CONTRACT

Effect of rescission of contract on exception clauses

In *Suisse Atlantique Société D'Armement Maritime S.A.* v. *N. V. Rotterdamsche Kolen Centrale*[1], the respondents agreed to charter a vessel from the appellants for a total of two years' consecutive voyages. Fixed periods of laytime were provided within which the respondents were obliged respectively to load and discharge the vessel on each voyage. In the event of these being exceeded demurrage was payable at the rate of 1,000 dollars a day. Apparently the respondents found it more economical to pay demurrage than freight and adopted the policy of making as few trips as possible during the period of the charter. The appellants contended *inter alia* that these delays amounted to a fundamental breach of the charterparty which prevented the respondents from relying on the demurrage clause and allowed the appellants to sue for damages at large.

The substance of the judgments of the members of the House of Lords is no doubt well known—that there is no doctrine of fundamental breach as a substantive rule of law, and that generally whether an exception clause will relieve a party from the consequences of breach or not depends upon the construction of the contract. It is not proposed in this note to comment on this aspect of the decision. However, in the course of their judgments several of their Lordships made observations concerning the effect of discharge by breach on the operation of exception clauses which are important in their implications and seem to warrant separate examination. It may be mentioned at the outset that these observations were not essential to the decision because, in this case, the appellants had never accepted the respondents' breach but had instead elected to affirm the contract.

Lord Reid stated that where an innocent party has elected to treat the breach as a repudiation, bring the contract to an end and sue for damages, "the whole contract has ceased to exist including the exclusion clause, and I do not see how that clause can then be used to exclude an action for loss which will be suffered by the innocent party after it has ceased to exist, such as loss of the profit which would have accrued if the contract had run its full term"[2].

Lord Upjohn said: " . . . It is common ground that had the owners accepted the assumed repudiation and sailed away, thereby terminating the contract, none of its terms survived, and damages for breach of contract would have been at large, including damages for loss of profitable employment of the ship for the term of the charterparty"[3]. Later in his judgment his Lordship again adverted to this point:

> "If I am right in drawing this conclusion then the necessary result, in my opinion, is that the principle upon which one party to a contract cannot rely on the clauses of exception or limitation of liability inserted for his sole protection, is not because they are regarded as subject to any special rule of law applicable to such clauses as being in general opposed to the policy of the law or for some other reason but, just as in the deviation cases, it is the consequence of the application of

1. [1966] 2 W.L.R. 944, H.L.
2. *Ibid.*, at 958.
3. *Id.*, at 976.

> the ordinary rules applicable to all contracts, that if there is a fundamental breach accepted by the innocent party the contract is at an end; the guilty party cannot rely on any special terms in the contract. If not so accepted the clauses of exception or limitation remain in force like all the other clauses of the contract"[4].
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> Viscount Dilhorne and Lord Hodson also apparently took a similar view[5].

The proposition that an exception clause is necessarily destroyed by rescission for breach was apparently considered by members of the House to be the one exception to the general rule that the effect of such a clause depends upon the construction of the contract. This exception seems to have been thought to derive from the decision of the House of Lords in *Hain Steamship Co. Ltd.* v. *Tate and Lyle Ltd.*[6] which was cited with approval extensively throughout the judgments in the *Suisse Atlantique* case. In *Hain* v. *Tate and Lyle*, the Court was concerned with the effect of a deviation, where accepted as a repudiation, on an exception clause in a charterparty. The Court held that in such a case the wrongdoer is disabled from relying on the exception clause; where on the other hand the contract is affirmed, the exception clause along with the rest of the contract remains effective. Lord Atkin (with whom Lord Thankerton and Lord Macmillan concurred) said that this was the result of "the ordinary law of contract"[7]. Lord Wright on the other hand confined his observations to the particular effect of deviations only.

Coote has shown convincingly that this effect of a deviation on a charterparty has been recognised by courts in a long line of cases dating back to as early as 1830, and appears to have been in its origins a special incident of bailment and peculiar to it[8]. In *Hain* v. *Tate and Lyle*, Lord Atkin by attempting to explain the effect of deviation in terms of "the ordinary law of contract" unfortunately provided a basis for the view subsequently taken by members of the House of Lords in the *Suisse Atlantique* case that in all cases the effect of an exception clause can be got rid of if the innocent party rescinds the contract for breach. The influence which Lord Atkin's view carried is seen perhaps at its clearest in the judgment of Lord Upjohn where, after citing the former's judgment in *Hain* v. *Tate and Lyle*, and after examining certain cases dealing with warehousing contracts and contracts of carriage of goods by land, his Lordship concluded that no special rules apply to any of these classes of case: "[all] are governed by and *only* by the general law relating to contracts"[9].

Coote in a recent article[10] attacks the view of the House of Lords on the effect of rescission for breach on exception clauses on the grounds that a substantial body of authority supports the proposition that rescission for breach terminates a contract not retrospectively to the date of breach but from the moment of rescission only so that until that moment an exception clause will remain effective. He concludes: "For its part, discharge by breach by itself can never be the cause of the non-application of exception clauses otherwise than in respect of loss incurred after termination of the contract"[11].

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4. [1966] 2 W.L.R. 944, at 981.
5. See *id.*, at 956, 968, 971.
6. [1936] 2 All E.R. 597.
7. *Ibid.*, at 601.
8. *Exception Clauses* (1964) 80 *et seq.*
9. [1966] 2 W.L.R. 944, H.L., at 981.
10. "The Rise and Fall of Fundamental Breach", (1967) 40 A.L.J. 336.
11. *Id.*, at 346.

It is proposed in this note to show that the decision of the House of Lords in *Hain* v. *Tate and Lyle* cannot be regarded as expressing any general contractual principle, and that the members of the House in the *Suisse Atlantique* case who would have applied the decision to exception clauses at large were accordingly mistaken. It is also proposed to show however that Coote's view is unsatisfactory and is in any event largely beside the point.

That the effect of deviation on an exception clause in a charterparty is not to be explained on ordinary contractual considerations is made clear by the decision of the House of Lords in *Heyman* v. *Darwins Ltd.*[12] In this case an arbitration clause in a contract between manufacturers and distributors relating to the sale of steel products provided that any dispute arising between the parties in respect of the contract should be referred to arbitration. The appellants claimed that the respondents had repudiated the contract and brought proceedings asking for a declaration to that effect and damages for breach. The respondents applied to have the action stayed in order that it might be dealt with under the arbitration clause.

The House of Lords held that the dispute fell within the terms of the arbitration clause and that the action ought to be stayed. All members of the Court were agreed that even on the basis that the appellants had rescinded the contract for a repudiatory breach by the respondents, the arbitration clause still applied.

In reaching this conclusion, the Court stressed the limited nature of the effect which rescission for breach has upon a contract. Lord Macmillan said:

> "I am accordingly, of opinion that what is commonly called repudiation or total breach of a contract, whether acquiesced in by the other party or not, does not abrogate the contract, though it may relieve the injured party of the duty of further fulfilling the obligation which he has by the contract undertaken to the repudiating party. The contract is not put out of existence, though all further performance of the obligations undertaken by each party in favour of the other may cease. *It survives for the purpose of measuring the claims arising out of the breach*, and the arbitration clause survives for determining the mode of their settlement. The purposes of the contract have failed, but the arbitration clause is not one of the purposes of the contract. . . .
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> It is said to be wrong to allow a party to a contract who has refused to perform his obligations under it at the same time to insist on the observance of a clause of arbitration embodied in the contract. The doctrine of approbate and reprobate is said to forbid this. I appreciate the apparent dilemma, but with the greatest respect I venture to think it is based on a misapprehension. The key is to be found in the distinction which I have endeavoured to draw between the arbitration clause in a contract and the executive obligations undertaken by each party to the other . . . It is not a case of one party refusing to perform the obligations in favour of the other and at the same time insisting that obligations in favour of himself shall continue to be performed. The arbitration clause, as I have said, is not a stipulation in favour of either party"[13].

12. [1942] A.C. 356; cited in argument but not in any of the judgments in the *Suisse Atlantique* case.
13. [1942] A.C. 356, H.L., at 374 (italics added).

Lord Wright expressed a similar view:

> "The commonest application of the word 'repudiation' is to what is often called the anticipatory breach of contract where the party by words or conduct evinces an intention no longer to be bound and the other party accepts the repudiation and rescinds the contract. In such a case, if the 'repudiation' is wrongful and the rescission is rightful, the contract is ended by the rescission but only as far as concerns future performance. *It remains alive for the awarding of damages either for previous breaches or for the breach which constitutes the repudiation*"[14].

Later in his judgment, Lord Wright re-emphasizes that this proposition extends to damages for anticipatory breach where rescission follows[15].

Lord Porter also adopted the same view:

> "What then is the effect of such repudiation if it be accepted? In such a case the injured party may sue on the contract forthwith whether the time for performance is due or not . . . he is still acting under the contract. *He requires to refer to its terms at least to ascertain the damage . . .*
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> To say that the contract is rescinded or has come to an end or has ceased to exist may in individual cases convey the truth with sufficient accuracy, but the fuller expression that the injured party is thereby absolved from future performance of his obligations under the contract is a more exact description of the position. Strictly speaking, to say that on acceptance of the renunciation of a contract, the contract is rescinded is incorrect. In such a case the injured party may accept the renunciation as a breach going to the root of the whole of the consideration. By that acceptance he is discharged from further performance and may bring an action for damages but the contract itself is not rescinded. The injured party may, therefore, rely on the contract and apply to have the action stayed if he desires to do so"[16].

Lord Porter went on to say that equally the wrongdoer has this last right.

The substance of these views can be stated quite shortly. Rescission for breach operates only to discharge obligations for future performance in execution of the contract. It leaves the contract intact in all other respects, and in particular it leaves the contract on foot "for the purpose of measuring the claims arising out of the breach"[17].

The decision in *Heyman* v. *Darwins* has been followed in several subsequent cases relating to arbitration clauses[18] and has never in any way been controverted. Its significance, of course, extends beyond arbitration clauses. In particular in our present context, it seems to follow from this decision that exception clauses are not affected by rescission for breach. If, as is thought to be the case, the only effect of rescission for breach on a contract is to terminate obligations of future performance under the contract, an exception clause not being a term setting out such obligations but instead being

14. [1942] A.C. 356, at 379 (italics added).
15. *Id.*, at 381.
16. *Id.*, at 397, 399 (italics added).
17. See text to n. 13, *supra.*
18. *Kruse* v. *Questier* [1953] 1 Q.B. 669; *Daniels* v. *Carmel* [1953] 2 Q.B. 242; *Government of Gibraltar* v. *Kenny* [1956] 2 Q.B. 410.

concerned only with "measuring the claims arising out of a breach" survives rescission and remains binding on the parties. If this is correct, it follows that Lord Atkin's observation in *Hain* v. *Tate and Lyle* that the effect of deviations, when accepted, on exception clauses is to be explained in terms of the ordinary law of contract cannot stand beside *Heyman* v. *Darwins*. In reviewing the weight to be attached to that observation, it must be borne in mind that *Heyman* v. *Darwins* was decided several years after *Hain* v. *Tate and Lyle* and that furthermore two judges in the case, Lord Macmillan and Lord Wright, were parties to the earlier decision.

Two possible objections to the view propounded above must be considered.

In *Woolf* v. *Collis Removal Service*[19], again concerning the effect of an arbitration clause (this time in a warehousing contract), the Court of Appeal (Cohen and Acquith L.JJ.) stated, in reliance on *Heyman* v. *Darwins Ltd.*, that where there has been rescission for breach there are "radical distinctions" between exception clauses and arbitration clauses[20]. The Court referred to Lord Macmillan's statement in *Heyman* v. *Darwins* that arbitration clauses are not clauses inserted in favour of one party or the other, and stated that he was emphasising "the distinction between exception clauses (stipulations inserted for the protection of or benefit of one party) and arbitration clauses". The Court concluded: "If deviation equals repudiation, then, under the decision in *Heyman* v. *Darwins Ltd.*, which is binding on this court, even if it is accepted, the arbitration clause survives, although exception clauses, if the implied repudiation is accepted, become a dead letter"[21]. Chitty, also referring to *Heyman* v. *Darwins*, distinguishes arbitration clauses and exemption clauses in the same way[22]. It is submitted that this distinction mistakes the point of *Heyman* v. *Darwins* completely. The Court in this case did not decide that an arbitration clause is unaffected by rescission for breach simply because it is not a term in favour only of one party, but because it is not a stipulation requiring performance under the contract: it is not a clause which requires performance by one party in favour of another of an obligation by way of execution of the contract (an "executive obligation" in Lord Macmillan's own terms) and rescission terminates only obligations of future performance but otherwise leaves the contract standing[23]. At least as clearly as an arbitration clause, an exception clause does not embody any executive obligation, for by its very nature it is a term which only becomes relevant on non-performance. There seems no sense at all in a bald distinction between terms in favour of one party and terms in favour of both as regards the effect on them of rescission for breach. The view of *Heyman* v. *Darwins* advanced here explains very adequately without recourse to such a distinction as the foregoing why, for example, it has never been suggested that a liquidated damages clause which is stated to operate upon a specified breach ceases to operate because incidentally the innocent party happens as well to rescind for that breach.

A second possible objection to the conclusion that exception clauses are not affected by rescission for breach might be thought to derive from the

19. [1948] 1 K.B. 11, C.A.

20. *Ibid.*, at 16

21. *Id.*, at 17.

22. *Chitty on Contracts: General Principles* (22nd ed., 1961), 322.

23. A recent case in which a similar distinction is made between these two classes of terms in a contract is *Robophone Facilities Ltd.* v. *Blank* [1966] 3 All E.R. 128, C.A.; note *ibid.*, at 141, *per* Diplock L.J.

view developed by Coote in his work on exception clauses[24]. He suggests that the true function of exception clauses is to help define the nature of the obligations undertaken under a contract. Given this view, it might be argued that an exception clause is thus a stipulation helping to set out executive obligations. Two points might be made by way of meeting this objection. First, despite Coote's view of what should be the true function of exception clauses, it nevertheless remains the case that English law has not traditionally approached such clauses in this way. Generally, as Coote himself concedes, "it seems to have been taken for granted that an exception clause provides merely a shield to a claim for damages and that it does not in itself affect the obligations undertaken by the promisor"[25]. In other words, an exception clause relates only to the enforcement of obligations, not to the obligations themselves. Secondly, even if Coote's view were to be adopted, the proposition advanced above based on *Heyman* v. *Darwins* would not be affected. The only way an exception clause can "define" an obligation is, it would seem, to define it out of existence. Any exception clause which simply imposes a limit on liability for breach of a given obligation is not part of the contract defining the obligations. The obligations are conceded. If, on the other hand, an exception clause provides, for example, that there is *no liability* for breach of a given condition, Coote would presumably argue that no obligation in relation to that condition has been undertaken. But if this is the case there could not be any action in damages for breach to be affected by the exception clause simply because there is no obligation to breach. Thus where following rescission for an established breach an action is brought in damages for *that breach,* it must necessarily be the case that any exception clause relating to that breach is not a clause helping to define the obligation undertaken, that is, it is not part of the contract stipulating the executive obligations and will therefore not be affected by the rescission.

While one can agree with Coote that the cases strongly support the proposition that rescission for breach must be regarded as terminating a contract as from the moment of rescission and not as from the breach, this in the present context is beside the point. Whether or not the rescission relates back to the breach, it simply cannot affect an exception clause. This is not to suggest that situations cannot arise in which this question might become important. For example, where as in *Boston Deep Sea Co.* v. *Ansell*[26] a servant who has committed a sufficiently serious breach of his contract of service to justify dismissal subsequently performs services under the contract before dismissal, the question may arise as to whether he is entitled to payment for those services in terms of the contract. The Court in *Boston Deep Sea Co.* v. *Ansell* in these circumstances held that the servant was so entitled and that the contract was only terminated from the moment of dismissal. *Heyman* v. *Darwins* was not of course concerned with this sort of question at all. However, Lord Macmillan did point out in this case that the doctrine of approbate and reprobate may prevent any party who is refusing to perform the executive obligations he has undertaken to the other party from insisting that obligations of the same nature in favour of himself shall continue to be performed. The operation of this doctrine is in no way dependent on any question of rescission. Even if the doctrine had been argued in *Boston Deep Sea Co.* v. *Ansell,* the decision may well have been the same because although the servant had

24. *Exception Clauses* (1964).

25. *Op. cit.*, 1.

26. (1888) 39 Ch. D. 339; applied in *Healy* v. *S.A. Franchise Rubastic* [1917] 1 K.B. 946.

committeed a material breach justifying rescission of the contract, he was not refusing further performance of his obligations under the contract and in this sense probably had not "reprobated" it.

With regard to Coote's conclusion that "discharge by breach by itself can never be the cause of the non-application of exception clauses *otherwise than in respect of loss incurred after termination of the contract*"[27], this would produce odd results, even on his own premise. Damage flowing from the one breach (committed of course while the contract applies in full to the breach) is governed by the exception clause up until the moment that the breach is accepted but thereafter ceases to be so governed. To say that damages for anticipatory breach, that is, breach of future obligations, are not affected by an exception clause is little better because notwithstanding that the obligations are future the anticipatory breach is committed as soon as the repudiation occurs (again when the contract applies in full to the breach): "anticipatory breach means simply that a party is in breach from the moment that his actual breach becomes inevitable"[28] and an immediate right of action for damages for breach arises[29]. Moreover, Lord Wright in *Heyman* v. *Darwins* expressly stated that damages for anticipatory breach where rescission follows are, like damages for any other breach, governed by the contract[30].

It is accordingly submitted that the view expressed by the House of Lords in the *Suisse Atlantique* case as to the effect of rescission for breach upon an exception clause is mistaken. It is suggested that the effect to be given an exception clause in this circumstance ought to be no different from that given it in any other: *in every case* its operation will depend entirely upon the true construction of the contract.

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REGULATORY OFFENCES

Sheep straying — Interpretation of the Impounding Act 1920-1962, s. 46 (1)

Norcock v. Bowey[1] is a recent decision of the Court of Criminal Appeal of South Australia on the interpretation of a regulatory offence[2]. It is significant for two reasons[3]. First, it indicates that the doctrine of strict liability (to the extent that it exists in Australia[4]) is less draconic in operation than its English

27. (1967) 40 A.L.J. 336, at 346 (italics added). This view finds some support in the passage from the judgment of Lord Reid in the *Suisse Atlantique* case cited at p. 105, *supra*.
28. *Universal Cargo Carriers Corporation* v. *Citati* [1957] 2 Q.B. 401, at 438, *per* Devlin J.
29. *Hochster* v. *De La Tour* (1853) 2 E. & B. 678; *Frost* v. *Knight* (1872) L.R. 7 Ex. 111.
30. Cited at p. 108, *supra*.

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1. [1966] S.A.S.R. 250.
2. The term, "regulatory offence" embraces those classes of summary offences where proof of *mens rea* is usually not required. See Howard: *Strict Responsibility* (1963), 1, n. 3.
3. The second may seem to contradict the first. However, see the discussion of the court's reasoning, *infra*.
4. See generally, Howard, *Strict Responsibility* (1963).