *PT Garuda Indonesia Ltd v Australian Competition and Consumer Commission* [2011] FCAFC 52, (2011) 277 A.L.J.R. 67. For the position of a state's central bank or other monetary authority, see State Immunity Act 1978 s.14(3), (4); *AIC Ltd v Federal Government of Nigeria* [2003] EWHC 1357 (QB); *AIG Capital Partners Inc v Republic of Kazakhstan* [2005] EWHC 2239 (Comm), [2006] 1 W.L.R. 1420.

state. Rather, it should be regarded as limited to an entity owned or controlled by the foreign state since it is only if such ownership or control exists that an entity can realistically be regarded as capable of doing something in the exercise of sovereign authority.<sup>23</sup>

To the general principle of immunity there are several important and wide-ranging exceptions. The most important is that there is no immunity for a state's commercial transactions,<sup>24</sup> thus confirming the judicial developments confining the common law rule to *acta iure imperii*, though it may still be difficult to determine in any particular case the dividing line between commercial and governmental activity.<sup>25</sup> The funds in the bank account of a state's London embassy have been considered not to be used for commercial purposes.<sup>26</sup> There is no immunity for contractual obligations (whether arising out of a commercial

<sup>23</sup> Dicey, *Morris and Collins on the Conflict of Laws*, 14th edn (2006), para.10–09. See also *Re Rafidain Bank* [1992] B.C.L.C. 301; *Kuwait Airways Corp v Iraqi Airways Co* [1995] 1 W.L.R. 1147, (for further proceedings, see *Kuwait Airways Corp v Iraqi Airways Co (No.2)* [2001] 1 W.L.R. 430; *Kuwait Airways Corp v Iraqi Airways Co* [2003] EWHC 31 (Comm), [2003] 1 Lloyd's Rep. 448); *Propend Finance Pty Ltd v Sing, The Times*, May 2, 1997, 111 Int. L.R. 611; *Ministry of Trade of the Republic of Iraq v Tsavlis Salvage (International) Ltd* [2008] EWHC 612, [2008] 2 Lloyd's Rep. 90; *Wilhelm Finance Inc v Ente Administrador del Astillero Rio Santiago* [2009] EWHC 1074 (Comm), [2009] 1 C.L.C. 867.

<sup>24</sup> s.1(a). In *NML Capital Ltd v Argentina* [2011] UKSC 31, [2011] 2 A.C. 495 it was held (by majority) that proceedings to enforce a foreign judgment entered in respect of a commercial transaction are not, of themselves, proceedings relating to a commercial transaction; the same principle applies in respect of proceedings to register a foreign judgment against a foreign state under Administration of Justice Act 1996, *AIC Capital Partners v Federal Government of Nigeria* [2003] EWHC 1357 (QB), and to applications to enforce an arbitration award under Arbitration Act 1996 s.101, *Svenska Petroleum Exploration AB v Republic of Lithuania (No.2)* [2006] EWCA Civ 1529, [2006] Q.B. 886, applied in *Ministry of Trade of the Republic of Iraq v Tsavlis (International) Ltd* [2008] EWHC 612 (Comm), [2008] 2 Lloyd's Rep. 90. See further *ETI Euro Telecom International NV v Republic of Bolivia* [2008] EWCA Civ 880, [2009] 1 W.L.R. 665; *Continental Transfert Technique Ltd v Federal Government of Nigeria* [2009] EWHC 2898 (Comm); *Servaas Inc v Rafidain Bank* [2011] EWCA Civ 1256; cf. *Kensington International Ltd v Congo* [2005] EWHC 2684 (Comm), [2006] 2 B.C.L.C. 296.

<sup>25</sup> *Congreso del Partido* [1983] 1 A.C. 244, where the House of Lords divided 3:2 on this issue. Section 3(3) of the 1978 Act defines a "commercial transaction" as any contract and any guarantee or indemnity in respect of such a transaction or other financial obligation, or any other transaction or activity into which a state enters (apart from a contract of employment between a state and an individual) otherwise than in the exercise of sovereign authority. On this provision, see *Alcom Ltd v Republic of Colombia* [1984] A.C. 580; *Amalgamated Metal Trading Ltd v Dept of Trade and Industry, The Times*, March 21, 1989; *Kuwait Airways Corp v Iraqi Airways Co* [1995] 1 W.L.R. 1147 (for further proceedings, see *Kuwait Airways Corp v Iraqi Airways Co (No.2)* [2001] 1 W.L.R. 430; *Kuwait Airways Corp v Iraqi Airways Co* [2003] EWHC 31 (Comm), [2003] 1 Lloyd's Rep. 448); *Central Bank of Yemen v Cardinal Finance Investment Corp* [2001] Lloyd's Rep. Bank. 1; *Svenska Petroleum Exploration AB v Government of the Republic of Lithuania (No.2)* [2006] EWCA Civ 1529, [2008] Q.B. 886; *Koo Golden East Mongolia v Bank of Nova Scotia* [2007] EWCA Civ 1529, [2008] Q.B. 717; *Orascom Telecom Holding SAE v Republic of Chad* [2008] EWHC 1841 (Comm), [2008] 2 Lloyd's Rep. 396; *Servaas Inc v Rafidain Bank* [2011] EWCA Civ 1256; *NML Capital v Argentina* [2011] UKSC 31, [2011] 2 A.C. 495; see also *Littrell v Government of the United States (No.2)* [1995] 1 W.L.R. 82; *Holland v Lampen Wolfe* [2001] 1 W.L.R. 1573; *PT Garuda Indonesia (No.2)* [1995] 1 W.L.R. 82; *Holland v Lampen Wolfe* [2001] 1 W.L.R. 1573; *PT Garuda Indonesia Ltd v Australian Competition and Consumer Commission* [2011] FCAFC 52, (2011) 277 A.L.J.R. 67. See *Staker* (1995) 66 B.Y.I.L. 496; *Fox* (1996) 112 L.Q.R. 186.

<sup>26</sup> *Alcom Ltd v Republic of Columbia* [1984] A.C. 580. See also *AIC Ltd v Federal Government of Nigeria* [2003] EWHC 1357 (QB).



transaction or not) to be performed in the United Kingdom<sup>27</sup>; or in the case of contracts of employment made or to be performed in the United Kingdom<sup>28</sup>; or as to claims for personal injury or damage to property caused by misconduct in the United Kingdom<sup>29</sup>; or in proceedings relating to immovables in the United Kingdom<sup>30</sup> or to an interest in other property by way of succession, gift or bona vacantia<sup>31</sup>; or in the case of proceedings relating to various forms of intellectual property<sup>32</sup>; or the administration of estates or trusts, or insolvency, even though a state may claim an interest in the property<sup>33</sup>; or where a state is a member of a corporate or unincorporate body constituted under United Kingdom law or controlled from the United Kingdom<sup>34</sup>; or in relation to various tax claims<sup>35</sup>; or as to claims arising from use of ships for commercial purposes<sup>36</sup> (again confirming an important common law development); or, finally, where the state has submitted to the jurisdiction of our courts.<sup>37</sup>

<sup>27</sup> 1978 Act s.3(1)(b), though note the limitation, s.3(2). See *J.H. Rayner (Mincing Lane) Ltd v Dept of Trade and Industry* [1989] Ch. 72, 194–195, 222, 252, affirmed without reference to the point, [1990] 2 A.C. 418.

<sup>28</sup> s.4. This section does not apply to proceedings concerning the employment of the members of a mission within the meaning of the Convention scheduled to the Diplomatic Privileges Act 1964 or of the members of a consular post within the meaning of the Convention scheduled to the Consular Relations Act 1968 s.16(1)(a). See *Sengupta v Republic of India* [1983] I.C.R. 221; *United Arab Emirates v Abdelghafar* [1995] I.C.R. 65; *Arab Republic of Egypt v Gamal-Eldin* [1996] I.C.R. 13; *Ahmed v Government of the Kingdom of Saudi Arabia* [1996] I.C.R. 25; *Malaysian Industrial Development Authority v Jeyasingham* [1998] I.C.R. 307; *Government of the Kingdom of Saudi Arabia v Nasser* Unreported November 14, 2000 CA; *Garnett* (1997) 46 I.C.L.Q. 81; *Garnett* (2005) 54 I.C.L.Q. 705. And see *Fogarty v United Kingdom* (2002) 34 E.H.R.R. 302; *Al-Kadhimi v Government of Saudi Arabia* [2003] EWCA Civ 1689; *Aziz v Republic of Yemen* [2005] EWCA Civ 754, [2005] I.C.R. 1391; *Mauritius Tourism Promotion Authority v Wong Min* (UKEAT/0186/04) November 24, 2008 (EAT); *United States of America v Nolan* [2009] I.R.L.R. 923; *Wokan v Kassam* [2012] EWHC 105 (Ch).

<sup>29</sup> s.5; see *Military Affairs Office of The Embassy of the State of Kuwait v Caramis, Toker* (EAT/1054/02/RN, April 10, 2003); *Federal Republic of Nigeria v Ogbonna* (UKEAT/0585/10/ZT, July 12, 2011) (EAT).

<sup>30</sup> As with proceedings for breach of covenants in a lease: *Intpro Properties (UK) Ltd v Sausel* [1983] Q.B. 1019. cf. *Re B (A Child) (Care Proceedings: Diplomatic Immunity)* [2002] EWHC 1751 (Fam), [2003] Fam. 16.

<sup>31</sup> 1978 Act s.6. See *Palmer v Ingram* [2009] EWCA Civ 947.

<sup>32</sup> s.7.

<sup>33</sup> s.6(3). See *Re Rafidain Bank* [1992] B.C.L.C. 301.

<sup>34</sup> s.8. See *Maclaine, Watson & Co Ltd v International Tin Council* [1989] Ch. 253, 282–283, affirmed on other grounds, [1990] 2 A.C. 418.

<sup>35</sup> s.11.

<sup>36</sup> s.10. See *Ministry of Trade of the Republic of Iraq v Tsavliris Salvage (International) Ltd* [2008] EWHC 612 (Comm), [2008] 2 Lloyd's Rep. 90.

<sup>37</sup> s.2; see *A Co Ltd v Republic of X* [1990] 2 Lloyd's Rep. 520; *Kuwait Airways Corp v Iraqi Airways Co* [1995] 1 W.L.R. 1147 (for further proceedings, see *Kuwait Airways Corp v Iraqi Airways Co (No.2)* [2001] 1 W.L.R. 429; *Kuwait Airways Corp v Iraqi Airways Co* [2003] EWHC 31 (Comm), [2003] 1 Lloyd's Rep. 448); *Mills v Embassy of the United States of America* Unreported May 9, 2000 CA; *Sabah Shipyard (Pakistan) Ltd v The Islamic Republic of Pakistan* [2002] EWCA Civ 1643, [2003] 2 Lloyd's Rep. 571; *Servaas Inc v Rafidain Bank* [2011] EWCA Civ 1256; *NML Capital Ltd v Argentina* [2011] UKSC 31, [2011] 2 A.C. 495. On submission in arbitration proceedings, see s.9; *Svenska Petroleum Exploration AB v Government of the Republic of Lithuania* [2005] EWHC 9 (Comm), [2005] 1 Lloyd's Rep. 515; *Svenska Petroleum Exploration AB v Government of the Republic of Lithuania (No.2)* [2005] EWHC 2437 (Comm), [2006] 1 Lloyd's Rep. 181; affirmed [2006] EWCA Civ 1529, [2007] Q.B. 886; *Donegal International Ltd v Zambia* [2007]

The 1978 Act also deals with a variety of procedural matters, such as service of process on a foreign state.<sup>38</sup> Power is given to restrict or extend the Act's immunities and privileges by Order in Council in relation to individual foreign states<sup>39</sup>; and provision is also made for the recognition here of foreign judgments involving the United Kingdom as a foreign state.<sup>40</sup> A certificate from the Secretary of State is conclusive evidence on the question as to whether for the purposes of the Act any country is a state, is part of a federal state and as to the person or persons to be regarded as the head or government of a state.<sup>41</sup>

**Acts of sovereign states.** In addition to the law relating to the immunity of foreign states or sovereigns, there are other circumstances in which an English court will decline to entertain proceedings involving sovereign states.<sup>42</sup> Under the "act of state" doctrine, the courts have no jurisdiction to investigate the propriety of an act of the Crown<sup>43</sup> performed in the course of its relations with a foreign state<sup>44</sup> and the concept of "act of state" may extend to cover acts authorised or ratified by the Crown in the exercise of sovereign power.<sup>45</sup> Furthermore, English courts have no jurisdiction, it appears, to investigate the propriety of the acts of a foreign sovereign state recognised by Her Majesty's Government, where the act is performed on the territory of that state.<sup>46</sup> Indeed, there is now established a general principle that "the courts will not adjudicate upon the transactions of foreign sovereign states"—a principle which calls in

EWHC 197 (Comm), [2007] 1 Lloyd's Rep. 397; *Ministry of Trade of the Republic of Iraq v Tsavliris Salvage (International) Ltd* [2008] EWHC 612 (Comm), [2008] 2 Lloyd's Rep. 90.

<sup>38</sup> ss.12–14; see *Alcom Ltd v Republic of Colombia* [1984] A.C. 580; *Westminster City Council v Government of the Islamic Republic of Iran* [1986] 1 W.L.R. 979; *Kuwait Airways Corp v Iraqi Airways Co* [1995] 1 W.L.R. 1147 (for further proceedings, see *Kuwait Airways Corp v Iraqi Airways Co (No.2)* [2001] 1 W.L.R. 429; *Kuwait Airways Corp v Iraqi Airways Co* [2003] EWHC 31 (Comm), [2003] 1 Lloyd's Rep. 448); *Crescent Oil and Shipping Services Ltd v Importing UEE* [1997] 3 All E.R. 428; *ABCI v De Banque Franco Tunisienne* [2003] EWCA Civ 205; [2003] 2 Lloyd's Rep. 146; *Wilhelm Finance Inc v Ente Administrador del Astillero Rio Santiago* [2009] EWHC 1074 (Comm), [2009] 1 C.L.C. 867; *NML Capital Ltd v Argentina* [2011] UKSC 31, [2011] 2 A.C. 495; *Mashat v Kaguta* [2011] EWHC 3111 (QB). And see *Soleh Boneh International Ltd v Government of the Republic of Uganda* [1993] 2 Lloyd's Rep. 208, 213; *Norsk Hydro ASA v State Property Fund of Ukraine* [2002] EWHC 2120 (Comm).

<sup>39</sup> s.15.

<sup>40</sup> ss.18–19.

<sup>41</sup> s.21(a). On the importance of the certificate, see *R. (on the application of Alamiyeseigha) v Crown Prosecution Service* [2005] EWHC 2704 (Admin); *R. (on the application of HRH Sultan of Pahang) v Secretary of State for the Home Department* [2011] EWCA Civ 616; *Khurts Bai v The Investigating Judge of the German Federal Court* [2011] EWHC 2029 (Admin); *British Arab Commercial Bank Plc v National Transitional Council of the State of Libya* [2011] EWHC 2274 (Comm); *Democratic Republic of the Congo v FG Hemisphere Associates LLC* [2011] HKFCA 747 (Hong Kong Court of Final Appeal).

<sup>42</sup> See *Dicey, Morris and Collins on the Conflict of Laws*, 14th edn (2006), paras 5-041–5-050.

<sup>43</sup> The position of the Crown generally is discussed in Ch.10.

<sup>44</sup> e.g. *Secretary of State in Council of India v Kamachee Boye Sahaba* (1859) 13 Moo. P.C. 22, 75; *Salaman v Secretary of State of India* [1906] 1 K.B. 613.

<sup>45</sup> e.g. *Buron v Denman* (1848) 2 Exch. 167; *Nissan v Att-Gen* [1970] A.C. 179.

<sup>46</sup> *Duke of Brunswick v King of Hanover* (1844) 6 Beav. 1, 57–58; (1848) 2 H.L.C. 1, 21–22; 26–27; *Carr v Francis Times* [1902] A.C. 179–180; *Johnstone v Pedlar* [1921] 2 A.C. 262, 291; *Empresa Exportadora de Azucar v Industria Azucarera Nacional SA* [1983] 2 Lloyd's Rep. 171; 194.



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## 1. THE NATURE OF DAMAGES FOR BREACH OF CONTRACT

### (a) General

**26-001 Introduction.** Subject to a number of controls,<sup>1</sup> the parties to a contract may themselves specify in their contract the remedy available to the innocent party following the other's breach. In the absence of any such "tailor-made" clause on the remedy, the law on damages fills the gap with "default" provisions on the assessment of money compensation which apply to all types of contract.<sup>2</sup> In *Att-Gen v Blake*,<sup>3</sup> the traditional view was that damages for a breach of contract committed by the defendant are a compensation to the claimant for the damage, loss or injury he has suffered through<sup>4</sup> that breach,<sup>5</sup> and this remains the normal rule.<sup>6</sup> The claimant is, as far as money can do it and subject to the limitations referred to in the next paragraph, to be placed in the same position as if the contract had been performed.<sup>7</sup> This implies a "net loss" approach in which the

<sup>1</sup> e.g. the law on penalties below, paras 26-171 et seq.; and statutory controls such as the Unfair Contract Terms Act 1977 (above paras 14-059 et seq.), the Unfair Terms in Consumer Contracts Regulations 1999 (above, Ch.15) and the Consumer Credit Act 1974 (as amended by the Consumer Credit Act 2006) (below, Vol.II, paras 38-002 et seq.).

<sup>2</sup> Harris, Campbell and Halson, *Remedies in Contract and Tort*, 2nd edn (2002), pp.88-94.

<sup>3</sup> [2001] 1 A.C. 268 (see below, paras 26-045-26-056).

<sup>4</sup> For the necessary causal link between the breach and the loss, see below, para.26-057.

<sup>5</sup> *Robinson v Harman* (1848) 1 Ex. 850, 855; *Lock v Furze* (1866) L.R. 1 C.P. 441, 450-451, 453; *Livingstone v Rawyards Coal Co* (1880) 5 App. Cas. 25, 39; *Wertheim v Chicoutimi Pulp Co* [1911] A.C. 301, 307; *British Westinghouse Electric Co Ltd v Underground Electric Rys* [1912] A.C. 673, 689; *Watts & Co Ltd v Mitsui & Co Ltd* [1917] A.C. 227, 241; *Banco de Portugal v Waterlow & Sons Ltd* [1932] A.C. 452, 474; *Monarch S.S. Co Ltd v Karlshamns Oljefabriker (A/B)* [1949] A.C. 196, 220-221; *C. Czarnikow Ltd v Koufos* [1969] 1 A.C. 350, 414; *Johnson v Agnew* [1980] A.C. 367, 400.

<sup>6</sup> For exceptions see below, paras 26-042-26-056.

<sup>7</sup> For a recent use of this principle, see *Golden Strait Corp v Nippon Yusen Kubishika Kaisha* [2007] UKHL 12, [2007] 2 A.C. 353 at [9], [29], and [57] (see below, para.26-073).

gains made by the claimant as the result of the breach (e.g. savings made because he is relieved from performing his side of a contract which has been terminated for breach; savings in taxation; benefits obtained from partial performance; or the salvage value of something left in his hands) must be set off against his losses arising from the breach (after he has taken reasonable steps to minimise those losses).<sup>8</sup> In assessing damages for breach of contract, the court can take account of only the defendant's<sup>9</sup> strict, legal obligations; it cannot take account of "the expectations, however reasonable, of one contractor that the other will do something that he has assumed no legal obligation to do".<sup>10</sup> Thus, if the contract-breaker had a choice of alternative methods of performance, damages will be assessed on the basis of his minimum legal obligation, viz on the alternative which would have been least onerous, or most beneficial to him.<sup>11</sup> If the claimant cannot establish an actual loss, he is entitled only to nominal damages.<sup>12</sup> Even where the claimant can prove his loss, damages are hardly ever a full recompense, since "it must be remembered that the rules as to damages can in the nature of things only be approximately just".<sup>13</sup>

**General limitations on recovery.** The law on damages places various conditions and restrictions on the principle that the claimant is generally entitled to recover all he has lost as a result of the breach. Traditionally the principal general limitations on recovery have been (1) the "mitigation" rule, that a claimant cannot recover for losses which he could have avoided by taking reasonable steps<sup>14</sup>; and (2) the "remoteness" rule, that the claimant will recover for losses only if they arose "in the usual course of things" or were losses that were contemplated by the parties at the time the contract was made.<sup>15</sup> Following the recent decision of the House of Lords in *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)*<sup>16</sup> it now seems that there is a third limitation of general application: (3) a claimant will not recover even losses that were not unlikely to occur in the usual course of things if the defendant could not reasonably be regarded as assuming responsibility for losses of the particular

<sup>8</sup> The language of "balancing" or "setting off" gains and losses is used by the House of Lords in the *British Westinghouse* case [1912] A.C. 673, 691, and in *Westwood v Secretary of State for Employment* [1985] A.C. 20, 44.

<sup>9</sup> It will on occasion take into account losses incurred by the claimant even though he was not legally obliged to incur them, e.g. payments made voluntarily to a third person injured as the result of the defendant's breach of contract. See below, para.26-032.

<sup>10</sup> *Lavarack v Woods of Colchester Ltd* [1967] 1 Q.B. 278, 294 (distinguished in a case of "unfair dismissal": *York Trailer Ltd v Sparkes* [1973] IRC 518; cf. *Janciuk v Winerte Ltd* [1998] I.R.L.R. 63, and in *Horkulak v Cantor Fitzgerald International* [2004] EWCA Civ 1287, [2005] I.C.R. 402, which involved a discretionary bonus clause).

<sup>11</sup> See below, para.26-074.

<sup>12</sup> See below, para.26-009.

<sup>13</sup> *Rodocanachi v Milburn* (1886) 18 QBD 67, 78. See further below, para.26-015. But see Street at Ch.5, and cf. the use of actuarial calculations approved by the House of Lords in *Wells v Wells* [1999] 1 A.C. 345.

<sup>14</sup> See below, paras 26-077 et seq.

<sup>15</sup> See below, paras 26-101 et seq.

<sup>16</sup> [2008] UKHL 48, [2009] 1 A.C. 61.



kind suffered.<sup>17</sup> Whether this is an aspect of the remoteness rule or is a separate limitation is not wholly clear but the two topics are considered together.<sup>18</sup>

**26-003 Particular restrictions.**<sup>19</sup> There are also a few restrictions on recovery of particular kinds of loss. Two of these have now been removed. The rule in *Bain v Fothergill*,<sup>20</sup> which limited the liability of the vendor of land who was unable to complete the contract because of a defect in his title, was abolished by the Law of Property (Miscellaneous Provisions) Act 1989.<sup>21</sup> The rule that if a breach consists in the late payment of money, interest is not recoverable unless the contract expressly or impliedly provides for it, nor damages for loss of interest,<sup>22</sup> has recently been reviewed in the House of Lords: damages for loss of interest should be recoverable whenever the loss has been pleaded or proved.<sup>23</sup> However, a number of other restrictions remain. First, recovery of damages for distress, disappointment or loss of amenity caused by a breach of contract still seems to be limited to cases in which the object of the contract was to prevent distress or to provide enjoyment or the promised amenity.<sup>24</sup> Secondly, a valuer who negligently over-values a property is (in the absence of fraud) liable only for the difference between the over-valuation and what would have been the proper valuation at the time of the loan; he is not liable for further loss called by the property falling in value even if the borrower for whom the valuation was prepared would not have accepted it as security at all had he been given a correct valuation.<sup>25</sup> (It is possible that both the second and third restrictions are examples of the defendant not being liable for a loss for which it was unreasonable to think he was assuming responsibility.<sup>26</sup>) And thirdly, a party who in an action against the defendant has incurred legal costs for which it has not been awarded costs when those could have been awarded may not be able to recover them.<sup>27</sup>

**26-004 Contract excluding or varying right to damages.** At common law, the right of a contracting party to claim damages for a breach of the contract may be excluded or limited by the express terms of the contract, provided that the language employed to do so is plain.<sup>28</sup> But the Unfair Contract Terms Act 1977 and the Unfair Terms in Consumer Contracts Regulations 1999 impose some statutory restrictions on attempts to exclude or limit liability for breach of contract.<sup>29</sup> The parties may also agree that a particular sum shall be payable in the event of breach,<sup>30</sup> or agree on other forms of contractual provision designed to

<sup>17</sup> See below, para.26-123.

<sup>18</sup> See below, paras 26-123—26-131.

<sup>19</sup> See section 8 of this Chapter, beginning at para.26-136.

<sup>20</sup> (1874) L.R. 7 H.L. 158.

<sup>21</sup> s.3. See below, para.26-158.

<sup>22</sup> See below, paras 26-214 et seq.

<sup>23</sup> *Sempra Metals Ltd v Inland Revenue Commissioners* [2007] UKHL 34, [2008] 1 A.C. 561; below, para.26-217.

<sup>24</sup> See below, paras 26-137—26-142.

<sup>25</sup> See below, para.26-161.

<sup>26</sup> See below, paras 26-123—26-131.

<sup>27</sup> See below, para.26-143.

<sup>28</sup> On such exclusion or exemption clauses, see above, Ch.14.

<sup>29</sup> See above, paras 14-059 et seq., 15-004 et seq.

<sup>30</sup> See paras 26-171 et seq.

operate in the event of a breach.<sup>31</sup> The courts will enforce these subject to the law as to penalties<sup>32</sup> and to the general principles of the law of contract, such as illegality.<sup>33</sup>

**Damages in lieu of specific performance or injunction.** The court is empowered by what is still often referred to as Lord Cairns' Act<sup>34</sup> to award damages in addition to, or in substitution for an order for specific performance or an injunction: the assessment of damages under this power is examined in the next chapter.<sup>35</sup> There was at one time some support for the view that damages under Lord Cairns' Act might be assessed differently to damages at common law; they might be assessed at a different date<sup>36</sup> and the damages might include a share of the profit the defendant had made by breaking the contract.<sup>37</sup> However, in *Johnson v Agnew*<sup>38</sup> the House of Lords said that there should be no difference in the assessment of damages under the Act and damages at common law. It is now clear that on occasion damages at common law may include a share of the profit made by the defendant.<sup>39</sup>

**Concurrent liability.** If the claimant is able to sue in tort (i.e. there is concurrent liability,<sup>40</sup> which has been considerably widened by *Henderson v Merrett*<sup>41</sup>) he will be able to take advantage of the more favourable rules on damages in tort, e.g. on remoteness of damage.<sup>42</sup> But concurrent liability in tort must benefit the defendant, e.g. in regard to contributory negligence.<sup>43</sup>

#### (b) Liquidated and Unliquidated Damages

**Liquidated and unliquidated damages.** The term liquidated damages is applied where the damages have been agreed and fixed by the parties in a way which complies with the criteria developed by the courts for their validity,<sup>44</sup> or fixed by statute as in the case of damages against parties to a dishonoured bill of exchange.<sup>45</sup> Unliquidated damages is the term applied where the damages are at large and are to be assessed by the court; the rules as to remoteness of damage<sup>46</sup> are the main criteria for such damages. Often the parties to a contract fix a sum as liquidated damages in the event of one specific breach, and leave the claimant to sue for unliquidated damages in the ordinary way if other types of breach

<sup>31</sup> For illustrations, see below, paras 26-189 and 26-191.

<sup>32</sup> See below, paras 26-171 et seq.

<sup>33</sup> See Ch.16.

<sup>34</sup> Chancery Amendment Act 1858 s.2; see now Senior Courts Act 1981 s.50.

<sup>35</sup> Below, paras 27-078 et seq.

<sup>36</sup> See *Wroth v Tyler* [1974] Ch 30; see below, para.27-080.

<sup>37</sup> See *Wrotham Park Estate Co v Parkside Homes* [1974] 1 W.L.R. 798; discussed below, paras 26-048—26-053.

<sup>38</sup> [1980] A.C. 367, 400.

<sup>39</sup> See below, paras 26-045 et seq.

<sup>40</sup> See above, paras 1-146 et seq.

<sup>41</sup> [1995] 2 A.C. 145.

<sup>42</sup> Below, paras 26-104 et seq.

<sup>43</sup> Below, para.26-075.

<sup>44</sup> The rules on "penalty clauses": see below, paras 26-171 et seq.

<sup>45</sup> Bills of Exchange Act 1882 s.57 (see Vol.II, para.34-117); *Re Rickett* [1949] 1 All E.R. 737.

<sup>46</sup> Below, paras 26-104 et seq.



occur.<sup>47</sup> Again, where there is provision for liquidated damages the claimant may, in appropriate cases, nevertheless elect to ask instead for an injunction to restrain a breach.<sup>48</sup>

(c) *Claims for an Agreed Sum*

26-008

**Distinction between claims for payment of an agreed sum and claims for damages.** There is an important distinction between a claim for payment of a debt and a claim for damages for breach of contract. A debt is a definite sum of money fixed by the agreement of the parties as payable by one party in return for the performance of a specified obligation by the other party or upon the occurrence of some specified event or condition<sup>49</sup>; damages may be claimed from a party who has broken his contractual obligation in some way other than failure to pay such a debt. (It is also possible that, in addition to a claim for a debt, there may be a claim for damages in respect of consequential loss caused by the failure to pay such a debt at the due date.<sup>50</sup>) The relevance of this distinction is that rules on damages do not apply to a claim for a debt, e.g. the claimant who claims payment of a debt need not prove anything more than his performance<sup>51</sup> or the occurrence of the event or condition<sup>52</sup> on which the sum becomes payable; there is no need for him to prove any actual loss suffered by him<sup>53</sup> as a result<sup>54</sup> of the defendant's failure to pay; the whole concept of the remoteness of damage<sup>55</sup> is therefore irrelevant; the law on penalties does not apply to the agreed sum<sup>56</sup>; the claimant's duty to mitigate his loss does not generally apply<sup>57</sup>; and the claimant will usually be able to seek summary judgment.<sup>58</sup> The distinction may also be

<sup>47</sup> e.g. *Aktieselskabet Reidar v Arcos Ltd* [1927] 1 K.B. 352. See below, para.26-171.

<sup>48</sup> But the claimant cannot have both an injunction and liquidated damages in respect of a single breach: *Saintier v Ferguson* (1849) 1 Mac. & G. 286; *Carnes v Nesbitt* (1862) 7 H. & N. 778; *General Accident Insurance Co v Noel* [1902] 1 K.B. 377. cf. the position if there are different breaches: *Imperial Tobacco Co v Parslay* [1936] 2 All E.R. 515; *Elsley v J. G. Collins Insurance Agencies Ltd* (1978) 83 D.L.R. (3d) 1 Sup.Ct. of Canada (injunction granted to restrain future breaches of employee's covenant not to compete, together with damages in respect of past breaches). See also *Upton v Henderson* (1912) 28 T.L.R. 398. The fact that the agreement provides for liquidated damages to be payable for some breaches does not mean that damages are an adequate remedy for every breach: *Araci v Fallon* [2011] EWCA Civ 668 at [52].

<sup>49</sup> e.g. *Alder v Moore* [1961] 2 Q.B. 57 (below, para.26-192); *Hyundai Heavy Industries Co Ltd v Papadopoulos* [1980] 1 W.L.R. 1129 HL (guarantee; see Vol.II, Ch.44); *Damon Compania Naviera SA v Hapag-Lloyd International SA* [1985] 1 W.L.R. 435, 449 (suing in debt to recover an unpaid deposit); *Jervis v Harris* [1996] Ch. 195. See below, para.26-182; Vol.II, Ch.41 (contracts of insurance).

<sup>50</sup> See below, para.26-168. Interest may also be payable on a debt; below, paras 26-214 et seq.

<sup>51</sup> On the question when an action lies for the price under a contract for the sale of goods, see Vol.II, paras 43-395 et seq.

<sup>52</sup> See fn.49, above.

<sup>53</sup> cf. para.26-015.

<sup>54</sup> On causation, see below, paras 26-057 et seq.

<sup>55</sup> See below, paras 26-104 et seq.

<sup>56</sup> See below, para.26-171.

<sup>57</sup> *White and Carter (Councils) Ltd v McGregor* [1962] A.C. 413; but note the qualification that if the price is not yet payable because claimant has not yet performed, and he has no legitimate interest in performing, he may not be able earn the price by doing so: see below, paras 26-090 and 26-102.

<sup>58</sup> CPR Pt 24. A debt can be factored, viz sold to a financial institution.

relevant where a contract provides for payment to be made by instalments; thus, under a hire-purchase agreement, a claim for arrears of instalments already due is a claim in debt quite distinct from a claim for damages for breach of the contract as a whole.<sup>59</sup> Under a contract for payment by instalments, no claim in respect of instalments due in the future may be brought as a claim for a debt,<sup>60</sup> but if the party due to pay the instalments has committed a breach of his obligations which entitles the other party to terminate the contract, then, subject to the general rules on damages, an award of damages may be made in respect of the prospective loss of the future instalments, allowance being made for a discount on account of the earlier payment of a lump sum to be received under the judgment instead of the instalments spread over the future period.<sup>61</sup>

(d) *Nominal, General and Special Damages*

**Nominal damages.** Wherever the defendant is liable for a breach of contract, the claimant is in general entitled to nominal damages although no actual damage is proved<sup>62</sup>; the violation of a right at common law will usually entitle the claimant to nominal damages without proof of special damage.<sup>63</sup> Normally, this situation arises when the defendant's breach of contract has in fact caused no loss to the claimant, but it may also arise when the claimant, although he has suffered loss, fails to prove any loss flowing from the breach of contract,<sup>64</sup> or fails to prove the actual amount of his loss.<sup>65</sup> A regular use of nominal damages, however, is to establish the infringement of the claimant's legal right, and sometimes the award of nominal damages is "a mere peg on which to hang costs".<sup>66</sup>

<sup>59</sup> *Overstone Ltd v Shipway* [1962] 1 W.L.R. 117, 123, 129. (See Vol.II, para.38-342; cf. Vol.II, paras 38-203-38-206, 38-369.)

<sup>60</sup> Unless the contract provides for payment to be accelerated in the circumstances which have occurred: see below, para.26-187.

<sup>61</sup> *Interoffice Telephones Ltd v Robert Freeman Co Ltd* [1958] 1 Q.B. 190; *Robophone Facilities Ltd v Blank* [1966] 1 W.L.R. 1428; *Lombard North Central Plc v Butterworth* [1987] Q.B. 527; *Stoczna Gdanska SA v Latvian Shipping Co* [1998] 1 All E.R. 883 HL. On the question of the discount, see also *Overstone Ltd v Shipway* [1962] 1 W.L.R. 117 (approved by HL in *Christopher Moran Holdings Ltd v Bairstow* [2000] 2 A.C. 172, 180, 184, 188) and below, para.26-205, between fnn.1040 and 1041. On damages for prospective loss in general, see below, paras 26-011-26-013.

<sup>62</sup> *Marzetti v Williams* (1830) 1 B. & Ad. 415; *The Mediana* [1900] A.C. 113, 116; *Surrey CC v Bredero Homes Ltd* [1993] 1 W.L.R. 1361.

<sup>63</sup> *Ashby v White* (1704) 2 Ld. Raym. 938; *Constantine v Imperial Hotels Ltd* [1944] K.B. 693. On nominal damages when a bank wrongly dishonours a customer's cheque, see Vol.II, para.34-320.

<sup>64</sup> *Columbus & Co Ltd v Clowes* [1903] 1 K.B. 244; *Weld-Blundell v Stephens* [1920] A.C. 956; *Taylor & Sons Ltd v Bank of Athens* (1922) 91 L.J.K.B. 776; *James v Hutton and J. Cook & Sons Ltd* [1950] 1 K.B. 9; *Sykes v Midland Bank Executor and Trustee Co Ltd* [1971] 1 Q.B. 113. See below, paras 26-057 et seq.

<sup>65</sup> *Erie County Natural Gas and Fuel Co Ltd v Carroll* [1911] A.C. 105; cf. *Government of Ceylon v Chandris* [1965] 3 All E.R. 48; cf. *Tai Hing Cotton Mill Ltd v Kamsing Knitting Factory* [1979] A.C. 91, 106 (see above, para.26-015, text at fn.85); cf. also *Dean v Ainley* [1987] 1 W.L.R. 1729.

<sup>66</sup> *Beaumont v Greathead* (1846) 2 C.B. 494, 499. But costs are in the discretion of the court, and sometimes a claimant who recovers nominal damages will not receive costs: *Anglo-Cyprian Trade Agencies Ltd v Paphos Wine Industries Ltd* [1951] 1 All E.R. 873, 874.



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## I. THE NATURE OF CONSTRUCTION CONTRACTS

### (a) Definitions

**37-001 Construction.** The term "construction" comprehends any form of building or assembling, but is usually confined to the creation of, or the carrying out of work to or in connection with, immovable property. Construction embraces the carrying out of both building and engineering works. The same principles, with some adaptation, apply to construction in relation to other property such as ships, aircraft, plant and machinery, as well as computer hardware and software.

**37-002 Construction contract.** English law, with some exception, contains no rules or principles which would regulate the performance of construction work, and hence construction contracts subject to English or other similar legal systems generally employ relatively elaborate forms of contract setting out the rights and duties of the parties, which have been said to resemble a "legislative code".<sup>1</sup> The term "Construction Contract" includes both "Building Contract" and "Engineering Contract", which will have particular characteristics depending upon the technical subject matter of the contract under consideration. Building usually indicates a structure intended for occupation whereas engineering will embrace any form of construction, which need not be static. The former tends to employ the JCT<sup>3</sup> Standard Form of Building Contract and the latter the ICC<sup>4</sup> form in the case of civil engineering works or other specialist forms. The JCT and ICC forms are referred to in this chapter to illustrate the many legal points which can arise

<sup>1</sup> This covers all common law jurisdictions including the United States; and even where Code law exists defining rights and duties in relation to construction activities, there is an increasing tendency to use standard forms similar to the English models.

<sup>2</sup> *Amalgamated Building Contractors v Waltham Holy Cross UDC* [1952] 2 All E.R. 452, per Lord Denning at 453.

<sup>3</sup> Joint Contracts Tribunal.

<sup>4</sup> Until 2011 this form was sponsored by and bore the name of the Institution of Civil Engineers (ICE). The ICE in 2011 withdrew its sponsorship and the (substantially unamended) form is now issued by its other sponsors, the Civil Engineering Contractors Association (CECA) and the Association of Consulting Engineers (ACE) under the new name of the Infrastructure Conditions of Contract (ICC).

and the way in which the standard forms deal with them. Many construction contracts are now let on individually drafted contract forms, but on analysis their terms will usually be found to be based on one or more of the standard forms dealt with in this chapter.

**Work, materials and design.** Construction contracts involve the provision of work (also referred to as labour and, more recently, services) and materials (including goods, plant or equipment). In addition, construction contracts usually involve an element of "design", a ubiquitous and imprecise term which is often a source of dispute. At its lowest level, design involves the choice of appropriate materials and working methods, where not specified in the contract. At another level, design includes determination of the detailed physical characteristics of the building or works to comply with stated requirements or performance criteria. Such a contract is usually termed "design and build" but there are many intermediate stages. Similarly, "management" is comprehended to some degree in all construction contracts. Where this is the primary contribution of the contractor, who is intended otherwise to sub-let all physical work, the arrangement is usually called a "Management Contract".<sup>5</sup>

**Building contract.** A building contract has been judicially described as:

... an entire contract for the sale of goods and work and labour for a lump sum price payable by instalments as the goods are delivered and the work is done ...<sup>6</sup>

although the payment for work by instalments is not a necessary feature of all construction contracts<sup>7</sup>; and nor are all building contracts for a lump sum. The subject matter of construction contracts will often require complex and specialist provisions and contractual machinery not often found in other commercial contracts, such as provisions in relation to the grant of an extension of time for completion of the contract works. However, consistent with the above definition, the law relating to construction contracts is the application in a particular context of the general principles of the law of contract, and no more.<sup>8</sup>

<sup>5</sup> See below, para. 37-015.

<sup>6</sup> Lord Diplock in *Modern Engineering (Bristol) Ltd v Gilbert-Ash (Northern) Ltd* [1974] A.C. 689, 717B, and at 722G. This is a definition more recently referred to in *Beaufort Developments (NI) Ltd v Gilbert-Ash (NI) Ltd* [1999] 1 A.C. 226, 290.

<sup>7</sup> A construction contract falling within the definition provided by ss.104 and 105 of the Housing Grants, Construction and Regeneration Act 1996 must now contain provision for payment by instalments unless it is specified in the contract that the duration of the work is to be less than 45 days (s.109).

<sup>8</sup> Lord Reid in *Modern Engineering (Bristol) Ltd v Gilbert-Ash (Northern) Ltd* [1974] A.C. 689, 699H: "... When parties enter into a detailed building contract there are, however, no overriding rules or principles covering their contractual relationship beyond those which generally apply to the construction of contracts ...". More recently, Lord Lloyd of Berwick in *Beaufort Developments (NI) Ltd v Gilbert-Ash Ltd* [1999] 1 A.C. 226, 290: "... Standard forms of building contract have often been criticised by the courts for being unnecessarily obscure and verbose. But in fairness one should add that it is sometimes the courts themselves who have added to the difficulty by treating building contracts as if they were subject to special rules of their own ...".



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CONSTRUCTION CONTRACTS

37-004

37-006

**Application of Housing Grants, Construction and Regeneration Act 1996.** Housing Grants, Construction and Regeneration Act 1996 applies whether or not the contract is subject to English law, provided the construction operations are within the jurisdiction.<sup>15</sup> Furthermore, Housing Grants, Construction and Regeneration Act 1996 provides that “where an agreement relates to construction operations and other matters, this part applies to it only so far as relates to construction operations”.<sup>16</sup> The notional division of contracts in relation to payment obligations may be workable but the resolution of disputes by adjudication<sup>17</sup> in relation to part only of a contract, or the operation of a right of

<sup>9</sup> For a table of the dates on which the relevant provisions of the Housing Grants, Construction and Regeneration Act 1996 came into force, see Housing Grants, Construction and Regeneration Act 1996 (Commencement No.3) Order 1997 (SI 1997/2846 (C.108)).

<sup>10</sup> s.104(2)(a).

<sup>11</sup> s.104(2)(b).

<sup>12</sup> The statutory definition has been further considered in *Nottingham Community Housing Association Ltd v Powerminster Ltd* [2000] B.L.R. 309; *Shepherd Construction Ltd v Mcwright Ltd* [2000] B.L.R. 489; and *ABB Zantingh Ltd v Zedal Building Services Ltd* [2001] B.L.R. 66. It is also to be noted that a party can become estopped from contending, at the stage of enforcement of the Adjudicator's Decision, that the Housing Grants, Construction and Regeneration Act 1996 and the Scheme do not apply; see *Maymac Environmental Services Ltd v Faraday Building Services Ltd* (2000) 75 Con. L.R. 101.

<sup>13</sup> See s.105(3).

<sup>14</sup> *Baldwins Industrial Services Plc v Barr Ltd* [2003] B.L.R. 176.

<sup>15</sup> s.104(6), (7).

<sup>16</sup> s.104(5).

<sup>17</sup> s.108 and see below, paras 37-263 et seq.

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suspension<sup>18</sup> in relation to part of the work, may require further consideration.<sup>19</sup>

### (b) Types of Construction Contract—Payment

**Range of subject matter.** From the descriptions of construction contracts above, it follows that there is a very broad range of subject matter which will fall under this heading, ranging from the refurbishment of a domestic dwelling to the construction of a power station or a motorway. In view of this diversity of technical subject matter, and the vastly different requirements and anticipated roles of the parties to the contracts, construction contracts can be usefully considered as falling into one of several broad categories, depending upon how the obligations of the parties are defined and arranged.

**Lump sum contract.** In a lump sum contract, the contractor is required to carry out and complete the entirety of the identified contract works for a fixed sum agreed in advance, or, as is more usual, if there are changes in the scope of the named contract works, for “... such other sum as shall become payable under this contract”.<sup>20</sup> In the case of lump sum contracts, the proposed contract works will be of a known extent (that is, not at the development/design stage) and will be set out in detail in a specification, bill of quantities or in drawings or in a combination of these. Where the specification or bill of quantities forms part of the contract,<sup>21</sup> provided the work is sufficiently described, the contractor will be taken to have included for that work in his fixed price.<sup>22</sup> Where work is not sufficiently described, and its existence is not reasonably to be inferred from the language of the contract,<sup>23</sup> the contractor will be entitled to recover payment in addition to the fixed price.<sup>24</sup> A lump sum contract may include responsibility for design and management.

**Degree of completion required.** An important question in the context of lump sum contracts is the extent to which completion of the entire contract must be achieved before the lump sum price is payable, assuming the absence of any right of the contractor to payment by instalments. The general position is that where, on a true construction, a contract is an entire contract, then the contractor is entitled to recover nothing on the contract before the work is completed.<sup>25</sup> However, this does not mean that the employer will be able to avoid payment of the fixed price by reference to defects or omissions since:

<sup>18</sup> s.112.

<sup>19</sup> The Housing Grants, Construction and Regeneration Act 1996 has been amended by the Local Democracy, Economic Development and Construction Act 2009 but ss.104 and 105 are unchanged.

<sup>20</sup> Art.2 of the Articles of Agreement, JCT Standard Building Contract (2011 edn).

<sup>21</sup> *Paman & Fotheringham v Pilditch* (1904) 2 H.B.C. (4th edn) 368.

<sup>22</sup> *A-Jac Demolition (London) Ltd v Umlin Rent-A-Car Inc* (1990) 74 O.R. 2nd 474 DC.

<sup>23</sup> *Williams v Fitzmaurice* (1858) 3 H. & N. 844.

<sup>24</sup> *C Bryant & Son Ltd v Birmingham Hospital Saturday Fund* [1938] 1 All E.R. 503.

<sup>25</sup> *Hoenig v Isaacs* [1952] 2 All E.R. 176, 178H, per Somervell L.J.; and see *Sumpster v Hedges* [1898] 1 Q.B. 673.

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**37-005** **Recent statutory definition.** The above description of construction contracts now needs to take account of the Housing Grants, Construction and Regeneration Act 1996 which, in ss.104 and 105, provides an extensive, but by no means comprehensive, statutory definition of "construction contract". Thus, by s.104(2) of the Housing Grants, Construction and Regeneration Act 1996, a construction contract will include an agreement to do architectural, design or surveying work,<sup>10</sup> or an agreement to provide advice on building, engineering, interior or exterior decoration or on the laying-out of landscape,<sup>11</sup> in relation to construction operations. However, drilling for oil or gas, tunnelling generally, plant or steel work for nuclear processing, power generation, water or effluent treatment or chemical, oil, gas, steel or food and drink production and the supply (excluding installation) of components, materials, plant and machinery generally are all excluded from the definition and therefore the provisions of the Housing Grants, Construction and Regeneration Act 1996.<sup>12</sup> In addition, by statutory instrument<sup>13</sup> Private Finance Initiative ("PFI") contracts and highway and sewerage works for adoption are excluded from the definition of "construction contract". These exclusions together cover a major portion of what is generally regarded as construction work. Furthermore, the structure of s.105 in terms of "inclusions" and "exclusions" leads to the position that a contract between a contractor and an owner of a crane for the hire of a crane plus a driver was held to be a contract for construction operations which formed an integral part of, or were preparatory to, or were for rendering complete, construction operations within s.105(1)(a).<sup>14</sup>

**37-006** **Application of Housing Grants, Construction and Regeneration Act 1996.** Housing Grants, Construction and Regeneration Act 1996 is to apply whether or not the contract is subject to English law, provided the construction operations are within the jurisdiction.<sup>15</sup> Furthermore, Housing Grants, Construction and Regeneration Act 1996 provides that "where an agreement relates to construction operations and other matters, this part applies to it only so far as relates to construction operations".<sup>16</sup> The notional division of contracts in relation to payment obligations may be workable but the resolution of disputes by adjudication<sup>17</sup> in relation to part only of a contract, or the operation of a right of

<sup>9</sup> For a table of the dates on which the relevant provisions of the Housing Grants, Construction and Regeneration Act 1996 came into force, see Housing Grants, Construction and Regeneration Act 1996 (Commencement No.3) Order 1997 (SI 1997/2846 (C.108)).

<sup>10</sup> s.104(2)(a).

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the parties to a particular contract. In *Viking Grain Storage v TH White Installations*<sup>34</sup> the court considered whether the contractor (White) had assumed a responsibility for the design of a grain drying and storage installation. After considering the evidence in relation to the formation of the contract, the Official Referee said<sup>35</sup>:

"Those documents and the conduct of the parties as borne out by the correspondence before me, from 29 January 1980, point unequivocally, in my view, to the assumption by White of responsibility for all aspects of the project, including its design from start to finish . . . The lump sum price was to include the services which were to be laid on. The specifications and drawings for the civil works were prepared by White; as were those for drainage and other services, for the buildings and for the functional parts of the installation . . ."

Where the contractor takes on design work, and there is reliance on his skill and judgment,<sup>36</sup> then, save where the implication of a term is displaced by the express terms of the contract, there will be an implied term as to the fitness of those works for their intended purpose.<sup>37</sup> This is a valuable implied term to an employer because it will be no defence for the contractor to show that he has taken reasonable skill and care in the preparation of the relevant aspect of design. Most standard forms, however, seek to limit the contractor's responsibility to one of reasonable skill and care. Contractors may engage a professional firm to carry out the design element of a design and build contract as a sub-contractor. In such circumstances the relevant standard of care owed to the contractor will be at least a duty to take reasonable care, although it is possible for a strict obligation (analogous to that ordinarily owed by a contractor to his client in respect of construction issues) to be owed.<sup>38</sup> Similarly, the employer may engage professionals to safeguard his own interests and to inspect the contractor's design and work.

**37-015 Management contracts.** This expression refers to a variety of different types of contract under which the principal role of the contractor is the management of the construction operation as opposed to the physical performance of the work,

<sup>34</sup> (1985) 33 B.L.R. 103.

<sup>35</sup> (1985) 33 B.L.R. 103 at 110-111.

<sup>36</sup> *Young & Marten v McManus Childs* [1969] 1 A.C. 454, 472; *Nortia Wallpapers v John Sisk & Sons* (1976) 14 B.L.R. 53 (a decision of the Irish Supreme Court); *IBA v EMI and BICC* (1980) 14 B.L.R. 1, 44-46; *University of Warwick v Sir Robert McAlpine* (1988) 42 B.L.R. 1 at 10-16 (in which Garland J. considered all of the decisions referred to above).

<sup>37</sup> *Samuels v Davies* [1943] 1 K.B. 526; *Greaves & Co (Contractors) Ltd v Baynham Meikle & Partners* [1975] 1 W.L.R. 1095; *Independent Broadcasting Authority v EMI Electronics Ltd and BICC Construction Ltd* (1980) 14 B.L.R. 1; *Viking Grain Storage Ltd v TH White Installations Ltd* (1985) 33 B.L.R. 103. In *John Lelliott (Contracts) Ltd v Byrne Bros (Formwork) Ltd* (1992) 31 Con. L.R. 89 at 92 His Honour Judge Newey Q.C. said: "I think that the effect of the cases is that when a party to a contract agrees to supply a structure for a particular purpose knowing that his knowledge and skill will be relied upon by the other party the courts will readily imply a term requiring that it will be fit for that purpose, but that express terms of the contract, particular facts or general background may result in this not being so . . ." See also *Rotherham MBC v Frank Haslam Milant* (1996) 78 B.L.R. 1 CA.

<sup>38</sup> See *Greaves and Co Ltd v Baynham Meikle* [1975] 1 W.L.R. 1095 CA; and *George Hawkins v Chrysler UK Ltd* (1986) 38 B.L.R. 36.

which is usually substantially or wholly sub-contracted. Although the physical work is sub-contracted, the management contractor will often undertake primary responsibility for carrying out the work in accordance with the time limits and quality requirements specified in the contract. However, the forms of contract usually limit the liability of the management contractor, often by reference to sums recovered from the sub-contractor who may be in default.<sup>39</sup> Management contracts generally require the whole of the physical work to be sub-let and treated as prime cost, with the main contractor receiving remuneration in the form of a management fee, rather than payment based on value of the work executed. Standard forms of management contract are issued by both the JCT and ICC and these also provide the basis for further *ad hoc* forms devised by parties, often with specific projects in mind.

**Term contracts.** Such arrangements are commonly used for the carrying out of large numbers of small repetitive items such as excavation and backfilling to carry out work to statutory undertakers' equipment in highways (holes in the road). The relevant authority may let a contract to carry out such work as may be instructed within a given period, at rates which are specified or ascertainable. Part of the consideration may be in the form of a periodic "retainer" to cover overheads and there may be provisions covering substantial changes to the anticipated quantity of work. It is a matter of construction in each case, whether the arrangement consists of one continuing contract or a series of contracts created when orders are placed.<sup>40</sup>

**Joint Ventures.** Contracts are frequently undertaken by two or more contractors operating as a "Joint Venture". This has no effect on the position of the employer other than through the advantage of having two or more contractors who are usually required to accept joint and several liability. The structure of the joint venture may take any legal form. If a partnership is used, each partner will undertake direct liability to the employer; or if a company structure is used, the companies forming the joint venture will be required to enter into direct collateral agreements with the employer. As between the joint venturers *inter se* there will be a management structure which will define *inter alia* the sharing of cost and profit, the provision of capital, the management of the project and the settlement of any disputes between the joint venturers. The rights of joint venturers *inter se* will be determined by the general law of partnership or companies. Joint ventures may be formed to bid for a single project or for a number of projects; or for a continuing business. Provision will need to be made for the costs of tendering for unsuccessful projects, particularly where it is intended to form the joint venture only upon the tender being accepted.

**Private Finance Initiative ("PFI").** This represents the most far-reaching change to the UK (and worldwide) construction industry since the early 1990s,

<sup>39</sup> See *Cophorne v Arup Associates* (1997) 85 B.L.R. 22 (a case on the JCT Form of Management Contract, 1987 edn).

<sup>40</sup> See *Brogden v Metropolitan Railway* (1877) 2 App. Cas. 666. For an indication of the way in which the courts approach term (or "maintenance") contracts, see *Bonnells Electrical Contractors v London Underground* (1995) C.I.L.L. 1110.