CASE NOTE

RUXLEY ELECTRONICS AND CONSTRUCTION LTD V FORSYTH

LADDINGFORD ENCLOSURES LTD V FORSYTH

I. INTRODUCTION

Ruxley Electronics and Construction Ltd v Forsyth[1] ("*Ruxley*") is a recent House of Lords decision which highlights the difficulty in assessing damages for defective performance of a construction contract when:

(i) there is no diminution in the value of the property containing the defects; and

(ii) the cost of reinstatement in order to remedy the defects is disproportionately high when compared to the benefit that the owner of the property will obtain from the reinstatement.

The above factors were evident in *Ruxley*. The House of Lords held that it would be unreasonable to award reinstatement costs and agreed that the trial Judge's decision to award a modest sum of damages to compensate the owner of property for "loss of amenity" was sufficient. In making this decision the House of Lords reversed the majority decision of the Court of Appeal and reinstated the decision of the County Court.

This Note describes the decision and the law prior to the decision, then comments on the new method of calculating damages that the House of Lords adopted. The Note concludes that the introduction into contract law of reasonableness as suggested by *Ruxley* reduces the certainty of contract and moves away from the general rule that damages in contract should put the aggrieved party back in the position he or she would have been in had the contract not been breached.

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

II. The Decision

1. The Facts

In 1987 Mr. Forsyth ("Forsyth") entered into contracts with Ruxley Construction Ltd ("Ruxley") and Laddingford Enclosures Ltd ("Laddingford") for the construction of a swimming pool and a building to house it on his property in Kent. Ruxley was to construct the swimming pool and Laddingford the building.

It was an express term of the contract with Ruxley that the maximum depth of the pool would be 7 ft 6 in. Some time after the pool was completed Forsyth discovered that the maximum depth of the pool was only 6 ft 9 in, and only 6 ft where diving was most likely to occur.

During negotiation of the contract Forsyth had specifically requested that the contract be amended to increase the maximum depth to 7 ft 6 in because he was a big man and would feel safer diving into a pool with a greater depth. In agreeing to this request Ruxley did not increase the contract price.

The total cost of the pool and the building was 70,178.74 pounds. Forsyth paid sums on account and Ruxley and Laddington sued for the balance of 39,072.85 pounds. Forsyth counterclaimed for breach of contract.

There was no decrease in the value of the pool as constructed compared with a pool with a maximum depth of 7 ft 6 in. Forsyth claimed the cost of rectification of the pool to satisfy the term of the contract. The evidence at trial established that the only way to do this was to demolish the existing pool, excavate further and rebuild the pool at a cost of 21,569 pounds.

2. Approaches of the Courts

The County Court

The trial judge awarded Forsyth general damages of 2,500 pounds for loss of amenity.[2] He held that:

(i) there was no diminution in the value of the pool due to the breach of contract;

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2 13 July 1993, Judge Diamond QC, Cenral London County Court.

(ii) it would be unreasonable for Forsyth to carry out the rectification work because the cost of the work was disproportionate to the benefit Forsyth would obtain; and

(iii) he was not satisfied that Forsyth would actually carry out the work.

The Court of Appeal

A majority decision of the Court of Appeal reversed the decision of the trial judge and awarded Forsyth 21,560 pounds in place of the general damages.[3] The Court held that Forsyth had suffered a real loss which could be measured by the cost of rebuilding to meet the terms of the contract, there being no other available measure. The Court confined itself to a choice between two methods of measuring the loss, the difference in value or the cost of reinstatement. Earlier cases had looked at the question of whether or not it was reasonable to award damages for reinstatement. Staughton LJ held that the question of the reasonableness of the remedy sought is a matter of mitigation. He said:

> Is it unreasonable of a plaintiff to claim an expensive remedy if there is some cheaper alternative which would make good his loss. Thus he cannot claim the cost of reinstatement if the difference in value would make good his loss by enabling him to purchase the building or chattel that he requires elsewhere. But if there is no alternative course which will provide what he requires, or none which will cost less, he is entitled to the cost of repair or reinstatement even if that is very expensive.[4]

Mann LJ held that it was not unreasonable to construct a new pool because this was a contract for a personal preference rather than for a financial gain. Forsyth contracted for a personal preference i.e. a pool with a maximum depth of 7ft 6 in which he would feel safe diving in and that is what he should be entitled to.

The entire Court agreed that the owner's intended use of any damages award was irrelevant. (At this stage Forsyth had provided the Court with an undertaking that he would use any damages for reinstatement to rebuild the pool).

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3 [1994] 3 All ER 801, [1994] 1 WLR 650 (Staughton LJ and Mann LJ, with Dillon LJ dissenting).

4 Ibid, 810.

The House of Lords

The House of Lords reinstated the decision of the trial judge. The Lords focused on the question of reasonableness and held that it was unreasonable to insist on reinstatement of the pool because the cost of rebuilding the pool was wholly disproportionate to any prospective benefit to Forsyth. Lord Lloyd said:

> If reinstatement is not the reasonable way of dealing with the situation, then diminution in value, if any, is the true measure of the plaintiff's loss. If there is no diminution in value, the plaintiff has suffered no loss. His damages will be nominal.[5]

Lord Jauncey considered that it is unreasonable to request reinstatement costs where the objective of the contract has been achieved to substantial extent.

The House of Lords held that intention to carry out the work is not a requirement to establishing a claim for compensation but it is a factor to be considered when deciding whether it is reasonable to receive reinstatement costs.

In reinstating the trial judge's award of damages for "loss of amenity" Lord Lloyd saw such an award as falling within, or involving an acceptable extension to the "holiday cases". These cases establish the exception to the general rule that in contract damages for emotional distress are not available. (This general rule has been eroded significantly in New Zealand, see for example *Rowlands v Collow.*[6])

Lord Mustill on the other hand saw the award as compensation for loss of "consumer surplus" which can be described as the owner's "personal subjective non-monetary gain." This is discussed in more detail below. Unfortunately the Lords were not required to reconsider the award of 2,500 pounds general damages for loss of amenity and no significant conclusions were reached on how this assessment should be calculated.

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5 Supra note 1, 284

6 Rowlands v Collow [1992] 1 NZLR 178.

III. The Law Prior To The Decision

The starting point for any assessment of damages for breach of contract was expressed by Parke B in *Robinson v Harman*[7] as follows:

> The rule of the common law is that where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed.[8]

In *East Ham BC v Bernard Sunley & Sons*[9] the House of Lords held that the plaintiffs were entitled to damages for the cost of reinstatement of defectively fixed stone panels. The court referred to the alternate methods of calculating damages in defective building cases set out in Hudson's Building and Engineering Contracts[10] ("Hudson's (8 ed.)") and concluded that it was reasonable in the circumstances to award reinstatement costs.

Hudson's (8 ed.) sets out the following three alternatives for assessing such damages: (a) the cost of reinstatement; (b) the difference in cost to the builder of the actual work done and work specified; or (c) the diminution in value of the work done due to the breach of contract.

McGregor on Damages accepts the decision in *East Ham BC* as authority for the rule that damages for the cost of reinstatement are available in defective building cases where it is reasonable to effect the necessary repairs.[11] The text goes on to say that, "if, however, the cost of remedying the defect is disproportionate to the end result to be attained, the damages fall to be measured by the value of the building had it been built as required by the contract less its value as it stands".[12] The text does not consider application of this rule in a case where there is no diminution in value. The House of Lords had no difficulty in applying this general rule in *Ruxley* to conclude that, as there was no diminution in value, there was no loss — apart from a loss of amenity.

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7 *Robinson v Harman* (1848) 1 Exch 850 at 855, [1843-60] All ER Rep 383.

8 Ibid, at 385.

9 *East Ham BC v Bernard Sunley & Sons* [1965] 3 All ER 619, [1966] AC 406.

10 8th edition.

11 15th edition (Sweet and Maxwell, 1988) at paragraph 1091.

12 Idem.

In *Radford v De Froberville*[13] Oliver J held that the plaintiff was entitled to damages to cover the cost of building a wall which the defendant had failed to build in breach of a covenant entered into when the property was sold. Oliver J held that in order to award such damages he had to be satisfied that:

(i) the plaintiff has a genuine and serious intention of doing the work; and

(ii) the carrying out of the work is a reasonable thing for the plaintiff to do.[14]

In *Ruxley* both the House of Lords and the Court of Appeal referred to this case. Both courts were agreed in their conclusion that the plaintiff's intended use of any damages is irrelevant when deciding whether they should be awarded. However, the House of Lords held that the plaintiff's intention is a relevant factor to take into account when considering reasonableness. In referring to this decision the House of Lords decided that Forsyth's claim for reinstatement costs was unreasonable while the Court of Appeal decided that the claim was reasonable.

The High Court of Australia in *Bellgrove v Eldridge*[15] awarded damages to cover the cost of demolishing and rebuilding a house built with defective foundations in breach of specifications contained in the contract. The court held that the owners right to be compensated for remedial work is subject to the qualification that the work must be necessary to produce conformity with the contract and carrying out the work must be a reasonable course to adopt.

Bellgrove was not considered by the Court of Appeal in *Ruxley* but the House of Lords considered it to lend support to its approach to the question of reasonableness: that the reasonableness of an award of damages is to be linked directly to the loss sustained.[16] Where the contractual objective has been achieved to a substantial extent it may be unreasonable to award damages for demolition and rebuilding.

In New Zealand the question of damages for breach of a building contract was considered in the case of *Cooke v Rowe*.[17] The foundations of a

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13 [1978] 1 All ER 33.

14 Ibid, at 54.

15 *Bellgrove v Eldridge* (1954) 90 CLR 613.

16 Ruxley, supra note 1, at 274, per Lord Jauncey.

17 [1950] NZLR 410.

house built on a concrete raft failed. The concrete raft was supposed to ensure that the house settled evenly on a section partly filled with sawdust. The only way to remedy the problem was to rebuild using a "pier and beam" system which would cost more than the original house. Stanton J held that the measure of damages is the difference between the contract price and the cost of making the building conform to the contract. He said that the submission that assessment of damages on this basis was unreasonable because of the disparity between the cost of the house and the cost of putting in the new foundations was not a reason for departing from the general rule. He awarded damages reflecting the cost of rebuilding with new foundations, deducting a sum to take account of the added benefit the owner would obtain from the new foundations not contemplated in the original design. The decision in *Cooke v Rowe* appears to conflict with the House of Lords reasoning in *Ruxley.*

In *Bevan v Blackhall & Struthers (No 2)*[18] the New Zealand Court of Appeal referred to *Bellgrove,* holding that it was reasonable to award the cost of reinstatement of a sports centre according to an alternate design which was safe on the basis that the owners would have chosen the safe design at the beginning if they had been aware of the failings in the design they chose. The original engineer was held to be in breach of the implied term to exercise all reasonable skill and care in designing a building which was unsafe. Richmond P referred to the general rule that the owner is to be placed in the same position as he would have been in had the contract been performed.[19]

A review of these cases shows that courts have generally (except in *Cooke v Rowe)* considered whether it is reasonable to award damages for reinstatement before making such an award. If such an award is unreasonable then damages for diminution in value are generally awarded.

IV. A New Principle ?

The decision in *Ruxley* is unique in that a court had never before (in a reported decision) in assessing damages for breach of building contract due to defective performance applied the method of assessing the diminution in value where there was no diminution. In such a case the Lords agreed with the trial judge's decision to award modest damages for "loss of amenity" and declined to award damages for the cost of reinstatement.

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18 [1978] 2 NZLR 97.

19 Ibid, 108.

In declining to award damages for reinstatement the House of Lords considered whether reinstatement was reasonable. The application of the principle of reasonableness is not new. The factors which the Court took into account when determining reasonableness were:

- was the cost of reinstatement wholly disproportionate to any prospective benefit the owner would obtain by reinstatement; and
- was the contractual objective achieved to a substantial extent?

Isaac E Jacob (counsel for Forsyth in the House of Lords) asserts that the House of Lords accepted and enunciated a new principle in *Ruxley*: the principle that there is a midway point between giving an owner nil damages because there was no diminution in value and the full cost of the cure.[20] Isaac seems to suggest that the law prior to *Ruxley* required either one of these two methods to be applied. Other methods for calculating such losses have been discussed and applied prior to *Ruxley*. These are discussed below.

There do not appear at this stage to be any reported decisions which discuss *Ruxley*. The Privy Council in *Invercargill City Council v Hamlin*[21] referred to the Court of Appeal decision as being authority for the principle that, the measure of loss for defective buildings will be the cost of repairs, if it is reasonable to repair, or the depreciation in the market value if it is not.[22] The House of Lords decision can be said to have applied the same principle but came to a different conclusion on the question of reasonableness.

V. Alternate Methods For Calculating Damages

As has already been stated, the House of Lords and the Court of Appeal in *Ruxley* concentrated on two methods of calculating damages: (i) diminution in value; and (ii) cost of reinstatement.

There are a number of other ways in which damages in defective building cases can be assessed. They are:

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20 Jacob, "Is Near Enough Good Enough?" 139:27 Solicitor's Journal 67 (July 1995).

21 [1996] 1 All ER 756.

22 Ibid, 772.

(i) The difference in cost to the builder of the actual work done and the work specified in the contract (in other words the savings to the builder).

(ii) The difference in the price of the contract and the price the owner would have paid for the work actually completed.

(iii) An award to take account of the loss of "consumer surplus" or personal preference of the owner.

All of the above methods have limitations but one or other may be an appropriate method of assessment depending on the facts. Each is considered in more detail below.

1. The Difference in Cost to the Builder

This method of assessment is referred to in Hudson's (8ed.) and the current 11th edition.[23] Although it was mentioned by Lord Jauncey in *Ruxley* by reference to a quote from *East Ham BC* there was no attempt to apply the method.[24] Presumably because there was no evidence submitted on the point and it was not part of the appeal.

The method is in effect a restitutionary remedy and seeks to disgorge any savings made by the builder and credit them to the owner. Application of this method may require the court to order the builder to account for savings in order to assess the amount of damages unless such information can be obtained on discovery.

Hudson's (11ed.) submits that, "If... cost of reinstatement is rejected as the measure of damage, then the measure should be the difference in cost to the builder, or the diminution in value of the works whichever is the greater".[25] Hugh Beale talks of redistributing "unanticipated savings".[26]

This method has in fact been applied in New Zealand. In *Samson & Samson Ltd v Proctor*[27] MacArthur J applied the method in a case where the owner of the building claimed that the building had been built with insufficient steel reinforcing in breach contract. The building had subsequently been

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23 11 ed., at 1046.

24 Ruxley, supra note 1, at 272.

25 Ibid, at 1047.

26 Beale, "Damages For Rebuilding" (1995) 111 LQR 54.

27 [1975] 1 NZLR 655.

sold at a price equal to the price which would have been obtained had the contract been fully performed so there was no diminution in value. MacArthur J held that the proper measure of damages was the difference in cost to the builder of the actual work done and the work specified. He also said that the owner should be given credit for any element of profit that would have been exclusively referable to the performance of the work as specified. MacArthur J added that he did not think that the adoption of this measure was a departure from the fundamental principle of compensation. It appears that the parties sorted the exact amount of damages out between themselves as the matter was not reported again.

There did not appear to be any evidence in *Ruxley* about the savings the builder made in constructing the pool with a decreased depth. Presumably some concrete was saved and some labour costs. It is difficult to speculate on what the value of any savings might have been. It may however have been a useful exercise.

2. The Difference in Price of the Contract

Hudson's (11ed.) refers to "an intermediate measure" for assessing damages: that being the higher price paid for the for the contract compared with what would have been paid for the actual performance.[28] It is suggested that this difference represents the value the owner puts on his or her loss. Hugh Beale also suggests that this is a way of measuring the "unanticipated savings" made by the builder.[29]

This approach was not mentioned in *Ruxley.* However, Lord Lloyd noted that the builder agreed to increase the depth of the pool at no extra charge.[30] Application of this method would not therefore have been suitable in *Ruxley.*

3. Award to Take Account of Loss of "Consumer Surplus"

"Consumer surplus" is described by Harris, Ogus and Phillips as "the excess utility or subjective value obtained from a "good" over and above its market price".[31] The authors suggest that in some cases an attempt should be made to value the "consumer surplus" in order to compensate an owner sufficiently if there has been a loss of that surplus.

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28 Supra note 23, at 1057.

29 Beale, supra note 26.

30 Supra note 1, at 278.

31 "Contract Remedies and the Consumer Surplus" ((1979) 95 LQR 581.

Lord Mustill referred to these authors in *Ruxley* and used the the concept of loss of "consumer surplus" to support the award of 2,500 pounds made by the trial judge for "loss of amenity". Lord Mustill described "consumer surplus" as representing a "personal, subjective and non-monetary gain" and said that where it is lost the law should compensate for it in order to recognise the true loss suffered by the owner.[32] Lord Mustill was not required to illuminate on how such a loss could be valued because the quantum of the trial judge's award for loss of amenity had not been appealed.

Hugh Beale submits that an attempt to calculate the loss of "consumer surplus" in a case such as *Ruxley* is a commendable way of seeking to truly compensate an owner for loss.[33] Beale's article was written before the House of Lords decision was delivered and reflects the sentiments of Lord Mustill in suggesting that the trial judge's approach may not have been incorrect.

In the case of *Atkins Ltd v Scott*[34] the trial judge refused to grant damages for the cost of repair of defectively laid bathroom tiles but made an award of damages as an allowance for bad workmanship. The Court of Appeal agreed with the trial judge's approach: he had clearly found that the defects were not of a very serious character and that it would be unreasonable to completely strip the tiles and replace them. This award of damages to take account of poor workmanship is akin to damages for loss of "consumer surplus."

Although an assessment of the value "consumer surplus" is difficult, it is no more difficult than assessments judges are already required to make under heads such as emotional distress damages. Such an assessment could be a valuable alternative in cases such as *Ruxley,* where the established methods of assessment do not appear to be appropriate.

VI. Conclusion

The House of Lords decision in *Ruxley* raises some interesting questions in relation to assessment of damages for breach of construction contracts due to defective performance. The decision does not preclude development of the alternate methods of assessment discussed above. It is unfortunate that the House of Lords was not required by the terms of the appeal to

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32 Supra note 1, at 277.

33 Idem.

34 (1980) 7 Const. L.J. 215.

reconsider the award of general damages for loss of amenity granted by the trial judge. Lord Mustill hinted at the possibility of awarding damages for loss of "consumer surplus". Perhaps a fairer result would have been achieved if a more substantial award had been made under this head.

In New Zealand the courts may develop the method of assessment used by MacArthur J in *Samson & Samson Ltd v Proctor*: the difference in cost to the builder. In the end the courts are likely to choose the method of assessment which is most suitable to the facts of the case. The decision in *Ruxley* will not preclude courts from making their own choice.

The introduction of the concept of reasonableness as suggested by *Ruxley* into contract law reduces the certainty of contract and moves away from the general rule that damages in contract should put the aggrieved party back in the position he or she would have been in had the contract not been breached.

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