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**A Carrier to Remember:**  
**A Case Comment on *Transfield Shipping Inc. v. Mercator Shipping Inc.***

**by**

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## **Introduction**

*Transfield Shipping Inc. v. Mercator Shipping Inc.*<sup>1</sup> is the latest case in a saga of opinions on damages and remoteness. The case involved a contract for a carrier ship which was breached when the charterers returned the carrier late. This caused the owners of the carrier to miss the deadline for delivery with another charterer, the contract for which was concluded when the market rate for such services was extremely high. By the time the owners renegotiated the contract, the market price had fallen and so they sued Mercator for the difference between the contract price originally negotiated with the new charterers and renegotiated price for the 9 months the contract would have endured. The House of Lords held for the defendants and granted only the difference between market price and charter price for the 9 days the defendants retained the carrier. Though each Lord of Appeal gave different reasons for their decision, the majority chose to move away from the standard rules of remoteness outlined *Hadley v. Baxendale*,<sup>2</sup> *Victoria Laundry Ltd. v. Newmann Industries Ltd.*,<sup>3</sup> and *Koufos v. C. Czanikow Ltd.*<sup>4</sup> In addition to deviating from the standard rules, the decision created severe public policy implications.

## **Facts**

Transfield Shipping owned a carrier which was leased to Mercator Shipping for return May 2, 2004. In April 2004 they arranged to rent the carrier to another company to which they would have to default if the ship was delivered after May 8, 2004. Transfield gave notice to Mercator on April 20<sup>th</sup> to return the carrier between April 30<sup>th</sup> and May 2<sup>nd</sup>. Knowing this, the

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<sup>1</sup> [2008] UKHL 48 [*Transfield Shipping*].

<sup>2</sup> (1854) 9 Exch. 341 [*Hadley*].

<sup>3</sup> [1949] 2 K.B. 528 [*Victoria Laundry*].

<sup>4</sup> [1969] 1 A.C. 350 [*Heron II*].

defendants sublet the carrier to a third party close to the end of their lease. Had they thought that the third party trip would delay the ship past May 2<sup>nd</sup> they could have refused to lease it. The carrier was delayed and was not returned to the plaintiffs until May 11<sup>th</sup>. When Transfield Shipping leased the carrier to the new charterers in April the daily rate was high and the contract they entered into was very profitable; however after this date the daily rate began dropping. Transfield Shipping discovered that the carrier would not be returned to them in enough time to satisfy their contract with the new charterers on May 5<sup>th</sup> by which point the daily rate had dropped considerably. They convinced the new charterer to lease the carrier starting from a later date but had to agree to a lower market price.

Transfield Shipping sued Mercator for the difference between what they would have been paid under the high market price negotiated with the new charterers in April and the charter rate they were forced to agree to due to the missed deadline, which over a period from May to November would have amounted to \$1,364,584.37. The defence argued that the general and well-accepted rule for liability in shipping was that the defendants owed the difference between the current market value of the carrier and the charter rate for the extra days which would have amounted to only \$158,301.17.

At trial, the majority arbitrators found for the owners. They reasoned that though there was a general standard in the industry for breach, the loss of the new profitable contract was a natural consequence of the breach and therefore the owners were entitled to the damages they sought.<sup>5</sup> The dissenting arbitrator did not deny that it was likely that the plaintiffs would re-charter the carrier, but found that “a reasonable man in the position of the charterers would not

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<sup>5</sup>*Transfield Shipping*, *supra* note 1 at 6.

have understood that he was assuming liability for the risk of the type of loss in question.”<sup>6</sup> The Court of Appeal decided with the majority arbitrators.

### Analysis

In the House of Lords, five Lords of Appeal sat on this case and they unanimously allowed the appeal, however each offered their rulings separately.

Lord Hoffman’s incorporated the *Hadley* two-prong test<sup>7</sup> and its interpretation in *Heron II*,<sup>8</sup> but found them lacking and added his own qualification. The *Hadley* test gives the standard for remoteness and dictates that consequences must be either naturally arising from the breach or else reasonably foreseeable due to special circumstances communicated at time of contract or because they arise generally.<sup>9</sup> He clearly pinpointed the owners’ decision to re-charter the ship shortly after it was supposed to be returned was a reasonably foreseeable consequence, not outlined in the contract and therefore falling under the latter half of the second prong of the *Hadley* test.<sup>10</sup> *Hadley* defined ‘reasonably foreseeable’ to mean ‘in the great multitude of cases’<sup>11</sup> however this definition was significantly broadened in *Victoria Laundry* as meaning ‘a serious possibility’, ‘a real danger’ or ‘on the cards’.<sup>12</sup> This interpretation was narrowed again by *Heron II* to mean an outcome which is ‘not unlikely’, a definition not as strict as *Hadley*’s but is certainly farther from the concept of reasonable foreseeability which is used in torts than in *Victoria Laundry*.<sup>13</sup> Lord Hoffman chose to define ‘reasonably foreseeable’ under the *Heron II* standard as meaning ‘not unlikely to result’.<sup>14</sup> However, he added another component to this test,

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<sup>6</sup> *Ibid.* Hoffman L.J.

<sup>7</sup> *Supra* note 2.

<sup>8</sup> *Supra* note 4.

<sup>9</sup> *Supra* note 2.

<sup>10</sup> *Ibid.*, *supra* note 1 at para. 9.

<sup>11</sup> *Hadley*, *ibid.*

<sup>12</sup> *Supra* note 3.

<sup>13</sup> *Heron II*, *supra* note 4.

<sup>14</sup> *Ibid.*, *Transfield Shipping*, *supra* note 1 at para. 9.

which he pulled out of the House of Lords decision on *South Australia Asset Management Corp v. York Montague Ltd.*:<sup>15</sup> in addition to reasonable foreseeability, the commercial context must be taken into account when determining what a reasonable defendant would think was within the scope of his liability.<sup>16</sup> He claimed that despite the foreseeability, the defendants could not have understood that they were assuming liability for this specific outcome due to the general rule of breach for the shipping industry and the lack of communication of special circumstances in the contract and were therefore not responsible for it.<sup>17</sup>

Lord Hope, like Lord Hoffman, considered that foreseeability alone could not create liability and reasoned that the problem lay in whether “the loss was a type of loss for which the party can reasonably be assumed to have assumed responsibility.”<sup>18</sup> However, here Lords Hope and Hoffman parted ways. Lord Hope focused on the fact that the defendants had no control over the actions of the plaintiffs when Transfield leased the carrier to the new charterers. The period for which the carrier was contracted, the daily rate for the ship and when this deal was made were completely unpredictable and therefore unquantifiable for the defendants.<sup>19</sup> He further claimed this left the defendants with insufficient information to determine the extent of their liability and therefore they could not be liable. This focus on quantifiability of damages is noticeably absent in the three reference cases<sup>20</sup> and would add a new and arduous prong to the *Hadley* test. Though he approached it differently, ultimately Lord Hope agreed with Lord Hoffman that the *Hadley* standard<sup>21</sup> was insufficient and a new test for liability would have to be

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<sup>15</sup>[1997] AC 91 in *Transfield Shipping, ibid.* at para. 15.

<sup>16</sup>*Transfield Shipping, ibid.* at para. 17.

<sup>17</sup>*Ibid.* at para. 26.

<sup>18</sup>*Ibid.* at para. 32 Hope L.J.

<sup>19</sup>*Ibid.* at para. 29.

<sup>20</sup>S.M. Waddams, *The Law of Contracts*, 5<sup>th</sup> ed. (Toronto: Canada Law Book, 2005) at para. 733.

<sup>21</sup>*Supra* note 2.

established in which a reasonable person would have contemplated that they were liable for the type of loss that occurred.<sup>22</sup>

Lord Rodger used the *Hadley* test<sup>23</sup> quite extensively in his analysis of *Transfield Shipping*. Instead of trying to adapt the test for liability, he in found that the analysis undertaken by the courts so far did not capture the proper reasonably foreseeable outcome.<sup>24</sup> Lord Rodger, using *Hadley*'s definition of 'reasonably foreseeable' that is, 'in the usual course of things',<sup>25</sup> articulated that there were other factors which the courts overlooked in their analysis. Though he admitted it was reasonably foreseeable that the carrier would have been re-chartered by the owners, it was also reasonably foreseeable that the owners would be able find another charterer quickly due to the excess demand for carriers in the market. In the ordinary course of things there would be no foreseeable loss here.<sup>26</sup> The sudden and drastic shift in market value was unusual in this scenario and would not pass this test.<sup>27</sup> He argued that this more complete analysis was not considered by other judges and was necessary for proper evaluation of this case under the *Hadley* standard.<sup>28</sup>

Lord Walker based his criticism of the majority arbitrators' decision on the facts of *Victoria Laundry*, and more particularly, its ruling on loss of specific contracts. In *Victoria Laundry*, Lord Asquith ruled that defendants were not liable for unusually profitable contracts.<sup>29</sup> Lord Walker saw the rise in market price as leading to an unusually profitable contract analogous to the 'highly lucrative dyeing contracts for the Ministry of Supply' which were deemed not

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<sup>22</sup> *Transfield Shipping*, *supra* note 1 at para. 36.

<sup>23</sup> *Supra* note 2.

<sup>24</sup> *Transfield Shipping*, *supra* note 1 at para. 54, 60.

<sup>25</sup> *Supra* note 2.

<sup>26</sup> *Transfield Shipping*, *supra* note 1 at para. 54-60.

<sup>27</sup> *Ibid.* at para. 53.

<sup>28</sup> *Ibid.* at para. 53-54.

<sup>29</sup> *Supra* note 3.

foreseeable in *Victoria Laundry*.<sup>30</sup> However, he hesitated to rest his full decision on the *Victoria Laundry* standard due to some negative treatment it had received.<sup>31</sup> He therefore argued that even if the majority arbitrators' claim that the result was reasonably foreseeable was adopted, the *Hadley* test of foreseeability could not determine liability on its own.<sup>32</sup> Arriving at the same conclusion as Lords Hoffman and Hope but using reasons outlined in Hope's judgement, Lord Walker surmised that due to the defendants' lack of control or knowledge of the re-chartering of the carrier, it would be unfair to hold them liable since the type of loss could not be reasonably assumed to be in the minds of the defendants at time of contract.<sup>33</sup>

Baroness Hale indicated uncertainty over how to decide the case due to the strength of the arguments on each side.<sup>34</sup> Her decision was more a summary and critique of her colleagues' opinions than an analysis of the case at hand. It is clear that she was wary of Lords Hoffman, Hope and Walker's decisions as they step away from *Hadley* and moved towards a view of liability which she characterized as being akin to that of negligence.<sup>35</sup> Baroness Hale saw this as opposing the spirit of *Heron II* where Lord Reid warned against exploring liability as it existed in torts.<sup>36</sup> The Baroness was more comfortable with the narrower grounds of Lord Rodger's expanded foreseeability argument.<sup>37</sup>

### **Policy and Fairness**

There is a distinction between a case that is decided in the correct legal manner, and a decision which is morally right. The philosophical 'rightness' of a case is largely dependent on two factors, fairness and public policy considerations. This case may have been decided fairly,

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<sup>30</sup> *Ibid.*, *Transfield Shipping*, *supra* note 1 at para. 52-53.

<sup>31</sup> *Transfield Shipping*, *ibid.* at para. 84-86.

<sup>32</sup> *Ibid.* at para. 86; *supra* note 2.

<sup>33</sup> *Transfield Shipping*, *ibid.*

<sup>34</sup> *Ibid.* at para. 93.

<sup>35</sup> *Ibid.*

<sup>36</sup> *Ibid.*; *Heron II*, *supra* note 4.

<sup>37</sup> *Transfield Shipping*, *ibid.*

but it had negative public policy implications. It is the combination of these two aspects which will determine whether or not this case was decided rightly in a moral sense.

Fairness in this case is contextualized by the standard for breach which was already in place in the shipping world. Under this standard late delivery had been always compensated by the payment of current market value which was what the defendants agreed to.<sup>38</sup> Furthermore, as the judges raised, this situation involving fluctuating market prices inducing a loss due to breach in contract must have happened before, but the plaintiffs' claim for damages had never been suggested as a remedy.<sup>39</sup> This does not mean that a new standard cannot be created, but it does contextualize the expectations of the defendants. Knowing this it would not be fair to hold the defendants to a standard they were unaware of. This context also colours the plaintiffs' claim making it seem opportunistic, since they were also aware of this standard. In another question of fairness it does not seem right that the amount of damages going to the plaintiffs should be so drastically altered due to massive market fluctuations that could not be predicted at time of contract.

Both these observations make the House of Lords outcome appear just, however public policy implications must also be analyzed. Legal theorist Richard Epstein remarked “[a]ny effort to constrain misbehavior by the buyer invites misbehavior by the seller.”<sup>40</sup> Balancing these is what we engage in when we attempt to make good public policy choices. I would argue the balance between the plaintiffs' incentive to breach and that of the defendants is not adequately met in this case.

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<sup>38</sup> *Ibid.* at para. 6.

<sup>39</sup> *Ibid.* at para. 10.

<sup>40</sup> Richard A. Epstein, “Beyond Foreseeability: Consequential Damages in the Law Of Contract” in Richard Craswell & Alan Schwartz, eds., *Foundations of Contract Law: Interdisciplinary Readers in Law* (New York and Oxford: Oxford University Press, 1994) 67 at 70.

In *Transfield Shipping* the defendants' incentive to breach is much greater than the plaintiffs'. The defendants have no disincentive to breach because if they keep the carrier past the deadline, they only pay market value for their extra use.<sup>41</sup> This disadvantages plaintiffs who may have other use for this carrier but are only compensated for the loss of its use over this period and not damage to their reputation or the increased transaction costs involved in renegotiating contracts. It is clear that the plaintiffs need further compensation in this case to balance incentives to breach, however we must be wary not to tip the scale too far. A ruling such as that of the Court of Appeal<sup>42</sup> could make charterers wary of entering into contracts, forcing contract prices down for fear that late delivery would result in a large punishment. This would create a disincentive to do business which could be damaging to the shipping market. It would also create a disincentive for the plaintiffs to mitigate damages.

I would argue the court did not strike a good balance between fairness and public policy considerations. Epstein's theory of a fixed tariff (as opposed to expectation damages) would do a much better job at eliminating externalities while maintaining fairness.<sup>43</sup> If breaches were compensated by a fixed amount which was large enough to deter breach on behalf of the charterers but not so large as to overcompensate owners for their losses, it would create a deterrent to breach without unjust enrichment. Rulings would not rest on the external fluctuations in market price and everyone would be aware of the standard and their liability. However, it must also be noted that the adoption of this standard is not probable because of precedent surrounding expectancy damages. Given this, I would then advocate for a decision which fell somewhere between the extremes of what the plaintiffs and the defendants demanded so as to balance

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<sup>41</sup> *Transfield Shipping*, *supra* note 1 at para. 5.

<sup>42</sup> *Ibid* at para. 9.

<sup>43</sup> *Supra* note 40 at 71.

incentives to breach and compensate the plaintiffs for the costs involved in renegotiating their next chartering contract.

### **Conclusion**

*Transfield Shipping* is an extremely important case, illuminating not only the shortcomings of the *Hadley* test<sup>44</sup> but also the inconsistencies in how the courts have viewed it. Just as Waddams predicted, the *Hadley* standard did not last.<sup>45</sup> The majority holding of the House of Lords, based on the reasons of Hoffman, Hope and Walker created a new test for remoteness and damages which accounted for context and dealt more directly with whether parties could have reasonably contemplated the *liability* for the type of loss which occurred at the time of contract, not just whether that type of loss was foreseeable. This ruling will certainly have an impact on how future remoteness cases are decided if it is followed. Though due to the multiplicity of judgements even within this majority stream and the different discussions which flow from them, it is difficult to say which interpretation will be adopted out of this decision.

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<sup>44</sup> *Supra* note 2.

<sup>45</sup> *Supra* note 20 at para. 739.

*Hadley*, tried in 1854 gives the standard rule for judging remoteness. It says liability arises when either damages arise naturally from the breach of contract or when damages can be reasonably supposed to have been in the contemplation of the two parties at the time the contract was made as a probable result of the breach itself. This latter half of the test for liability was further clarified in *Hadley* by the idea of ‘special circumstances’. *Hadley* determined “if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated.” It also stated that if special circumstances were not known then liability was limited to those damages arising generally, that is to say, in the great multitude of cases, from the breach.

*Transfield Shipping* falls within the latter half of the second branch of the *Hadley* test as these sections are defined by Lord Walker in *Jackson v. Royal Bank of Scotland*. In *Jackson*, Lord Walker defines damages arising naturally as those in the ordinary course from what was written into the contract. He defines those arising generally as reasonably foreseeable though not explicit in the contract. This definition is not concrete, nor is it followed precisely by the judges in this case, however it provides a solid outline to categorize and specify the issues at stake here. Clearly, the damages in *Transfield Shipping* did not arise either naturally or due to specific circumstances because it was proven at trial that the rechartering of the carrier was not written in to the contract nor was it explicitly discussed between the two parties at the time of contract (or at any point thereafter for that matter). This helps clarify the problem at stake in this case as being one of the latter half of the second prong: Could the result be considered one which a reasonable person would believe to arise generally? What is meant by generally? And lastly, if it is decided that this outcome would arise generally, does that construe an assumption of liability for this outcome on behalf of the defendants?

The definition of ‘arising generally’ is unclear and constantly debated due to the varying definitions amongst *Hadley*, *Victoria Laundry*, and *The Heron II*. In *Hadley*, Lord Alderson clearly articulates that ‘arising generally’ refers to the great multitude of cases. *Victoria Laundry* outlines it as something which is a ‘serious possibility’, a ‘real danger’, or ‘on the cards’. Though this may seem to be a very broad interpretation of foreseeability and be widely divergent from *Hadley*, it has been interpreted much more narrowly in cases since. *The Heron II* tries to narrow the interpretation of *Victoria Laundry* by saying that Lord Asquith could not have meant to extend liability in contract to the extent that liability exists in tort law. He goes on to say that if this was in fact the intended meaning of *Victoria Laundry* then it was a bad decision and we should move closer to *Hadley*. *Transfield Shipping* seems to affirm this view. However this is not to say that *The Heron II* follows *Hadley* to the letter. Its definition of ‘not unlikely’ is not perfectly analogous to *Hadley* and instead seems to support the view that the degree of probability should be “considerably less than an even chance but nevertheless not very unusual and easily foreseeable.” (pg. 69) The House of Lords in *Transfield Shipping* on the whole seem to state and I would agree that though the circumstance that a carrier would be re-leased by the owner was a likely outcome under all definitions of the word, they raise the issue (Rodger) that the change in market value was unlikely to the extent it would not satisfy the *Heron* standard.

