Photo Production Ltd v Securicor Transport Ltd [1980] Int.Com.L.R. 02/14

HOUSE OF LORDS before Lord Wilberforce Lord Diplock Lord Salmon Lord Keith of Kinkel Lord Scarman. 14th February 1980.

Lord Wilberforce, MY LORDS,
This appeal arises from the destruction by fire of the respondents' factory involving loss and damage agreed to amount to £615,000. The question is whether the appellant is liable to the respondents for this sum.

The appellant is a company which provides security services. In 1968 it entered into a contract with the respondents by which for a charge of £8,15,0d. (old currency) per week it agreed to "provide their Night Patrol Service whereby "four visits per night shall be made seven nights per week and two visits shall "be made during the afternoon of Saturday and four visits shall be made during "the day of Sunday". The contract incorporated printed Standard Conditions which, in some circumstances, might exclude or limit the appellant's liability. The questions in this appeal are (i) whether these conditions can be invoked at all in the events which happened and (ii) if so, whether either the exclusion provision, or a provision limiting liability, can be applied on the facts. The trial judge (MacKenna J.) decided these issues in favour of the appellant. The Court of Appeal decided issue (i) in the respondents' favour invoking the doctrine of fundamental breach. Waller L.J. in addition would have decided for the respondents on issue (ii).

What happened was that on a Sunday night the duty employee of the appellant was one Musgrove. It was not suggested that he was unsuitable for the job or that the appellant was negligent in employing him. He visited the factory at the correct time, but when inside he deliberately started a fire by throwing a match on to some cartons. The fire got out of control and a large part of the premises was burnt down. Though what he did was deliberate, it was not established that he intended to destroy the factory. The judge's finding was in these words: - "*Whether Musgrove intended to light only a small fire (which was the "very least he meant to do) or whether he intended to cause much more "serious damage, and, in either case, what was the reason for his act, are "mysteries I am unable to solve".*

This, and it is important to bear it in mind when considering the judgments in the Court of Appeal, falls short of a finding that Musgrove deliberately burnt or intended to burn the respondents' factory.

The condition upon which the appellant relies reads, relevantly, as follows: "*Under no circumstances shall the Company [Securicor] be responsible for any injurious act or default by any employee of the Company unless such act or default could have been foreseen and avoided by the exercise of due diligence on the part of the Company as his employer; nor, in any event, shall the Company be held responsible for (a) Any loss suffered by the customer through burglary, theft, fire or any other cause, except insofar as such loss is solely attributable to the negligence of the Company's employees acting within the course of their employment...".*

There are further provisions limiting to stated amounts the liability of the appellant upon which it relies in the alternative if held not to be totally exempt.

It is first necessary to decide upon the correct approach to a case such as this where it is sought to invoke an exception or limitation clause in the contract. The approach of the Master of the Rolls in the Court of Appeal was to consider first whether the breach was "*fundamental*". If so, he said, the court itself deprives the party of the benefit of an exemption or limitation clause ([1978] 1 W.L.R. 863). The Lords Justices substantially followed him in this argument.

The Master of the Rolls in this was following the earlier decision of the Court of Appeal, and in particular his own judgment in ***Harbutt's Plasticine Ltd. v. Wayne Tank & Pump Co. Ltd.*** [1970] 1 Q.B. 447. In that case Lord Denning distinguished two cases (a) the case where as the result of a breach of contract the innocent party has, and exercises, the right to bring the contract to an end, (b) the case where the breach automatically brings the contract to an end, without the innocent party having to make an election whether to terminate the contract or to continue it. In the first case the Master of the Rolls, purportedly applying this House's decision in the ***Suisse Atlantique* case** [1967] 1 A.C. 361, but in effect two citations from two of their Lordships' speeches, extracted a rule of law that the "*termination*" of the contract brings it, and with it the exclusion clause, to an end. **The *Suisse Atlantique* case** in his view "*affirms the long line of cases in this court that when one party has been guilty of a fundamental breach of the contract . . . and the other side accepts it, so that the contract comes to an end . . . then the guilty party cannot rely on an exception or limitation clause to escape from his liability for the breach*" (***Harbutt's* case** p.467). He then applied the same principle to the second case.

My Lords, whatever the intrinsic merit of this doctrine, as to which I shall have something to say later, it is clear to me that so far from following this House's decision in the ***Suisse Atlantique*** it is directly opposed to it and that the whole purpose and tenor of the *Suisse Atlantique* was to repudiate it. The lengthy, and perhaps I may say sometimes indigestible speeches of their Lordships, are correctly summarised in the headnote—holding No. 3—"That "the question whether an exceptions clause was applicable where there was a "fundamental breach of contract was one of the true construction of the "contract". That there was any rule of law by which exceptions clauses are eliminated, or deprived of effect, regardless of their terms, was clearly not the view of Viscount Dilhorne, Lord Hodson, or of myself. The passages invoked for the contrary view of a rule of law consist only of short extracts from two of the speeches—on any view a minority. But the case for the doctrine does not even go so far as that. Lord Reid, in my respectful opinion, and I recognise that I may not be the best judge of this matter, in his speech read as a whole, cannot be claimed as a supporter of a rule of law. Indeed he expressly disagreed with the Master of the Rolls' observations in two previous cases (***Karsales (Harrow) Ltd. v. Wallis*** [1956] 1 W.L.R. 936 and ***U.G.S. Finance Ltd. v. National Mortgage Bank of Greece*** [1964] 1 Lloyd's Rep. 446 in which he had put forward the "rule of law" doctrine. In order to show how close the disapproved doctrine is to that sought to be revived in ***Harbutt's* case** I shall quote one passage from ***Karsales:***

"*Notwithstanding earlier cases which might suggest the contrary, it is now settled that exempting clauses of this kind, no matter how widely they are expressed, only avail the party when he is carrying out his contract in its essential respects. He is*

not allowed to use them as a cover for misconduct or indifference or to enable him to turn a blind eye to his obligations. They do not avail him when he is guilty of a breach which goes to the root of the contract". (l.c. p.940).

Lord Reid comments as to this that he could not deduce from the authorities cited in ***Karsales*** that the proposition stated in the judgments could be regarded as in any way "*settled law*" (p.401).

His conclusion is stated on p.405: "*In my view no such rule of law ought to "be adopted"—adding that there is room for legislative reform.*

My Lords, in the light of this, the passage cited by the Master of the Rolls has to be considered. For convenience I restate it: *"If fundamental breach is established the next question is what effect, if any, that has on the applicability of other terms of the contract. This question has often arisen with regard to clauses excluding liability, in whole or in part, of the party in breach. I do not think that there is generally much difficulty where the innocent party has elected to treat the breach as a repudiation, bring the contract to an end and sue for damages. Then 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." (****Suisse At/antique*** [1967] 1 A.C. at p.398.)

It is with the utmost reluctance that, not forgetting the "***beams***" that may exist elsewhere, I have to detect here a note of ambiguity or perhaps even of inconsistency. What is referred to is "*loss which will be suffered by the innocent "party after (the contract) has ceased to exist*" and I venture to think that all that is being said, rather elliptically, relates only to what is to happen in the future, and is not a proposition as to the immediate consequences caused by the breach: if it were that would be inconsistent with the full and reasoned discussion which follows.

It is only because of Lord Reid's great authority in the law that I have found it necessary to embark on what in the end may be superfluous analysis. For I am convinced that, with the possible exception of Lord Upjohn whose critical passage, when read in full, is somewhat ambiguous, their Lordships, fairly read, can only be taken to have rejected those suggestions for a rule of law which had appeared in the Court of Appeal and to have firmly stated that the question is one of construction, not merely of course of the exclusion clause alone, but of the whole contract.

Much has been written about the ***Suisse Atlantique***. Each speech has been subjected to various degrees of analysis and criticism, much of it constructive. Speaking for myself I am conscious of imperfections of terminology, though sometimes in good company. But I do not think that I should be conducing to the clarity of the law by adding to what was already too ample a discussion a further analysis which in turn would have to be interpreted. I have no second thoughts as to the main proposition that the question whether, and to what extent, an exclusion clause is to be applied to a fundamental breach, or a breach of a fundamental term, or indeed to any breach of contract, is a matter of construction of the contract. Many difficult questions arise and will continue to arise in the infinitely varied situations in which contracts come to be breached —by repudiatory breaches, accepted or not, anticipatory breaches, by breaches of conditions or of various terms and whether by negligent, or deliberate action or otherwise. But there are ample resources in the normal rules of contract Law for dealing with these without the superimposition of a judicially invented rule of law. I am content to leave the matter there with some supplementary observations.

1. The doctrine of "*fundamental breach"* in spite of its imperfections and doubtful parentage has served a useful purpose. There was a large number of problems, productive of injustice, in which it was worse than unsatisfactory to leave exception clauses to operate. Lord Reid referred to these in the ***Suisse Atlantique*** (p.406), pointing out at the same time that the doctrine of fundamental breach was a dubious specific. But since then Parliament has taken a hand: it has passed the Unfair Contract Terms Act 1977. This Act applies to consumer contracts and those based on standard terms and enables exception clauses to be applied with regard to what is just and reasonable. It is significant that Parliament refrained from legislating over the whole field of contract. After this Act, in commercial matters generally, when the parties are not of unequal bargaining power, and when risks are normally borne by insurance, not only is the case for judicial intervention undemonstrated, but there is everything to be said, and this seems to have been Parliament's intention, for leaving the parties free to apportion the risks as they think fit and for respecting their decisions.

   At the stage of negotiation as to the consequences of a breach, there is every- thing to be said for allowing the parties to estimate their respective claims according to the contractual provisions they have themselves made, rather than for facing them with a legal complex so uncertain as the doctrine of fundamental breach must be. What, for example, would have been the position of the respon- dents' factory if instead of being destroyed it had been damaged, slightly or moderately or severely? At what point does the doctrine (with what logical justification I have not understood) decide, *ex post facto,* that the breach was (factually) fundamental before going on to ask whether legally it is to be re- garded as fundamental? How is the date of "termination" to be fixed? Is it the date of the incident causing the damage, or the date of the innocent party's election, or some other date? All these difficulties arise from the doctrine and are left unsolved by it.

   At the judicial stage there is still more to be said for leaving cases to be decided straightforwardly on what the parties have bargained for rather than upon analysis, which becomes progressively more refined, of decisions in other cases leading to inevitable appeals. The learned judge was able to decide this case on normal principles of contractual law with minimal citation of authority. I am sure that most commercial judges have wished to be able to do the same (cf. ***Trade & Transport Inc. v. Iino Kaiun Kaisha Ltd.*** [1973] 1 W.L.R. 210, 232 per Kerr J.). In my opinion they can and should.

2. The case of ***Harbutt*** must clearly be overruled. It would be enough to put that upon its radical inconsistency with the ***Suisse Atlantique***. But even if the matter were *res Integra* I would find the decision to be based upon un- satisfactory reasoning as to the "termination" of the contract and the effect of "termination" on the plaintiffs' claim for damage. I have, indeed, been unable to understand how the doctrine can be reconciled with the well accepted principle of law, stated by the highest modern authority, that when in the context of a breach of contract one speaks of "termination", what is meant is no more than that the innocent party or, in some cases, both parties, are excused from further performance. Damages, in such cases, are then claimed under the con- tract, so what reason in principle can there be for disregarding what the con- tract itself says about damages—whether it "liquidates" them, or limits them, or excludes them? These difficulties arise in part from uncertain or inconsistent terminology. A vast number of expressions are used to describe situations where a breach has been committed by one party of such a character as to entitle the other party to refuse further performance: discharge, rescission, termination, the contract is at an end, or dead, or displaced; clauses cannot survive, or simply go. I have come to think that some of these difficulties can be avoided; in particular the use of "rescission", even if distinguished from rescission *ab initio,* as an equivalent for discharge, though justifiable in some contexts (see ***Johnson v. Agnew*** [1979] 1 All E.P. 883) may lead to confusion in others. To plead for complete uniformity may be to cry for the moon. But what can and ought to be avoided is to make use of these confusions in order to produce a concealed and unreasoned legal innovation: to pass, for example, from saying that a party, victim of a breach of contract, is entitled to refuse further performance, to saying that he may treat the contract as at an end, or as rescinded, and to draw from this the proposition, which is not analytical but one of policy, that all or (arbitrarily) some of the clauses of the contract lose, automatically, their force, regardless of intention.

   If this process is discontinued the way is free to use such words as "discharge" or "termination" consistently with principles as stated by modern authority which *Harbutt's* case disregards. I venture with apology to relate the classic passages: In ***Heyman v. Darwins Ltd.*** Lord Porter said:

   "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" ([1942] A.C.356, 399)

   and similarly Lord Macmillan at p.373: see also ***Boston Deep Sea Fishing & Ice Co. Ltd. v. Ansell*** 39 Ch.D. 339, 361 per Bowen L.J. In ***Moschi v. Lep Air Services Ltd.*** [1973] A.C. 331, 350, my noble and learned friend Lord Diplock drew a distinction (relevant for that case) between primary obligations under a contract, which on "rescission" generally come to an end, and secondary obligations which may then arise. Among the latter he includes an obligation to pay compensation, i.e., damages. And he states in terms that this latter obligation "is just as much an obligation arising from the contract as are the "*primary obligations that it replaces*". My noble and learned friend has developed this line of thought in an enlightening manner in his opinion which I have now had the benefit of reading.

   These passages I believe to state correctly the modern law of contract in the relevant respects: they demonstrate that the whole foundation of *Harbutt's* case is unsound. *A fortiori,* in addition to *Harbutt's* case there must be over- ruled the case of ***Wathes (Western) Ltd. v. Austins (Menswear) Ltd.*** [1976] 1 Lloyd's Rep. 14 which sought to apply the doctrine of fundamental breach to a case where, by election of the innocent party, the contract had not been terminated, an impossible acrobatic, yet necessarily engendered by the doctrine. Similarly, *Charterhouse* v. *Tolly* [1963] 2 Q.B. 683 must be over-ruled, though the result might have been reached on construction of the contract.

3. I must add to this, by way of exception to the decision not to "gloss" the ***Suisse Atlantique*** a brief observation on the deviation cases, since some reliance has been placed upon them, particularly upon the decision of this House in ***Hain Steamship Co. Ltd. v. Tate & Lyle Ltd.*** [1936] 2 All E.R. 597 (so earlier than the *Suisse Atlantique)* in the support of the ***"Harbutt"*** doctrine. I suggested in the ***Suisse Atlantique*** that these cases can be regarded as proceeding upon normal principles applicable to the law of contract generally viz., that it is a matter of the parties' intentions whether and to what extent clauses in shipping contracts can be applied after a deviation, i.e., a departure from the con- tractually agreed voyage or adventure. It may be preferable that they should be considered as a body of authority *sui generis* with special rules derived from historical and commercial reasons. What on either view they cannot do is to lay down different rules as to contracts generally from those later stated by this House in ***Heyman v. Darwins*** (l.c.). The ingenious use by Donaldson J. in ***Kenyon Son & Craven Ltd. v. Baxter Hoare & Co. Ltd.*** [1971] 1 W.L.R. 519 of the doctrine of deviation in order to reconcile the ***Suisse Atlantique*** with ***Harbutt's case***, itself based in part on the use of the doctrine of deviation, illustrates the contortions which that case has made necessary and would be unnecessary if it vanished as an authority.

4. It is not necessary to review fully the numerous cases in which the doctrine of fundamental breech has been applied or discussed. Many of these have now been superseded by the Unfair Contract Terms Act 1977. Others, as decisions, may be justified as depending upon the construction of the contract (cf. ***Levison v. Patent Steam Carpet Cleaning Co. Ltd.*** [1978] Q.B. 69) in the light of well known principles such as that stated in ***Alderslade v. Hendon Laundry Ltd.*** [1945] K.B. 189.

In this situation the present case has to be decided. As a preliminary, the nature of the contract has to be understood. Securicor undertook to provide a service of periodical visits for a very modest charge which works out at 26p per visit. It did not agree to provide equipment. It would have no knowledge of the value of the plaintiffs' factory: that, and the

efficacy of their fire precautions, would be known to the plaintiffs. In these circumstances nobody could consider it unreasonable, that as between these two equal parties the risk assumed by Securicor should be a modest one, and that the respondents should carry the substantial risk of damage or destruction.

The duty of Securicor was, as stated, to provide a service. There must be implied an obligation to use due care in selecting their patrolmen, to take care of the keys and, I would think, to operate the service with due and proper regard to the safety and security of the premises. The breach of duty committed by Securicor lay in a failure to discharge this latter obligation. Alternatively it could be put upon a vicarious responsibility for the wrongful act of Musgrove—viz., starting a fire on the premises: Securicor would be responsible for this upon the principle stated in *Morris* v. *Martin* [1966] 1 Q.B. 716, 739. This being the breach, does condition 1 apply? It is drafted in strong terms, *"In no circumstances". . . "any injurious act or default by any employee*". These words have to be approached with the aid of the cardinal rules of construction that they must be read *contra proferentem* and that in order to escape from the consequences of one's own wrongdoing, or that of one's servant, clear words are necessary. I think that these words are clear. The respondents in fact relied upon them for an argument that since they exempted from negligence they must be taken as not exempting from the consequence of deliberate acts. But this is a perversion of the rule that if a clause can cover something other than negligence, it will not be applied to negligence. Whether, in addition to negligence, it covers other, e.g., deliberate, acts, remains a matter of construction requiring, of course, clear words. I am of opinion that it does, and being free to construe and apply the clause, I must hold that liability is excluded. On this part of the case I agree with the judge and adopt his reasons for judgment. I would allow the appeal.

Lord Diplock, my lords,
My noble and learned friend Lord Wilberforce has summarised the facts which have given rise to this appeal. The contract which falls to be considered was a contract for the rendering of services by the defendants ("Securicor") to the plaintiffs ("the Factory Owners"). It was a contract of indefinite duration terminable by one month's notice on either side. It had been in existence for some two-and-a-half years when the breach that is the subject matter of these proceedings occurred. It is not disputed that the act of Securicor's servant, Musgrove, in starting a fire in the factory which they had undertaken to protect was a breach of contract by Securicor; and since it was the cause of an event, the destruction of the factory, that rendered further performance of the contract impossible it is not an unnatural use of ordinary language to describe it as a "*fundamental breach*".

It was by attaching that label to it that all three members of the Court of Appeal found themselves able to dispose of Securicor's defence based on the exclusion clause restricting its liability for its servants' torts in terms which Lord Wilberforce has already set out, by holding that where there had been a fundamental breach by a party to a contract, there was a rule of law which prevented him from relying upon any exclusion clause appearing in the contract, whatever its wording might be.

The Court of Appeal was, I think, bound so to hold by previous decisions of its own, of which the first was ***Harbutt's Plasticine v. Wayne Tank Co.*** [1970] 1 Q.B. 44. It purported in that case to find support for the rule of law it there laid down in the reasoning of this House in ***Suisse Atlantique v. Rotterdamsche Kolen Centrale*** [1967] A.C. 361. I agree with Lord Wilberforce's analysis of the speeches in ***Suisse Atlantique***, and with his conclusion that this House rejected the argument that there was any such rule of law. I also agree that ***Harbutt's Plasticine*** and the subsequent cases in which the so-called "rule of law" was applied to defeat exclusion clauses should be overruled, though the actual decisions in some of the later cases might have been justified on the proper construction of the particular exclusion clause on which the defendant relied.

My Lords, the contract in the instant case was entered into before the passing of the Unfair Contract Terms Act 1977. So what we are concerned with is the common law of contract - of which the subject-matter is the legally enforceable obligations as between the parties to it of which the contract is the source. The "*rule of law"* theory which the Court of Appeal has adopted in the last decade to defeat exclusion clauses is at first sight attractive in the simplicity of its logic. A fundamental breach is one which entitles the party not in default to elect to terminate the contract. Upon his doing so the contract comes to an end. The exclusion clause is part of the contract, so it comes to an end too; the party in default can no longer rely on it. This reasoning can be extended without undue strain to cases where the party entitled to elect to terminate the contract does not become aware of the breach until some time after it occurred; his election to terminate the contract could not implausibly be treated as exercisable *nunc pro tunc*. But even the superficial logic of the reasoning is shattered when it is applied, as it was in ***Wathes (Western) Ltd. v. Austins (Menswear) Ltd.*** [1976] 1 Lloyd's Rep. 14, to cases where, despite the "*fundamental breach*", the party not in default elects to maintain the contract in being.

The fallacy in the reasoning and what I venture to think is the disarray into which the common law about breaches of contract has fallen, is due to the use in many of the leading judgments on this subject of ambiguous or imprecise expressions without defining the sense in which they are used. I am conscious that I have myself sometimes been guilty of this when I look back on judgments I have given in such cases as ***Hong Kong Fir Shipping Co. Ltd. v. Kawakasi Kisen Kaisha Ltd.*** [1962] 2 Q.B. 26; ***Ward v. Bignall*** [1967] 1 Q.B. 534; ***Moschi v. Lep Air Services*** [1973] A.C. 331; and in particular ***Hardwick Game Farm v. S.A.P.P.A.*** [1966] 1 W.L.R. 287, when commenting unfavourably on the then budding doctrine of fundamental breach in a portion of my judgment in the Court of Appeal that did not subsequently incur the disapproval of this House.

My Lords, it is characteristic of commercial contracts, nearly all of which to-day are entered into not by natural legal persons, but by fictitious ones, i.e. companies, that the parties promise to one another that some thing will be done; for instance, that property and possession of goods will be transferred, that goods will be carried by ship from one port to another, that a building will be con- structed in accordance with agreed plans, that services of a particular kind will be

provided. Such a contract is the source of primary legal obligations upon each party to it to procure that whatever he has promised will be done, is done. [I leave aside arbitration clauses which do not come into operation until a party to the contract claims that a primary obligation has not been proved.]

Where what is promised will be done involves the doing of a physical act, performance of the promise necessitates procuring a natural person to do it; but the legal relationship between the promisor and the natural person by whom the act is done, whether it is that of master and servant, or principal and agent, or of parties to an independent sub-contract, is generally irrelevant. If that person fails to do it in the manner in which the promisor has promised to procure it to be done, as, for instance, with reasonable skill and care, the promisor has failed to fulfil his own primary obligation. This is to be distinguished from "vicarious liability" - a legal concept which does depend upon the existence of a particular legal relationship between the natural person by whom a tortious act was done and the person sought to be made vicariously liable for it. In the interests of clarity the expression should, in my view, be confined to liability for tort.

A basic principle of the common law of contract, to which there are no exceptions that are relevant in the instant case, is that parties to a contract are free to determine for themselves what primary obligations they will accept. They may state these in express words in the contract itself and, where they do, the statement is determinative; but in practice a commercial contract never states all the primary obligations of the parties in full; many are left to be incorporated by implication of law from the legal nature of the contract into which the parties are entering. But if the parties wish to reject or modify primary obligations which would otherwise be so incorporated, they are fully at liberty to do so by express words.

Leaving aside those comparatively rare cases in which the court is able to enforce a primary obligation by decreeing specific performance of it, breaches of primary obligations give rise to substituted or secondary obligations on the part of the party in default, and, in some cases, may entitle the other party to be relieved from further performance of his own primary obligations. These secondary obligations of the contract breaker and any concomitant relief of the other party from his own primary obligations also arise by implication of law - generally common law, but sometimes statute, as in the case of codifying Statutes passed at the turn of the century, notably the Sale of Goods Act 1893. The contract, however, is just as much the source of secondary obligations as it is of primary obligations; and like primary obligations that are implied by law, secondary obligations too can be modified by agreement between the parties, although, for reasons to be mentioned later, they cannot, in my view, be totally excluded. In the instant case, the only secondary obligations and concomitant reliefs that are applicable arise by implication of the common law as modified by the express words of the contract.

Every failure to perform a primary obligation is a breach of contract. The secondary obligation on the part of the contract breaker to which it gives rise by implication of the common law is to pay monetary compensation to the other party for the loss sustained by him in consequence of the breach; but, with two exceptions, the primary obligations of both parties so far as they have not yet been fully performed remain unchanged. This secondary obligation to pay compensation (damages) for non-performance of primary obligations I will call the "general secondary obligation". It applies in the cases of the two exceptions as well.

The exceptions are:

1. Where the event resulting from the failure by one party to perform a primary obligation has the effect of depriving the other party of substantially the whole benefit which it was the intention of the parties that he should obtain from the contract, the party not in default may elect to put an end to all primary obligations of both parties remaining unperformed. (If the expression "fundamental breach" is to be retained, it should, in the interests of clarity, be confined to this exception).
2. Where the contracting parties have agreed, whether by express words or by implication of law, that *any* failure by one party to perform a particular primary obligation ("condition" in the nomenclature of the Sale of Goods Act 1893), irrespective of the gravity of the event that has in fact resulted from the breach, shall entitle the other party to elect to put an end to all primary obligation of both parties remaining unperformed. (In the interests of clarity, the nomenclature of the Sale of Goods Act 1893, "breach of "condition" should be reserved for this exception.)

Where such an election is made (a) there is substituted by implication of law for the primary obligations of the party in default which remain unperformed a secondary obligation to pay monetary compensation to the other party for the loss sustained by him in consequence of their non-performance in the future and (b) the unperformed primary obligations of that other party are discharged. This secondary obligation is additional to the general secondary obligation; I will call it "the anticipatory secondary obligation".

In cases falling within the first exception, fundamental breach, the anticipatory secondary obligation arises under contracts of all kinds by implication of the common law, except to the extent that it is excluded or modified by the express words of the contract. In cases falling within the second exception, breach of condition, the anticipatory secondary obligation generally arises under particular kinds of contracts by implication of statute law; though in the case of "deviation" from the contract voyage under a contract of carriage of goods by sea it arises by implication of the common law. The anticipatory secondary obligation in these cases too can be excluded or modified by express words.

When there has been a fundamental breach or breach of condition, the coming to an end of the primary obligations of both parties to the contract at the election of the party not in default, is often referred to as the "determination" or "rescission" of the contract or, as in the Sale of Goods Act 1893 "treating the "contract as repudiated". The first two of these expressions, however, are mis- leading unless it is borne in mind that for the unperformed primary obligations of the party in default there are substituted by operation of law what I have called the secondary obligations.

The bringing to an end of all primary obligations under the contract may also leave the parties in a relationship, typically that of bailor and bailee, in which they owe to one another by operation of law fresh primary obligations of which the contract is not the source; but no such relationship is involved in the instant case.

I have left out of account in this analysis as irrelevant to the instant case an arbitration or choice of forum clause. This does not come into operation until a party to the contract claims that a primary obligation of the other party has not been performed; and its relationship to other obligations of which the contract is the source was dealt with by this House in ***Heyman v. Darwins Ltd.*** [1942] A.C. 356.

My Lords, an exclusion clause is one which excludes or modifies an obligation, whether primary, general secondary or anticipatory secondary, that would otherwise arise under the contract by implication of law. Parties are free to agree to whatever exclusion or modification of all three types of obligations as they please within the limits that the agreement must retain the legal characteristics of a contract; and must not offend against the equitable rule against penalties; that is to say, it must not impose upon the breaker of a primary obligation a general second obligation to pay to the other party a sum of money that is manifestly intended to be in excess of the amount which would fully compensate the other party for the loss sustained by him in consequence of the breach of the primary obligation. Since the presumption is that the parties by entering into the contract intended to accept the implied obligations exclusion clauses are to be construed strictly and the degree of strictness appropriate to be applied to their construction may properly depend upon the extent to which they involve departure from the implied obligations. Since the obligations implied by law in a commercial contract are those which, by judicial consensus over the years or by Parliament in passing a statute, have been regarded as obligations which a reasonable businessman would realise that he was accepting when he entered into a contract of a particular kind, the court's view of the reasonableness of any departure from the implied obligations which would be involved in construing the express words of an exclusion clause in one sense that they are capable of bearing rather than another, is a relevant consideration in deciding what mean- ing the words were intended by the parties to bear. But this does not entitle the court to reject the exclusion clause, however unreasonable the court itself may think it is, if the words are clear and fairly susceptible of one meaning only.

My Lords, the reports are full of cases in which what would appear to be very strained constructions have been placed upon exclusion clauses, mainly in what to-day would be called consumer contracts and contracts of adhesion. As Lord Wilberforce has pointed out, any need for this kind of judicial distortion of the English language has been banished by Parliament's having made these kinds of contracts subject to the Unfair Contract Terms Act 1977. In commercial contracts negotiated between business-men capable of looking after their own interests and of deciding how risks inherent in the performance of various kinds of contract can be most economically borne (generally by insurance), it is, in my view, wrong to place a strained construction upon words in an exclusion clause which are clear and fairly susceptible of one meaning only even after due allowance has been made for the presumption in favour of the implied primary and secondary obligations.

Applying these principles to the instant case; in the absence of the exclusion clause which Lord Wilberforce has cited, a primary obligation of Securicor under the contract, which would be implied by law, would be an absolute obligation to procure that the visits by the night patrol to the factory were conducted by natural persons who would exercise reasonable skill and care for the safety of the factory. That primary obligation is modified by the exclusion clause. Securicor's obligation to do this is not to be absolute, but is limited to exercising due diligence in its capacity as employer of the natural persons by whom the visits are conducted, to procure that those persons shall exercise reasonable skill and care for the safety of the factory.

For the reasons given by Lord Wilberforce it seems to me that this apportion- ment of the risk of the factory being damaged or destroyed by the injurious act of an employee of Securicor while carrying out a visit to the factory is one which reasonable business-men in the position of Securicor and the Factory Owners might well think was the most economical. An analogous apportionment of risk is provided for by the Hague Rules in the case of goods carried by sea under bills of lading. The risk that a servant of Securicor would damage or destroy the factory or steal goods from it, despite the exercise of all reasonable diligence by Securicor to prevent it, is what in the context of maritime law would be called a "misfortune risk"—something which reasonable diligence of neither party to the contract can prevent. Either party can insure against it. It is generally more economical for the person by whom the loss will be directly sustained to do so rather than that it should be covered by the other party by liability insurance. This makes it unnecessary to consider whether a later exclusion clause in the contract which modifies the general secondary obligation implied by law by placing limits on the amount of damages recoverable for breaches of primary obligations, would have applied in the instant case.

For the reasons given by Lord Wilberforce and in application of the principles that I have here stated, I would allow this appeal.

Lord Salmon, MY LORDS,

The contract with which this appeal is concerned is a very simple commercial contract entered into by two highly experienced business enterprises—the appellants whom I shall call Securicor and the respondents whom I shall call Photo Productions.

This appeal turns in my view entirely upon certain words in the contract which read as follows :— "*Under no circumstances shall [Securicor] be responsible for any injurious "act or default by any employee of [Securicor] unless such act or default "could have been foreseen and avoided by the exercise of due diligence on "the part of [Securicor] as his employer*."

We are not concerned with the Unfair Contract Terms Act 1977 since the present contract was entered into before that Act was passed. Accordingly, I prefer to express no view about the effect of that Act as the result of this appeal depends solely on the common law.

The facts relevant to this case are very short. Indubitably, one of Securicor's servants called Musgrove committed an injurious act or default which caused Photo Productions' factory to be burned down; and as a result, Photo Productions' suffered a loss of £615,000. This disaster occurred when Musgrove was visiting the factory on patrol one Sunday night and deliberately threw a lighted match on some cartons lying on the floor of one of the rooms he was inspecting. Whether Musgrove intended to light only a small fire or to burn down the factory, and what his motives were for what he did were found by the learned trial judge to be mysteries which it was impossible to solve.

No-one has suggested that Securicor could have foreseen or avoided by due diligence the act or default which caused the damage or that Securicor had been negligent in employing or supervising Musgrove.

The contract between the two parties provided that Securicor should supply a patrol service at Photo Productions' factory by four visits a night for seven nights a week and two visits every Saturday afternoon and four day visits every Sunday. The contract provided that for this service, Securicor should be paid £8.15 a week. There can be no doubt that but for the clause in the contract which I have recited, Securicor would have been liable for the damage which was caused by their servant, Musgrove, whilst indubitably acting in the course of his employment: ***Morris v. Martin*** [1966] 1 Q.B. 716. To my mind, however, the words of the clause are so crystal clear that they obviously relieve Securicor from what would otherwise have been their liability for the damage caused by Musgrove. Indeed the words of the clause are incapable of any other meaning. I think that any business man entering into this contract could have had no doubt as to the real meaning of this clause and would have made his insurance arrangements accordingly. The cost to Photo Productions for the benefit of the patrol service provided by Securicor was very modest and probably substantially less than the reduction of the insurance premiums which Photo Productions may have enjoyed as a result of obtaining that service.

Clauses which absolve a party to a contract from liability for breaking it are no doubt unpopular—particularly when they are unfair, which incidentally, in my view, this clause is not. It is, I think, because of the unpopularity of such clauses that a so called "*rule of law*" has been developed in the Court of Appeal to the effect that what was characterised as "a fundamental breach of contract", automatically or with the consent of the innocent party, brings the contract to an end; and that therefore the contract breaker will then immediately be barred from relying on any clause in the contract, however clearly worded, which would otherwise have safeguarded him against being liable *inter alia* in respect of the damages caused by the default; see for example ***Karsales (Harrow) Ltd. v. Wallis*** [1956] 1 W.L.R. per Denning L.J. at p.946 and ***Harbutt's "Plasticine" Ltd. v. Wayne Tank and Pump Co. Ltd.*** [1970] 1 Q.B. 447.

I entirely agree with my noble and learned friend Lord Wilberforce's analysis of the *Suisse Atlantique* case which explains why the breach does not bring the contract to an end and why the so-called "rule of law" upon which Photo Productions rely is therefore non-existent. This proposition is strongly sup- ported by the passage recited by Lord Wilberforce in Lord Porter's speech in ***Heyman v. Darwins Ltd***. [1942] A.C. 356 at p.399.

Any persons capable of making a contract are free to enter into any contract they may choose: and providing the contract is not illegal or voidable, it is binding upon them. It is not denied that the present contract was binding upon each of the parties to it. In the end, everything depends upon the true con- struction of the clause in dispute about which I have already expressed my opinion.

My Lords, I would accordingly allow the appeal.

Lord Keith of Kinkel, MY LORDS,
I agree with the speech of my noble and learned friend Lord Wilberforce, which I have had the advantage of reading in draft and to which I cannot usefully add anything.

Accordingly I too would allow the appeal.

Lord Scarman, MY LORDS,
I have had the advantage of reading in draft the speech delivered by my noble and learned friend Lord Wilberforce. I agree with it. I would, therefore, allow the appeal.

I applaud the refusal of the trial judge, MacKenna J., to allow the sophisticated refinements into which, before the enactment of the Unfair Contract Terms Act 1977, the courts were driven in order to do justice to the consumer to govern his judgment in a commercial dispute between parties well able to look after themselves. In such a situation what the parties agreed (expressly or impliedly) is what matters; and the duty of the courts is to construe their contract according to its tenor.