Damages - Disappointed Expectations - The Test of Reasonableness

Ruxley Electronics and Construction Ltd v Forsyth [1995] 3 All ER 268.

The decision of the Court of Appeal, noted in (1994) #39 Australian Construction Law Newsletter pp58-59 has been reversed by the House of Lords. The House of Lords' decision has most important ramifications for the construction industry. It introduces into construction law a novel category of damages, namely "damages for disappointed expectations".

The term "damages for disappointed expectations" won't be found in any text on construction contract law. It is one coined by the writer to describe this previously unknown category of damages for defective work. Prior to the House of Lords decision, it was generally believed that where a contractor performed defective work, the owner was entitled to either:

(1) the difference in value between the works with the defects and what they would have been worth if they had been constructed strictly in accordance with the contract (diminution in value): or

(2) the cost of work necessary to rectify the defects (cost of rectification).

Counsel for the owner stated the traditional view as follows (at 271):

"In a building contract case there is no admissible head of damages capable of assessment by reference to such concepts as loss of amenity, inconvenience or loss of satisfaction. These are imponderables which the court can only evaluate by plucking figures out of the air. If a possible head of damage of this nature were to be admitted in building contract cases this would introduce chaotic uncertainty into the law and undermine clear and well-settled principles. By these well-settled principles damages in a building contract case can only be assessed by reference to diminution in value or cost of reinstatement. There being no diminution in value, the only available measure of damages to compensate the respondent for his real loss is the cost of reinstatement."

The builder had constructed a swimming pool for the owner. The contract provided for a depth of 7 foot 6 inches at the deep end but the pool when built was only 6 foot deep. The owner sought to recover the cost of rebuilding the pool. However, the trial judge found that the pool was safe, it was no less valuable than it would have been if 7 foot 6 inches deep and that the cost of rebuilding the pool was wholly disproportionate to the disadvantage of having a pool only 6 foot deep. The trial judge awarded the owner £2,500 damages. The Court of Appeal disagreed. That Court decided that the cost of reconstructing the pool, namely £21,560 was the measure of damages. The House of Lords reinstated the trial judge's award of £2,500. Lord Bridge said (at 270):

"The circumstances giving rise to the present appeal exemplify a situation which one might suppose to be of not infrequent occurrence. A landowner contracts for building works to be executed on his land. When the work is complete it serves the practical purpose for which it was required perfectly satisfactorily. But in some minor respect the finished work falls short of the contract specification. The difference in commercial value between the work as built and the work as specified is nil. But the owner can honestly say: 'This work does not please me as well as would that for which I expressly stipulated. It does not satisfy my personal preference. In terms of amenity, convenience or aesthetic atisfaction I have lost something.' Nevertheless the contractual defect could only be remedied by demolishing the work and starting again from scratch. The cost of doing this would be so great in proportion to any benefit it would confer on the owner that no reasonable owner would think of incurring it. What is the measure of the loss which the owner has sustained in these circumstances? If there is no clear English authority which answers this question, I suspect this may be because parties to this kind of dispute normally have the good sense to settle rather than to litigate."

Prior to this case, there was no clear authority, either in England or Australia, on this question. The reason is more likely to do with the prohibitive cost of superior court litigation than to the good sense of owners and builders. The question arises every day in the NSW Building Disputes Tribunal. However the Tribunal does not have the difficulty which courts have. If the Tribunal finds that the builder's work is defective but it would be unreasonable for the owner to demolish the work and start again, section 31 of the *Consumer Claims Tribunals Act* 1987 requires the Tribunal to make "such orders as in its opinion, will be fair and equitable to all the parties to the claim". This is not necessarily the same as common law damages.

The Lords were unanimous in finding that the owner was not entitled to the cost of rebuilding the pool. They reinstated the trial judges award of £2,500 but did not go into the question of just how damages for disappointed expectations should be calculated. Lord Mustill at 277 said:

"In my opinion there would indeed be something

wrong if, on the hypothesis that cost of reinstatement and the depreciation in value were the only available measures of recovery, the rejection of the former necessarily entitled the adoption of the latter: and the court might be driven to opt for the cost or reinstatement, absurd as the consequences might often be, simply to escape from the conclusion that the promisor can please himself whether or not to comply with the wishes of the promisee which, as embodied in the contract, formed part of the consideration for the price. Having taken on the job the contractor is morally as well as legally obliged to give the (owner) what he stipulated to obtain, and this obligation ought not to be devalued. In my opinion, however, the hypothesis is not correct. There are not two alternative measures of damage, at opposite poles, but only one: namely the loss truly suffered by the promisee. In some cases the loss cannot be fairly measured except by reference to the full cost of repairing the deficiency in performance. In others, and in particular those where the contract is designed to fulfil a purely commercial purpose, the loss will very often consist only of the monetary detriment brought about by the breach of contract. But these remedies are not exhaustive, for the law must cater for those occasions where the value of the promise to the promisee exceeds the financial enhancement of his position which full performance will secure. This excess, often referred to in literature as the 'consumer surplus' is usually incapable of precise valuation in terms of money, exactly because it represents a personal, subjective and non-monetary gain. Nevertheless, where it exists the law should recognise it and compensate the promisee if the misperformance takes it away. The lurid bathroom tiles, or the grotesque folly ... may be so discordant with general taste that in purely economic terms the builder may be said to do the (owner) a favour by failing to install them. But this is too narrow and materialistic a view of the transaction. Neither the contractor nor the court has the right to substitute for the (owner's) individual expectation of performance a criterion derived from what ordinary people would regard as sensible. As my Lords have shown, the test of reasonableness plays a central part in determining the basis of recovery, and will indeed be decisive in a case such as the present when the cost of reinstatement would be wholly disproportionate to the non-monetary loss suffered by the employer. But it would be equally unreasonable to deny all recovery for such a loss. The amount may be small, and since it cannot be quantified directly there may be room for difference of opinion about what it should be. But in several fields the judges are well accustomed to putting figures to intangibles, and I see no reason why the imprecision of the existence should be a barrier, if that is what fairness demands."

It is interesting that Lord Mustill adopts a criterion of "fairness". It is significant that the case concerns residential building work, not commercial work. However, when commercial work is involved and:

(a) it would be unreasonable to rectify the defect: and
(b) there is no diminution in value,

xthere seems no reason in logic why, where fairness so demands, damages for disappointed expectations should not be awarded. There is no reason in logic why damages for defective commercial work should be confined to the cost of repairs or diminution in value, as has been the case until now. This is particularly so where the builder has deliberately departed from the specification in order to save money, or time. A decision of the House of Lords is not binding on Australian courts, but this decision is so eminently just that it seems likely that it would be followed by Australian courts.

- **Philip Davenport, Lecturer, School of Building, University of New South Wales.**