FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2024] CSIH 38
CA31/23

Lord President
Lord Malcolm
Lord Pentland

OPINION OF LORD CARLOWAY, THE LORD PRESIDENT

in the reclaiming motion

in the cause

FORTHWELL LIMITED

Pursuers and Respondents

against

PONTEGADEA UK LTD

Defenders and Reclaimers

Pursuers and Respondents: Borland KC, D Ford (sol adv); Brodies LLP
Defenders and Reclaimers: Dean of Faculty (Dunlop KC), G Reid; Burness Paull LLP

31 October 2024

Introduction

[1] This reclaiming motion (appeal) raises two questions. The first is: where the parties to a contract have put in place insurance for their mutual benefit, can one party sue the other for losses which are covered by that insurance? The second is: in what circumstances can a party to

a contract recover damages for a breach of that contract in respect of losses that were sustained, not by the contracting party, but by one of its subsidiaries?

Background

[2] The Rogano is one of the oldest and most celebrated restaurants in Glasgow. It traded continuously in Exchange Place from 1935 until it closed in 2020 at the height of the Covid 19 restrictions. On 9 and 14 December 2020 and 10 January 2021, it was damaged by flooding. An electrical fire broke out after the first flood. This rendered the electrics unsafe. The premises were left without heating. There was ongoing water ingress. Repairs have not been carried out. It has not been possible to reopen the restaurant in its present state.

[3] The current lease of the Rogano was originally entered into by The Exchange Proprietors Ltd and Ind Coope (Oxford & West) Ltd in 1996. On 20 August 2013, the tenant's interest was assigned to the pursuers by Lynnet Leisure (Properties) Ltd. The defenders are the landlords.

[4] The defenders, as landlords, are required (clause 13.1) to maintain insurance for the premises in their name:

> "(but … with the endorsement thereon of the respective interest of the Tenant and any permitted sub-tenant in such terms as to preclude the exercise by the insurance company of its subrogation rights against the Tenant and any such permitted sub-tenant)".

The lease requires the defenders to rebuild any part of the premises which has been destroyed or damaged by any "insured risk" (clause 13.2). This includes flooding (clause 1.1). The parties are agreed that the obligation to rebuild includes the lesser obligation to repair where the premises have been damaged rather than destroyed. The defenders hold an insurance policy for the premises. The risks insured by that policy include flooding.

[5] The pursuers contend that, since the damage was caused by an insured risk, the defenders are required to repair the property. They have asked the defenders to carry out the repairs. The defenders have not done so. The pursuers first conclude for specific implement, ordaining the defenders to carry out the repairs. They have a second conclusion wherein, if no decree for implement is granted, they seek damages. These are calculated by reference to the estimated cost of repairs. They do not claim damages in the event that the defenders fail to obtemper any decree for implement.

[6] The pursuers claim additional damages arising from the defenders' failure to maintain the restaurant in good repair, and for past and future loss of profit as a result of the restaurant's closure. However, since the date of entry, in August 2013, the Rogano has been operated by a third party, albeit a subsidiary of the pursuers, namely Lynnet Leisure (Rogano) Ltd, under a "Licence to Occupy" from the pursuers. This provides:

> "4.2.13 [The Licensee] acknowledges that the Licensor shall at no time become liable to the Licensee for (i) any loss, injury or damage which the Licensee may sustain from a deficiency in any part of the Licence Subjects except in the event of act, omission, default or negligence on the part of the Licensor or those for whom the Licensor is responsible in law or (ii) … or for damage to any property or for any losses …
> …
> 8 Licensor not liable for repairs
> The Licensee acknowledges and accepts that the Licensee cannot oblige the Licensor to carry out any repairs or other works to the Licence Subjects, and that the Licensor shall at no time become liable to the Licensee for any loss, injury or damage which the Licensee may sustain from any deficiency in any part of the Licence Subjects".

[7] The pursuers do not plead that they have suffered any loss beyond the cost of rebuilding. They aver that their subsidiary has suffered loss and will continue to do so (COND 6.6). The pursuers state that they are "bound to account" to their subsidiary for any damages which are recovered in respect of that loss. However, the conclusion does not seek payment to the subsidiary and the subsidiary has not been called as a party to the action, even

for any interest which they might have.

[8] The defenders maintain that they have not breached any of their obligations under the lease. They do not dispute that, in principle, the pursuers can seek specific implement. However, they seek dismissal of the claim for additional damages. They contend that, where a landlord and tenant have agreed to effect insurance for their mutual benefit, that insurance is the only means of recourse which the parties have in respect of insured losses. In any event, they were not obliged to pay compensation to the pursuers for losses suffered by a third party (the pursuers' subsidiary).

[9] The commercial judge rejected these arguments. He repelled the defenders' pleas to the relevancy of the damages claim generally and to the effect that the pursuers were not entitled to recover their subsidiary's losses. He allowed a proof before answer.

The commercial judge's decision

Mutual Insurance issue

[10] Whether a party to a contract could sue another party for losses, in respect of which there was insurance that inured to the benefit of them both, was a matter of contractual interpretation (*The Ocean Victory* [2017] 1 WLR 1793, at paras 114, 139 and 99). It involved the proper construction of the lease (*Mark Rowlands* v *Berni Inns* [1986] QB 211 and *Barras* v *Hamilton* 1994 SC 544). The issue did not turn on any speciality of insurance law, or on any circuity of action based on rights of subrogation, but on what the parties had intended. Where parties were jointly insured, they would almost invariably be found to have intended to exclude a claim by either of them against the other. That did not preclude other terms of the contract from being enforced.

[11] Clause 13.1 expressly provided that the defenders were to endorse the pursuers' interest

on the policy so as to preclude the exercise of subrogation rights against the pursuers and any permitted sub-tenant. That made it plain that the parties had intended that the pursuers were not to be sued in respect of an insured loss. The clause could not be construed as conferring any greater benefit than that on the pursuers, far less could it be construed as conferring any entitlement on the defenders not to be sued by the pursuers.

[12] The parties did not intend that the insurance should be a joint policy. Only the defenders were named as the insured. Even if the policy had been joint, or inured for the benefit of both parties, the defenders' argument would still have failed. It would be illogical for the pursuers to be entitled to sue for specific implement, but not for the alternative remedy of damages for loss caused by a breach of the same obligation. The circumstances in which the pursuers might seek to invite the court to award damages, instead of granting specific implement, were not entirely clear; nor was how the pursuers' losses would be quantified, if the defenders did not carry out the work, given that the pursuers did not own the premises.

Transferred Loss

[13] The general rule was that when A contracted with B, but C suffered loss as a result of B's failure to perform its obligations: (i) C would be unable to sue B, because C was not a party to the contract; and (ii) A would be unable to sue B since the loss had been suffered by another. The application of this rule could lead to an unjust outcome. The loss could fall into a legal black hole, which, in a well-regulated legal universe, should not exist (*McLaren, Murdoch and Hamilton* v *The Abercromby Motor Group* 2003 SCLR 323, at para [33]). A number of legal subterfuges had been employed to justify a departure from the rule to allow A to recover C's losses.

[14] In English law, there was a narrow exception. It had originally applied to contracts of carriage by sea (*The Albazero* [1977] AC 774, at 845). Later it had extended to building contracts whereby a party could sue for transferred loss where that loss was within the contemplation of the contracting parties at the time of the contract (*Alfred McAlpine Construction* v *Panatown* [2001] 1 AC 518, at 568, 575; *cf*. 530). The objective of the transaction must have been to benefit a third party. It must have been anticipated that the effect of a breach would cause loss to that third party (*Swynson* v *Lowick Rose* [2018] AC 313; *Nederlandse Industrie van Eiprodukten* v *Rembrandt Enterprises* [2020] QB 551, at paras 72 – 73). There were both narrow and broad grounds for applying the exception. The narrow ground applied where the property, which was the subject of the contract, had been transferred to C. The broad ground was that, although A had not suffered pecuniary damage, he had contracted with B for a benefit to be conferred on C.

[15] The general thrust of the Scottish cases was that a party could sue for loss sustained by a third party where the loss would otherwise fall into the legal black hole. This was justified as a matter of policy, rather than by resort to what the parties must have intended (*McLaren, Murdoch and Hamilton*, at para [42], following *Panatown*; *Marquess of Aberdeen and Temair* v *Turcan Connell* 2009 SCLR 336, at para [45]; *Axon Well Intervention Products Holdings* v *Craig* [2015] CSOH 4, at para [29]). The broad ground for applying the exception had no place in Scots law. The exception was most likely to arise where property, which was the subject of the contract, had been transferred to a third party, or where the contracting party intended to benefit a third party such as a family member or a company in the same corporate group. Where the third party had a remedy and a direct right of action, there was no need for the exception.

[16] The pursuers had pled a relevant case. If they recovered damages for the losses claimed, they would have to account for those to their subsidiary. It did not matter that a contract between the pursuers and the subsidiary expressly provided that the pursuers had no liability to the subsidiary for any loss which they might sustain. The obligation to account would arise from the recovery of damages itself, not from any pre-existing obligation to account.

Submissions

Defenders

Mutual Insurance

[17] Where parties to a venture had agreed that insurance would inure to the benefit of both of them, they could not claim against each other in respect of an insured loss (*The Ocean Victory* at paras 114, 139, and 99; *Barras* v *Hamilton* 1994 SC 544 at 551 – 553). That principle was not restricted to joint insurance. It was a question of construction of the contract. The parties had agreed that the insurance would inure for the benefit of both of them. In holding that they had not, the commercial judge had erred. He had not considered the entire scheme of the lease. Under that scheme, the defenders were obliged to take out insurance covering the pursuers' interest, and to endorse that interest (clause 13). The pursuers were obliged to pay for the insurance (clause 4.2). A stipulation to insure property, with no requirement to endorse the tenant's interest, was still an agreement to take out insurance for the parties' mutual benefit (*Berni Inns*). An oral agreement to insure property could be an agreement to take out insurance to inure for the benefit of both parties (*Barras* v *Hamilton*). The present case was *a fortiori* of those situations.

[18] The judge erred in concluding that, by agreeing to exclude subrogation rights in respect of the pursuers, the parties were agreeing that the defenders could not sue the pursuers under

the lease, but the pursuers could sue the defenders. That would be a very odd reading of a bilateral contract. It did not accord with *The Ocean Victory*. The agreed scheme was one in which parties were to look to the insurance fund rather than to each other (*The Ocean Victory*, at para 143). There was no other purpose for endorsing the pursuer's interest. The parties had only excluded subrogation against the tenant, and not the landlord, because there was no need to exclude subrogation against the defenders, as the insured party. Since the insurers stood in the shoes of the insured, if they sued the landlords they would be suing themselves. That would be a nonsense (*Palliser* v *Fate* [2019] Lloyds LR 341, at para 22). This was consistent with similar arrangements between a landlord and tenant which precluded claims between them (*Berni Inns*, at 225 and 232 – 233).

Transferred Loss

[19] The action proceeded only on the basis of contract. The general rule was that, in a breach of contract case, a person could only recover losses which he himself has sustained (*The Albazero* at 846). The defenders relied on the principle of privity in contract, whereas the pursuers founded upon the solution to the black hole problem. The origin of the transferred loss exception was a Scottish decision (*Dunlop* v *Lambert* (1839) Macl & Rob 663 as explained in *The Albazero* at 846 *et seq*). Losses suffered by a third party could only be recovered on one of two grounds.

[20] First, they could be recovered on the narrow ground (the *Albazero* exception), where the loss was in respect of property, and the parties intended to transfer title to that property to a third party (*Swynson,* at para 14). Examples included *Panatown* and *McLaren Murdoch & Hamilton*. This ground did not apply to the present case. There was no mutual or known intention to transfer any property to the subsidiary. Secondly, there was a broader ground,

which was only available where a pursuer showed that, at the time of contracting, there was a common intention or known objective in the lease to benefit the third party (*Swynson*, at paras 14 and 17; *Nederlandse Industrie*, at paras 72 – 73).

[21] The commercial judge erred in holding that Scots law differed to the law in England in that the broader ground had no application in Scots law. He had relied upon *McLaren Murdoch & Hamilton*, which in turn had relied upon Lord Clyde in *Panatown*. Lord Clyde could not, in an English appeal, set Scots law on a different course. In *Panatown*, neither Lord Clyde, nor Lord Jauncey, said that Scots law differed from that in England. Scottish authority subsequent to *McLaren Murdoch & Hamilton* had followed English law. It had referred to the need to show an imputed intention of the contracting parties (*Axon Well Intervention Products Holdings*, at para [42]). The pursuers did not suggest that their claim fell within the broader ground. Even if it did, the pursuers' claim failed because of the broader ground requirement to show intention to confer a benefit on a third party.

[22] On the commercial judge's approach, the exception would become the rule. Such a rule would drive a coach and four through freedom of contract. A party could recover losses sustained by anyone, subject only to questions of remoteness. The authorities emphasised that the exception was limited and closely defined. Parties were at liberty to choose with whom they contracted. The need for collateral warranties in construction contracts had arisen as a result of the restriction on the rights of third parties to make delictual claims for economic loss (*Murphy* v *Brentwood District Council* [1991] 1 AC 398). If the judge were correct, the development of the law in *Donoghue* v *Stevenson* 1932 SC (HL) 31 had been entirely unnecessary. *Winterbottom* v *Wright* (1842) ER 402 demonstrated why the law of contract did not have the result suggested by the judge.

[23] There was a difference between losses which fell into a legal black hole, and losses which were irrecoverable under a contract. There was nothing unjust in this. Parties who enter into contracts could be expected to look out for their own interests. A party who entered into an unauthorised licence of premises did so at his own risk. There could be no legitimate complaint when the party suffered loss as a result of a breach of contract by someone with whom he had not chosen to contract. Any other result was unwarranted by authority, unprincipled and of potentially limitless application.

Pursuers

Mutual Insurance

[24] The defenders' central proposition, that neither party could sue the other in respect of insured losses where they had agreed that insurance was to inure to the benefit of both parties, had no application. The commercial judge was right to hold that it was a matter of the interpretation of the lease (*The Ocean Victory*, at para 139; *Barras* v *Hamilton*, at 546, 554 to 555 and 556). The question was: what benefit was conferred upon the pursuers, as tenants, by clause 13.1? The sole benefit was to preclude pursuit of the pursuers by the insurers. The pursuers' right was enforceable against the defenders, as the other party to the lease. The parties had applied their minds at the time of the lease to the extent to which clause 13.1 would confer a benefit on the pursuers. There was nothing preventing the pursuers from suing the defenders for damages for a breach of the repairing obligation in clause 13.2.

[25] The wording of clause 13 provided no support for there being a bar on the pursuers' claim. The defenders' argument proceeded on the basis that it was agreed that some form of joint insurance would be taken out. That was not what was agreed. The policy was to be taken out in the name of the defenders. Only they were named in the policy. The insurance did not

inure for the benefit of the pursuers. Consequently, the pursuers had no rights against the insurer. They could not claim indemnification from the insurers. That being so, the pursuers were entitled to sue the defenders under clause 13.2. They were entitled to compel the defenders to reinstate the property. If they failed to do so, the pursuers could carry out the works. Specific implement was a discretionary remedy which the court might not grant.

Transferred Loss

[26] The concept of transferred loss was pithily described in *White* v *Jones* [1995] 2 AC 207 (at 266-267). It could be applied to cases by analogy. Its application did not involve an intention to benefit the third party. The pursuers' subsidiary was not a party to the lease. It could not sue the defenders directly in respect of its losses. The pursuers therefore sued on its behalf. The pursuers acknowledged that they had an obligation to account to the subsidiary for any damages recovered. Such a claim was permissible in Scots law (*McLaren Murdoch and Hamilton*, at paras [33] to [43]; *Marquess of Aberdeen and Temair*, at paras [45] and [46]; and *Axon Well Intervention Products Holdings,* at para [29]). The defenders argued that *Swynson* should be applied. If that were correct, these Scots cases were wrong.

[27] Scots law had long recognised an exception to the general rule that damages could not be recovered for losses caused to a third party. A subrogated claim, by an insured on behalf of an insurer who had paid out, was one exception. Another was that, in an undisclosed agency situation, even where the principal's existence was eventually disclosed, the agent was entitled to enforce the principal's claim (*AF Craig & Co* v *AF & JC Blackater* 1923 SC 472). Another arose in terms of *Panatown* (at 535) where a loss caused by a breach of contract would go uncompensated through an absence of privity. The solution was that the innocent contracting party would be deemed to be claiming on behalf of itself and any associated third party which

had suffered loss. The innocent party would require to account to the third party for any damages recovered.

[28] This approach had been followed in Scots law (*McLaren Murdoch & Hamilton*, at paras 38 – 43). The solution was imposed by law (*Panatown*, at 530; *McLaren Murdoch & Hamilton*, at para [42]; and *Marquess of Aberdeen and Temair*, at para [45]). It was a legitimate and justifiable response to the black hole problem. The exception had been delineated in the modern Scottish cases. It had not proved problematic in practice. There was no dissonance between the Scottish cases and *Swynson*. *Swynson* did not purport to decide definitively the position regarding transferred loss (at paras 17 and 106). Ultimately, it was a matter of legal policy. The court should do justice by permitting recovery of those losses by the party holding the remedy against the contract-breaker. It could do so on the basis of the principled approach identified in *Panatown*, and as developed and applied in the three modern Scottish cases. The concept was tightly circumscribed and applied only in familial or company group situations. Two elements were present: the closeness of the pursuers to the third party and the policy not to allow losses to fall into a black hole. Remoteness and reasonableness of damages would still apply. Nothing turned on the terms of the licence.

Decision

Mutual Insurance

[29] Where it is agreed that insurance is to inure for the benefit of both parties to a contract, they cannot claim against each other for a loss covered by that insurance (*The Ocean Victory* [2017] 1 WLR 1973, Lord Sumption at para 99; Lord Mance at para 114; Lord Toulson at para 139). The question is one of interpretation of the contract (*Barras* v *Hamilton* 1994 SC 544,

LJC (Ross) at 546 and 551); in this case a lease. The court requires to ascertain the parties' intention from the words used in the context of the lease as a whole.

[30] The defenders were obliged (cl 13.1) to insure the building. The interest of the tenant was to be endorsed on the policy, but the purpose of that endorsement was specified. It was to "preclude" the insurer from suing the pursuers, having subrogated to the defenders' rights against them. This would apply where, as in *Mark Rowlands* v *Berni Inns* [1985] 1 QB 211 and *Barras* v *Hamilton*, the damage had been caused by the tenant's negligence. The insurance was expressly to be in the sole name of the defenders. They alone could make a claim upon the fund. In that situation there is nothing in the lease to suggest that the pursuers were to be prevented from pursuing the defenders in respect of their obligation to rebuild, where damage had been caused by an insured risk (cl 13.2). The defenders' contention on mutual insurance therefore fails. The court should agree with the commercial judge's opinion on this point and adhere to his interlocutor of 13 June 2024 in that regard.

[31] The pursuers seek payment of a sum, which reflects the cost of the repairs, in the event that decree for specific implement is not granted. This is an unusual conclusion, since the pursuers are under no obligation to effect the repairs during the currency of the lease. They could not carry out the works without either the defenders' consent or a further order of the court. Their second conclusion does not accord with the relative plea-in-law (number 2), which seeks payment of damages "failing implement". Those damages are said to be the cost of repairs; but the damage is not to the pursuers' property but to the defenders'. Payment to the pursuers would not necessarily result in any repairs being carried out. The pursuers would receive a benefit, but the damage to the defenders' property would remain. Just how the pursuers intend to proceed is unclear (cf Law Reform (Miscellaneous Provisions) (Scotland) Act 1940, s 1(2); and see *infra*)).

Transferred loss

General

[32] At the heart of this issue is a simple question: what damages, if any, can the pursuers recover from the defenders as a result of the defenders' breach of the rebuilding obligation under the lease? The answer to that is equally straightforward. It is such damages as will, in monetary terms, place them, as the innocent party, as near as possible in the same position as if the obligation had not been breached (Gloag: *Contract* (2nd ed) 680 citing *Duke of Portland* v *Wood's Trs* 1926 SC 640, Lord Murray at 645). In this case, the pursuers do not seek damages as a primary remedy. Rather, they seek specific implement of the obligation.

[33] It is not disputed that, in principle, the pursers are entitled to that remedy. Although in oral submissions the pursuers raised the prospect of the court declining to grant the order sought, there are no grounds pled which would prevent the court from doing so. These grounds are well established: unenforceability; impossibility; impossibility of enforcement; and exceptional hardship. None are present here. The court should therefore proceed on the basis that implement will be granted.

[34] Two possibilities then arise. The first is that the defenders will carry out the requisite repairs. In that event what will remain to be determined are any consequential losses to the pursuers arising from the period of disrepair. The second is that the defenders do not carry out the repairs. A decree for specific implement is simply an opportunity to the defenders to carry out the works. If that is not done, the pursuers can apply to the court for authority to carry out the works at the defenders' expense (Gloag: 661). Once again, the residual question will be: what other losses flowed to the pursuers from the breach of the obligation meantime? In so far as relations between the contractual parties are concerned, there is no black hole in relation to

the repairing obligation. The pursuers will be able to authorise the repairs, under warrant of the court, and the court will grant decree against the defenders for payment of the costs of these repairs.

[35] The lease is of bar and restaurant premises (clause 5.2.2). There is a prohibition on sub-letting without consent (5.3.2; 5.3.4.1). Had the pursuers sub-let the premises, with the appropriate consent, there would, no doubt, have been a rent payable with a reciprocal condition that the premises remained fit for occupation. If the sub-lease rental were lost for a period, that would be the measure of the pursuers' additional damage. There was no sub-lease, but a licence to occupy. There was no rent or an equivalent licence fee (other than £1). There was no obligation on the pursuers to keep the premises in good repair. Had there been one, the subsidiary would have been able to claim damages from the pursuers, and the pursuers would in turn have been able to claim the equivalent from the defenders, at least if the defenders were aware of the arrangement. Not only was none of this contracted for, it was specifically agreed (Licence conditions 4.2.13 and 8) that, in the absence of negligence etc on the part of the licensor (the pursuers), the licensor would have no liability to the subsidiary for any loss due to deficiencies in the premises. That was the manner in which the parties elected to arrange their affairs. If the subsidiary's losses disappeared into a black hole, it was one of their own creation. As Lord Pentland states (at para [104]) it is reasonable to proceed on the basis that contracting parties can be expected to look after their own interests.

[36] The pursuers seek to rely on three Outer House cases which follow the *dictum* of Lord Clyde in *Alfred McAlpine Construction* v *Panatown* [2001] 1 AC 518. They argue that they are suing on behalf of the subsidiary and will be accountable to them for any sums recovered. The short answer to that is that they are not suing on behalf of the subsidiary. Had they wished to do that, they could have concluded for payment to the subsidiary. This would have required

them to call the subsidiary as a defender, at least for what interest they might have. As matters stand, any sum made payable to the pursuers would be inmixed with their funds, be expendable by them and be attachable by their creditors. There would be no immediately enforceable obligation to account, even if such an obligation existed. It would be the pursuers who would swallow the damages, leaving the black hole still in existence.

[37] The pursuers' claim for damages, based upon losses sustained by their subsidiary, must fail because, in accordance with the general rule of contract law, they have not sustained these losses. As Lord Pentland explains (at para [101]), the pursuers' approach places no meaningful limits on the extent of the exceptions. If there are exceptions to this rule in cases based on contract, either on narrow or broad grounds (see *infra*), the pursuers' claim does not meet the criteria for either exception. However, in deference to the arguments presented, the pursuers' case can be analysed in light of the authorities cited.

Foundation

[38] The foundation is Lord Clyde's *obiter dictum* in *Panatown* as adopted in three Outer House decisions. In a detailed analysis, Lord Clyde accepted (at 522 *et seq*) that the *Albazero* [1997] AC 774 was an exception to the general rule that, in a claim for breach of contract, a person could only recover damages for a loss which he has himself sustained. Lord Clyde held on the facts that the narrow ground exception, which involved the parties contemplating the transfer of property to a third party prior to any breach, did not apply because the third party had a direct remedy under a separate contract with the party in breach. Lord Clyde then continued (at 535), under reference to no authority, a principle whereby a party could sue in respect of losses suffered by a third party on behalf of that party and then be accountable to him for any damages recovered. Although the third party could not sue in contract, and could not

compel the contracting party to do so, the latter could apparently volunteer to instigate litigation on his behalf, presumably even if the third party did not wish to recover from the other contracting party.

[39] This hitherto unknown concept, at least in Scots law, was not adopted by the majority of the House of Lords in *Panatown*. Lord Goff accepted the existence of both the narrow (*Albazero*) exception, which was dependent on an anticipated transfer of property, and a broader ground which envisaged the contracting party having a performance interest which allowed him to sue directly for losses sustained by a third party for whom the performance was entitled to benefit (see also *Linden Gardens Trust* v *Lenesta Sludge Disposals* [1994] 1 AC 85, Lord Griffiths at 97). Although Lord Goff was in the minority on the ultimate outcome, Lord Jauncey (at 574) and Lord Browne-Wilkinson (at 577) agreed with him on this point.

Developments in England

[40] This court must be very careful when analysing English authorities. Its judges are not qualified to determine English law. It should certainly exercise caution before stating what it considers English law to be. It is not without moment to comment that, as is seen in the cases in England following the *Albazero* [1997] AC 774, whilst English common law often proceeds by increment, Scots law looks to find a general principle which it can apply to the facts.

[41] Much has been written about the development of English law following the loss of the barrel of whisky aboard the Ardincaple steamer *en route* from Leith to Newcastle (*Dunlop* v *Lambert* (1839) Macl & Rob 663). The subsequent misunderstanding of what was a Scottish appeal led to the enshrinement, in subsequent English cases, of an erroneous general principle that a consignor could sue the carrier for damages in respect of the loss of a cargo even when ownership of, and risk to, that cargo had transferred to the consignee; the so called *Albazero*

exception (Lord Diplock at 846-847). The jurisprudence which followed in England was rigorously analysed by Lords Clyde and Goff in *Panatown*; each reaching a different conclusion, with Lord Clyde prevailing in the 3-2 majority. By that time what had been an exception in carriage by sea had been translated into building, and subsequently to other, contracts.

[42] *Swynson* v *Lowick Rose* [2018] AC 313 may represent the current thinking of the UK Supreme Court. Lord Neuberger neatly encapsulates the exception (at para 102) as applying to the transfer of, and subsequent damage to, property. As Lord Neuberger narrates, in so far as the exception contravenes the general principle on damages in English (and Scots) law, it is an anomaly. For that reason, the exception should be applied in "defined" and limited circumstances. The performance principle may require to be revisited in English law (*ibid* at 106).

[43] More recently, in *Nederlandse Industrie* v *Rembrandt Enterprises* [2020] QB 551, Coulson LJ carried out another extensive exploration of the authorities. He concluded (at para 73), without hesitation, that:

> "… for a successful claim for transferred loss that seeks to rely on the so-called broader ground, as explained in *Linden Gardens* and *Panatown*, the claimant must show that, at the time that the underlying contract was made, there was a common intention and/or a known object to benefit the third party or a class of persons to which the third party belonged."

Developments in Scotland

[44] Whatever the current thinking south of the border may be, there is little reason for Scots law to follow it down a rabbit burrow which was formed as a result of an admittedly erroneous interpretation of *Dunlop* v *Lambert* (The *Albazero*, Lord Diplock at 843-845). The place of transferred loss in Scots law was extensively examined by the Scottish Law Commission, under Lord Pentland's chairmanship, in a discussion paper (no 163) in 2017 (*Remedies for Breach of*

Contract, chapter 9) and in its report (no 252) in 2018 (*Review of Contract Law etc.,* chapter 18). Ultimately (para 18.53 *et seq*) the SLC recognised that, in terms of the Outer House cases (*infra*), Scots law did encapsulate some form of transferred loss. The SLC recommended confining that to cases of property transfer (following the guidance of Lord Neuberger in *Swynson* v *Lowick Rose* (at paras 102 *et seq*). This has not found its way into legislation. However, a third party who has suffered losses may have a claim under the Contract (Third Party Rights) (Scotland) Act 2017 (replacing the *ius quaesitium tertio*) or, outwith contract, under quasi-delictual or unjustified enrichment principles. The present case is pled only under the law of contract.

[45] Lord Clyde's *dictum* in *Panatown* was accepted by the Lord Ordinary (Drummond Young) in *McLaren Murdoch & Hamilton* v *The Abercromby Motor Group* 2003 SCLR 323 (at 343). As was said in that case, the problem of the black hole did not arise on the facts (*ibid* at 340). Nevertheless, the Lord Ordinary went on to analyse an alternative basis for the claim; being the broader performance interest ground which had been accepted by most of the judges in *Panatown*, and which involves no obligation to account to the third party. Having rejected the application of the *ius quaesitium tertio*, the Lord Ordinary rejected the performance interest ground on the basis (at 343) that a party to a contract did not have a right to recover substantial damages merely because he was such a party (cf specific implement). The Lord Ordinary repeated the general purpose of damages; to place the other contracting party in the same position as he would have been in but for the breach.

[46] The Lord Ordinary in *McLaren Murdoch & Hamilton* went on to look at the problem of the black hole. He adopted Lord Clyde's view, restating, as a rule, that (at 344):

> "the party who is not in breach may recover substantial damages even if that loss has been sustained by another person; … however, the contracting party must sue on behalf of that other, and must accordingly account to that other for the damages recovered".

Other than its reference to Lord Clyde's *dictum*, this "rule" appears to have emerged from the ether. Not only is it not based on any principle of Scots law, it is also contrary to the general principle, to the opposite effect, on what a party may recover in damages. Other than in well-known situations, such as agency or insurance, a contracting party cannot sue for damages suffered by a third party and, even if he could, there is no hitherto known obligation to account. The Lord Ordinary in *McLaren Murdoch & Hamilton* excluded the situation in which the third party had a direct right of action against the contractual party. Here, the third party (the subsidiary) has expressly disavowed in his licence any right of recovery against the pursuers; thus potentially creating the so-called black hole. It would be baffling if the subsidiary could then sue the licensors' landlords, who were not even aware of the subsidiary's existence.

[47] The *obiter dictum* in *McLaren Murdoch & Hamilton* has been accepted in two other Outer House cases (*Marquess of Aberdeen and Temair* v *Turcan Connell* 2009 SCLR 336, Lady Smith at para [45]; and *Axon Well Intervention Products Holdings* v *Craig* [2015] CSOH 4, Lord Doherty at para [29]). In neither is there any explanation of where the transfer of loss concept comes from in Scots law beyond Lord Clyde's *dictum* in the English appeal in *Panatown*. There may require to be a deeper analysis of that in an appropriate case. Suffice it to say, for present purposes, the pursuers' case falls into neither the narrow (property transfer) or broader (interest performance/common intention to benefit) grounds.

Conclusion

[48] The court should sustain the defenders' seventh plea-in-law. To that extent, the reclaiming motion should be allowed.

FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2024] CSIH 38
CA31/23

Lord President
Lord Malcolm
Lord Pentland

OPINION OF LORD MALCOLM

in the reclaiming motion

in the cause

FORTHWELL LIMITED

Pursuers and Respondents

against

PONTEGADEA UK LTD

Defenders and Reclaimers

Pursuers and Respondents: Borland KC, D Ford (sol adv); Brodies LLP
Defenders and Reclaimers: Dean of Faculty (Dunlop KC), G Reid; Burness Paull LLP

31 October 2024

[49] The issue of principle raised in this appeal regarding transferred loss claims can be summarised as follows. Suppose A contracts with B for the provision of services by B. A does not mention that they will accrue to C's benefit, not his, and this is not obvious to B who assumes that only A's interests are involved. A similar scenario would arise if after completion of the contract but before performance, and unknown to B, circumstances changed in a way

which inserted C as the beneficiary of performance of the bargain. The contract is performed badly, or not at all. Also let us assume that specific implement is not available, or if it is open, in the meantime C has sustained consequential loss. C is a stranger to the contract and he has no direct right of his own to sue B for damages under it or on any other legal basis such as delict or a collateral warranty. The question is, can A as the disappointed contracting party sue B for damages despite the fact that the loss was sustained by C, not him; and if so, is he subject to an obligation to account to C for them?

[50] The argument against is that such a claim breaches the compensatory principle of damages in that A is recovering monies in respect of harm sustained by another. The contract in the present case is one of lease with a number of rights and obligations on each side, and no doubt at any proof relevant facts and circumstances one way or the other might emerge, but resolution of the above general point of principle should resolve whether the pursuer is at least entitled to a proof before answer on the attempt to recover damages for losses sustained by Lynnet Leisure (Rogano) Ltd, its licensee trading company.

[51] It has been said (Lord Drummond Young in *McLaren, Murdoch and Hamilton* v *The Abercromby Motor Group,* 2003 SCLR 323) that if neither A nor C have a remedy, the first because he did not sustain the harm, the latter because he is not a party to the contract, the loss caused by B's default has fallen into a "legal black hole", and in a well-regulated legal universe they should not exist (para 33). In *Alfred McAlpine Construction* v *Panatown,* [2001] 1 AC 518, an English case, at 535 Lord Clyde constructed a legal principle which he described as "a realistic and practical solution" to the problem, namely permitting A to recover for the loss sustained by C and being duly accountable therefor to C. He recognised that C would have no right to compel A to do this, however in most cases where the problem was likely to arise, namely the domestic affairs of a family or the commercial affairs of a group of companies, this would not be

a practical issue. If C had no relationship with A, for example if in the commercial field he was a remote future proprietor, a solution by way of a collateral warranty might still be required. The need for reasonableness in the quantification of damages should ease any concerns as to excessive recoveries.

[52] Earlier in his speech at 530 Lord Clyde said: "If the exception is founded primarily upon a principle of law (which was his view), and not upon the particular knowledge of the parties to the contract, then it is not easy to see why the necessity for the contemplation of the parties that there will be potential losses by third parties is essential." He also disclaimed a need for an intention to benefit a third person. Lord Drummond Young considered that Lord Clyde's speech provided helpful guidance which could be adopted in Scots law. It outlined a solution to the legal black hole problem "that is capable of almost universal application" (para 42).

The submissions of parties

Defenders

[53] Under reference to certain recent decisions south of the border, namely *Swynson Ltd* v *Lowick Rose,* [2018] AC 313, and *BV Nederlandse Industrie van Eiprodukten* v *Rembrandt Enterprises*, [2020] QB 551, the defenders accept that in certain circumstances A can recover on behalf of C, but only if and when it was within the reasonable contemplation of B that his defective performance would adversely affect C or a class of persons to which he belongs. This would apply if the contract concerned property which it was appreciated might be transferred to a third party, which does not arise here, or where both parties anticipated that a third party would benefit. There is no offer by the pursuers to establish such, therefore it follows that this part of the claim should be refused now. Were it otherwise a coach and four would be driven through the general rule that in a claim by A for a breach of contract by B, A can recover only in

respect of losses which he has sustained. The development of the law in *Donaghue* v *Stevenson,* 1932 SC (HL) 31, would have been unnecessary. There would be no further need for collateral warranties. And there would be no restraint on recovery for damages well in excess of those foreseeable at the time of the contract, for example if leased premises were converted by a third party from a take-away to a Michelin starred restaurant. (Clearly this example proceeds on the assumption that the latter establishments are considerably more profitable.)

Pursuers

[54] The pursuers observe that there are well established exceptions to the general rule, for example a subrogated claim or that by an undisclosed agent. Lord Clyde's solution to the black hole problem was adopted by Lord Drummond Young. This was approved in two subsequent Outer House decisions by Lady Smith and Lord Doherty, and again by the commercial judge in the present case ([2024] CSOH 59). It reflects appropriate legal policy and has been, failing which should be, adopted in Scots law. It does not allow recovery for all and any loss sustained by a third party, but only for that directly caused by the breach of contract with the usual rules as to remoteness of damage, etc, applying. Since Lord Drummond Young's opinion, the floodgates have not opened. If after *Swynson* and *Nederlandse Industrie* this diverges from the approach currently in vogue south of the border, Scots law can follow its own path and avoid an unjust windfall benefit for the defaulting party.

Discussion

[55] There are fundamental differences which might render separate outcomes on either side of the border less than surprising. Scots law has no doctrine of consideration, and has long recognised that third parties can have rights arising from promises in a contract between other

persons. A greater emphasis on privity of contract might explain why the perceived injustices to third parties have largely been the subject of discussion by judges in England and Wales, with the resultant fashioning of the concept of what has been dubbed transferred loss.

[56] Similarly it can be noted that south of the border damages are considered the primary remedy, whereas in Scotland they have no priority over specific implement. If however an order for specific implement forcing B to carry out his side of the bargain is unavailable or not obeyed, or if in the meantime C has sustained loss consequential on the breach, it would seem odd to deny a remedy in damages. If notwithstanding the interposition of a benefitting third party damages remained available, this would protect what is sometimes described as the "performance" or "expectation" interests of the aggrieved contracting party, for example see Thomson *"Restitutionary and Performance Damages"* 2001 SLT (News) 71. If it is objected that this is contrary to damages being compensatory, an obligation to account would direct the monies to the person suffering the harm and provide no more and no less than substitutionary redress. In any event, damages are described as compensatory not generally by reference to the person entitled to receive them, but to differentiate from other possibilities such as penal awards or the disgorgement of profits accruing to the defaulter from the breach. In *Panatown* much of Lord Goff's speech encouraged active recognition of the innocent party's interest in the performance of the contract, an interest which has always enjoyed prominence in our law.

[57] The cases in England and Wales have developed third party rights incrementally and have been marked by numerous expressions of dissatisfaction with the general rule, see for example *Beswick* v *Beswick,* [1968] AC 58 at 72; *Woodar Investment Development Ltd* v *Wimpey Construction UK Ltd,* [1980] 1 WLR 277 at 291D, 297-298, 300-301; and *Darlington Borough Council* v *Wiltshier Northern Ltd,* [1995] 1 WLR 68 at 76, where Steyn LJ (as he then was) said that there was no doctrinal, logical or policy reason for it, and that while barely tolerable in Victorian

England, it had been recognised for half a century that the privity rule "has no place in our more complex commercial world." However more recently in *Swynson* Lord Sumption said that transferred loss is an exception, not an alternative to a fundamental principle of the law of obligations (para 16). Lord Neuberger described it as anomalous and should "only apply in defined and limited circumstances" (para 102). Perhaps it was Lord Clyde's background in Scots law which enabled him to describe a solution which was required "where the law will not tolerate a loss caused by a breach of contract to go uncompensated through an absence of privity between the party suffering the loss and the party causing it" (*Panatown* at 535F).

[58] The number of recognised exceptions to the general rule whereby substantial damages can be recovered by the contracting party for loss caused to a third party raises questions as to how much force it should have. In the hypothesis mentioned at the outset, if A was an undisclosed agent for C there would be no difficulty. Similarly if B had defaulted on a contract to ship goods when the risk and property had passed from A to C and the latter was without means of redress. This is *The Albazero* exception ([1977] AC 774) which allowed a party to sue in his own name to recover a loss he had not suffered, he being accountable for any monies obtained to the person who sustained the loss. While this particular exception can be justified by the foreseeability of the property involved being transferred after the contract was made, it is equally possible to see it as designed to prevent a claim from falling into a black hole. Indeed at 847 Lord Diplock recognised that there could be other cases where a "rational legal system" would require the person causing loss to compensate the person harmed. It is not obvious why the law should tolerate a black hole simply because the involvement of C was not within the contemplation of both A and B when the bargain was made.

[59] There are two parts to the general rule. The first is that a contract between A and B cannot impose liabilities on C. This makes good sense and has caused no difficulties. As a

generality the second element, namely that the contract affords no rights to C, also makes sense. Absent a clear intention to the contrary, only the parties to a contract should have title to enforce its terms. In the scenario mentioned at the outset, if B defaults and A sits on his hands, C cannot sue on the bargain. But if A is keen to hold B to account on behalf of C who has no direct means of redress, why should this be refused if otherwise it means that B has breached the contract with impunity? Lord Clyde's "realistic and practical solution" recognises A's entitlement to performance of B's promise to him, and avoids a windfall benefit to an undeserving B. There is no breach of the compensatory principle if, as in *The Albazero*, the appropriate level of damages are directed through A to the party directly harmed by B's default.

Panatown

[60] *St Martins Property Corp Ltd* v *Sir Robert McAlpine & Sons*, [1994] 1 AC 85, extended *The Albazero* exception beyond contracts for the carriage of goods. In *White v Jones*, 1995 2 AC 207, at 267 Lord Goff described it as a noteworthy decision which reflected a need for the court to make a remedy available as a matter of law in a case where it was clear that there was no common intention to benefit the third party. Lord Mustill recognised the decisions in *The Alabazero* and *St Martins* as addressing situations "where there was a single loss which might have been suffered indifferently by the obligee or by someone else, and which the courts were content to attribute to the obligee" (282). The *Darlington BC* decision provided an exception to the general rule where there was no transfer of property.

[61] *Panatown* was decided on the basis that it was not a black hole case because a separate deed of duty of care had been granted to the third party. However it seems plain that absent that document, all of their Lordships would have refused the contractor's appeal and, despite it

having suffered no loss, would have affirmed the employer's right to recover substantial damages. Lord Clyde examined the earlier cases and identified that they discussed three possible routes to recovery. The first, sometimes called "the narrow ground", is that developed from *The Albazero* and proceeds on the basis that the parties have contracted for the benefit of a third party (532C-D). This approach was described as "contract-based" by Evans LJ in *Panatown* in the Court of Appeal. Secondly, a broader ground involved A suing for his own loss and with no obligation to account to C. It had to be shown that the cost of putting matters right had fallen or would fall on A (533C). Thus it involved no conflict with the privity of contract/compensatory principle; in truth it is not an exception to the general rule. However it was noted that Lord Griffiths' speech in *St Martins* also contained the idea that it would be enough simply to show that the bargain had not been performed. Lord Clyde described this as "a more radical formulation" of the broader ground whereby it would not matter whether A was or was not going to carry out repairs. The breach of the contract would in itself constitute a recoverable loss by A.

[62] Having articulated the more radical formulation of the broader ground, Lord Clyde explained the difficulties with it, including its failure to compensate the party who sustained the adverse consequences caused by the defective performance. Furthermore, it may not be able to embrace consequential losses. In his Lordship's view a breach of contract may cause a loss but is not itself a loss in any meaningful sense (534D). Lord Browne-Wilkinson considered it a nonsense for the party sustaining real tangible damage to recover nothing with an award made to someone who suffered no loss.

[63] Lord Clyde noted that no one had suggested a solution on the lines of a *jus quaesitum tertio* (the third party has acquired a right), and in any event it would probably require legislation. However, the gap created by its absence could be filled by his "realistic and

practical solution" (described above at paras 51/52) which would be achieved by operation of law. "If the entitlement to sue is not to be permitted to the party who has suffered the loss, the law has to treat the person who is entitled to sue as doing so on behalf of the third party." It was acknowledged that this may carry with it some element of artificiality and "may not be supportable on any clear or single principle" (535D). The issue arising for decision by this court is whether in our law Lord Clyde's solution should be rejected in favour of restricting transferred loss claims to a narrow ground based on a need for the harm to the third party to be within the reasonable contemplation of the parties when the contract was made.

[64] In *Panatown* Lord Goff considered that it is commonplace for contracts to be made for the benefit of third parties, often in the context of the family, and that it would be "an extraordinary defect in our law" if there was no remedy for defective performance (538H). He was not surprised that the authority for the supposed rule excluding a right to damages was thin, and he noted that its very existence had been doubted by distinguished writers, including Professor Treitel and Duncan Wallace QC. In *St Martins* Lord Griffiths was not concerned with a problem of privity of contract but with the effective remedy of the party who has made a bargain for the benefit of another (545D). For Lord Goff the issue concerned not privity of contract, but the supposed rule that A could recover only for his own loss. "In truth, what we are concerned with here is the effectiveness of the rights conferred on Panatown under the building contract" (545H). The task was "to reach a solution which is in accordance with principle and also does practical justice as between the parties, without leaving too great a legacy of problems for the future" (546B).

[65] Lord Goff's starting point was the protection of A's interest in the performance by B of his contractual obligations. He asked, why should the fact that the loss has fallen on C prevent the recovery of damages for B's failure to fulfil his side of the bargain and for which B will have

received consideration? It is clear from his discussion of the issue that Lord Goff was adopting Lord Griffiths' "more radical formulation" of the broader ground, driven it would seem by a desire to enforce A's performance or expectation interest in B's compliance with the contract. It was this which (subject to a reasonableness qualification, see 556B-F) enabled him to sanction substantial damages for the employer notwithstanding that the third party had its own right to sue the contractor under the duty of care deed. This would include damages for delay in the completion of the development. There was no good reason why that must fall on the owner of the site (554E -555C). For Lord Goff, the broader ground as so understood was an alternative route to the same conclusion as that reached by the Court of Appeal on the narrow ground; it was the "underlying principle " on which earlier decisions were based (557G-H). Towards the end of his speech Lord Goff departed from the most extreme expression of the broader ground when stating that there could be no double recovery in that Panatown would be obliged to use any recoveries for the completion of the development (559 G- 561A). Thus although Lord Goff does not refer to it, the practical difference between his approach and Lord Clyde's solution to the problem is hard to detect.

[66] Lord Goff insisted that his discussion was in accordance with existing principle, but in any event, and faced with a submission that the matter should be left to the legislature, he observed that "it is surely within the scope of the type of development of the common law which, especially in the law of obligations, is habitually undertaken by appellate judges as part of their ordinary judicial function" (553C-D). It was noted that the Law Commission itself recognised that legislation within a developing part of the common law can lead to ossification and a rigid segregation of legal principle which disfigures the law and impedes future development of legal principle on a coherent basis.

[67] With regard to the differing approaches of Lord Clyde and Lord Goff, the author of *Treitel's Law of Contract*, 15th ed. offers the view that a need to avoid a black hole should generate the remedy, para 14-038. He cites Rix LJ in *Offer-Hoare* v *Larkstore Ltd,* [2006] 1 WLR 2926 at para 85: "where a real loss has been caused by a real breach of contract, then there should if at all possible be a real remedy which directs recovery from the defendant towards the party which has suffered the loss." This seems a reasonable objective for our law which, as a matter of general principle, favours the provision of redress for a wrongful act such as a breach of contract. It was the dynamic driving Lord Clyde's solution and the enthusiastic reception afforded to it by Lord Drummond Young. The defenders' principal objection rests on more recent decisions south of the border, so it is necessary to turn to them.

Swynson* v *Lowick Rose

[68] The first is *Swynson.* It was an unusual case on its facts. A lending company made three loans to a borrower relying on a due diligence report prepared by a firm of accountants. The borrower having failed to repay the loans, the accountants were sued for negligence for not having reported a substantial adverse difference between the borrower's forecast and actual working capital. Before the judge could assess damages, two of the loans were repaid using monies lent to the borrower as part of a refinancing by H, the owner and controller of the claimant lending company. H did this because he wanted the loans off the company's books.

[69] The UK Supreme Court held that the repayments should not be ignored as *res inter alios acta* and were not collateral benefits. It was irrelevant that H had provided the means to repay the loans. The loss arising from the first two loans had been made good when they were repaid to the claimant. There was no unjust enrichment of the accountants. Furthermore, H's loss

could not be transferred to the claimant thereby allowing it to recover damages from the accountants.

[70] On this last matter Lord Sumption distinguished between (a) transferred loss and (b) what had become known as the broader ground whereby the claimant seeks recovery of his own loss. The former had been recognised only in cases where the third party suffers loss as the intended transferee of the property affected by the breach. It was a limited exception to the general rule that a claimant can recover no more than his own loss. It applies only where the known object of the transaction is to benefit a third party and the anticipated effect of a breach will be to cause loss to that person. The broader ground was not limited to cases of transferred property. However both were an exception to a fundamental principle driven by legal necessity to give effect to the object of the transaction and avoid a "legal black hole". Thus the general rule will apply if the third party has his own right of action.

[71] In the circumstances of the case only the broader principle could be relevant. Lord Sumption considered that there was much to be said for it. (It is unclear whether this covered both formulations of the broader ground.) However, since it was no part of the transaction between the lenders and the accountants to benefit H, it was plain that neither ground could apply. H's loss was caused by the refinancing arrangement with the borrower and had nothing to do with the accountants. Lords Neuberger, Clarke and Hodge agreed with Lord Sumption, though Lord Neuberger gave a short judgment of his own with which Lord Clarke agreed.

[72] Lord Mance noted a recognised exception to the general rule when at the time of the contract the parties contemplated that the property which was the subject of the contract and the breach would be transferred to or occupied by a third party. The claimant could then sue on the third party's behalf and account to him accordingly. Another broader principle had been suggested by Lord Griffiths in *St Martins* whereby the contracting party's interest in

performance of the bargain enabled a claim in damages without proof of actual loss. (This is a reference to the "more radical formulation" of the broader ground.) In his Lordship's view this theory faced a *prima facie* difficulty in embracing any consequential losses sustained by the third party, and it was not clear whether and on what basis the recovering party would be under a liability to account to him. However, in the circumstances of the case neither ground assisted the claimant. As to the narrow principle, the claimant lending company did not contract with the accountants on behalf of or for the benefit of H. And the broad principle could not apply when the claimant's performance interest had been met when the loans were repaid.

[73] The issue was also considered by Lord Neuberger. For him transferred loss applied if a contract concerned property subsequently acquired by a third party. That A could recover for loss suffered by C was self- evidently an anomalous principle and so should apply only in defined and limited circumstances. The law had moved to the point that in order to avoid a black hole transferred loss can apply if (a) at the time of the contract with A, B would reasonably have anticipated that A would transfer the property concerned to a person such as C who would suffer loss if B breached the contract so that the contract can be seen as having been entered into by B partly for C's benefit, and (b) there is nothing in the contract or surrounding circumstances which negatives the conclusion that the principle should apply. *Panatown* had decided that one such circumstance was if C enjoyed direct contractual rights against B.

[74] For Lord Neuberger it was unnecessary to discuss the validity of another version of the principle, first articulated by Lord Griffiths, namely that B could be liable to A if, despite transferring away the property, A retained an interest in B performing his obligations. Given that the loans had been repaid, the lending company could not sensibly still have an interest in the performance of the accountants' duties.

[75] Lord Neuberger identified two defects in the transferred loss argument in the appeal. First, this was not a case involving property coming into the hands of H. Rather he sustained loss because of the new loan made by him, whereas the lending company would have suffered a loss in relation to the original loans. Secondly, the principle could not apply because when the accountants were tendering their advice it was not reasonably foreseeable that the loan would be repaid through the medium of a fresh loan made to the borrower by a third party. It was not anticipated that there would be a refinancing arrangement. It followed that H could not be regarded as an intended beneficiary of the original lender's rights against the accountants.

[76] Perhaps *Swynson* was not the best vehicle for an examination of the issue at hand. The particular facts made transferred loss a non-starter whichever approach was adopted. Two of the loans were repaid thus in respect of them the accountants' alleged negligence did not cause loss to anyone. The third party's loss flowed from an entirely separate contract between himself and the borrower. There was no question of a claim against the accountants disappearing into a black hole. This might explain the absence of any consideration of Lord Clyde's approach and its adoption in Scotland. That said, the justices who spoke on the topic stressed the importance of the general rule and described a restricted approach confining the narrow ground, and per Lords Neuberger and Sumption also the broader ground, to contracts intended to benefit a third party. All three confined the narrow ground to cases of transferred property.

Nederlandse Industrie

[77] *Nederlandse Industrie* was also an unusual case on its facts. It concerned a contract whereby A agreed to supply a large amount of egg product to B for set prices per kilo. After shipments began, A arranged for some of the product to be supplied by C, another company in the same corporate group. When B refused to accept and pay for the product C had no cause of

action against B. A claimed for the entire loss of profits. It was held that A could not recover the profits lost by its sister company.

[78] Longmore and Peter Jackson LJJ agreed with Coulson LJ's judgment on this aspect of the case. He noted that to all intents and purposes C was a subcontractor to A and had no basis for suing B for its loss. A late amendment whereby A sought to rely on a settlement it had reached with C had been refused, but a part of it based on a claim of transferred loss was allowed to proceed. However it was rejected by the trial judge since, as per Lord Sumption in *Swynson*, B was unaware of any intention to benefit C.

[79] Coulson LJ reviewed various passages from the judgments in *St Martins*, *Panatown* and *Swynson*, and made reference to other decisions, including *And So To Bed Ltd* v *Dixon*, [2001] FSR 47 (Ch D). It was accepted by counsel for A that the narrow ground had no application and that the claim depended on the broader ground. (Again there appears to have been no reliance on Lord Clyde's "realistic and practical solution" to the avoidance of a black hole.) Three sub-issues were identified: (a) is the broader ground subject to a known third party benefit test? (b) does the broader ground apply to contracts for the sale of goods? and (c) since C could recover from A, was it a "black hole" case at all?

[80] Coulson LJ considered that the broader ground was still good law. After reference to passages in the speeches of Lord Griffiths in *St Martins*; Lord Browne-Wilkinson and Lord Goff in *Panatown*; and Lord Sumption and Lord Neuberger in *Swynson*, his Lordship concluded that for the broader ground to apply "the claimant must show that at the time the underlying contract was made, there was a common intention and/or a known object to benefit the third party or a class of persons to which the third party belonged" (para 73). However when the agreement regarding the supply of egg product was made B was not even aware of C's existence, thus the claim must fail. (It was common ground in the present appeal that if the

pursuers require to demonstrate a known intention to benefit its trading company, the transferred loss claim must fail.)

[81] Coulson LJ considered that if the plea were successful it would turn transferred loss from a narrow exception to the rule that a party can recover only for his own loss "into a commonplace route for recovery", and something which would go far beyond even what Lord Griffiths had in mind (para 75). It mattered not that A and C were sister companies with a common owner. They traded with each other on commercial terms and could not rely on their separate personalities when it suited them and break down the barriers when they created difficulties.

[82] As to the other sub-issues, Coulson LJ suggested that it would be difficult to treat different types of contracts in a different way. Also loss of profit is a recognised head of loss in claims under or for breach of commercial contracts so "it may again be difficult to exclude the principle of transferred loss merely because of the nature of the damages claimed" (para 78). He had sympathy with the submission that since C could look to A for redress, this was not a black hole case. It might be said that since A was not successful in recovering from B the monies paid out to C, this was such a case, but it was not necessary to decide the point (para 79).

[83] It is of interest that at the end of his judgment Coulson LJ articulates Lord Griffiths' less radical formulation of the broader ground; one which does not require an exception to any general rule since A would be suing for its own loss. Other than perhaps that the late amendment raising the point was refused, it is not explained why A could not recover in respect of its payments to C.

Discussion continued

[84] It was and remains possible to explain the exception set down in *The Albazero* by reference to a common intention to benefit a third party. It is more difficult to do so in non-transfer cases such as *Darlington*. And as noted earlier, Lord Goff described *St Martins* as a case where there was no such common intention (*White v Jones* at 267). Prior to the decisions in *Swynson* and *Nederlandse Industrie* there seemed to be broad approval of Lord Griffiths' wide approach based on the innocent contracting party's interest in the performance of the bargain, albeit there was controversy as to whether there would be an obligation to account, and on whether recovery was excluded if the third party had a direct claim. It seems odd that now that legislation in England and Wales (The Contracts (Rights of Third Parties) Act 1999) has allowed third parties to have rights in contracts intended to benefit them, the courts are limiting black hole avoidance claims to such arrangements, albeit no doubt there might be occasions when the terms of the statute are not met. The added restriction of both the narrow and broader grounds to cases of transferred property is a further significant retrenchment on the scope of exceptions to the general rule recognised in earlier decisions.

[85] A study of the judgments in *Swynson* suggests that this has been caused by a renewed emphasis on a claimant being able to sue only for loss caused to him by a breach of contract, described by Lord Sumption in *Swynson* as "a fundamental principle of the law of obligations" in England and Wales. As to north of the border, it would be hard to say that Scots law has set its face against third party rights. It is true that our own legislation on the topic has now replaced the *jus quaesitum tertio*. But it would be curious if Scots law accepted transferred loss claims only on proof that the parties wanted to confer a benefit on a third party, the very circumstance when they are unlikely to be needed. And if the underlying concern is to prevent

an outcome whereby a defaulter can breach a contract with impunity, what is the rationale in allowing this to happen simply because the case does not involve a transfer of property?

[86] To put some flesh on the bones of the hypothesis mentioned at the outset of this opinion, suppose I ask a contractor to do work on an empty cottage. I am paying for it. He does the work badly. Why should the fact that, unknown to the contractor, the cottage belongs to someone else prevent me from recovering damages for harm directly caused by his breach of the contract, for example the cost of putting matters right, if otherwise he escapes liability? Or suppose after instructing the work I sell the property to someone. Why should the outcome depend on whether the contractor was made aware of an intention to do this at the time of the bargain?

[87] There is a subsidiary issue as to whether if I recover damages I must account to the owner of the cottage? If, as Lords Clyde and Drummond Young said, the answer to that is yes and the monies go to the party sustaining the loss, what harm is done to the principle that damages are compensatory? The compensatory principle is usually mentioned for the purpose of ruling out damages assessed on some other basis. And if I take it upon myself to finance the necessary work, surely I would be entitled to make a claim – but why should that make a difference?

[88] Transferred loss claims as discussed by Lord Clyde in *Panatown* at 530 and 535/6 and by Lord Drummond Young in *McLaren, Murdoch* at para 42 respect the primary measure of damages, namely that "a party who breaks his contract is liable for those consequences which a reasonable man, possessing the knowledge which the party had at the time of contracting, would have anticipated" (Gloag 697); here that the restaurant business would lose trade if the premises were not repaired. The general rule that there is no liability for indirect adverse effects on third parties is not affected. In transferred loss claims the harm to the third party is not consequential on, or parallel with, loss suffered by the contracting party; the breach of contract

is its direct and proximate cause. The usual limitations on recovery such as causation; remoteness; reasonableness; failure to minimise loss and contributory negligence apply in the normal manner. If such a claim imposed an uncovenated burden on the defaulter that would be a reason for refusing or reducing recovery. The argument that the floodgates would open is not compelling.

[89] I respectfully agree with Coulson LJ that loss of profit claims are in no separate category and that it would be difficult to discriminate depending on the type of contract involved. The majority view in *Panatown* that a direct claim available to the third party rules out a transferred loss claim seems sound; the remedy depends on avoiding a black hole. As to accountability, this was recognised and applied in *The Albazero.* I see no problem in principle in the court framing an appropriate order whereby there is an enforceable obligation upon the pursuers to pass on monies recovered to Lynnet.

[90] I agree with the commercial judge that the licence agreement between the pursuer and Lynnet is not relevant to the issue at hand (para 39 of his opinion). The claim is based on the landlord's breach of contract, and there is nothing in the licence which excludes the pursuer from recovering damages for that on the licensee's behalf. In any event, I do not understand your Lordships' views to be that but for the terms of the licence the claim would be available. If the licence does present a difficulty for the pursuer, it is a matter specific to this case, and might appropriately be explored along with all other relevant circumstances at a proof before answer.

[91] In short, I am in agreement with the commercial judge (para 35) that in *McLaren, Murdoch* Lord Drummond Young "offered a reasoned Scots law solution to the problem, recognising, as had Lord Clyde, that the right of the contracting party to sue was conferred as a matter of general legal policy to ensure that if a loss results from a breach of contract it can be

recovered from the party responsible for the breach." I am similarly unpersuaded that our law should now be aligned with what was said in *Swynson* and *Nederlandse Industrie.*

[92] While I differ from your Lordships on the transferred loss claim, as to the insurance issue I am in full agreement with the views expressed by your Lordship in the chair.

FIRST DIVISION, INNER HOUSE, COURT OF SESSION

[2024] CSIH 38
CA31/23

Lord President
Lord Malcolm
Lord Pentland

OPINION OF LORD PENTLAND

in the reclaiming motion

in the cause

FORTHWELL LIMITED

Pursuers and Respondents

against

PONTEGADEA UK LTD

Defenders and Reclaimers

Pursuers and Respondents: Borland KC, D Ford (sol adv); Brodies LLP
Defenders and Reclaimers: Dean of Faculty (Dunlop KC), G Reid; Burness Paull LLP

31 October 2024

[93] I have had the advantage of reading the Lord President's opinion in draft. I am in full agreement with it for the reasons he has cogently set out and would dispose of the reclaiming motion in the manner he proposes. I add some observations of my own on the topic of transferred loss.

[94] The question before the court on the transferred loss issue is whether a factual inquiry should be allowed into the pursuers' attempt to recover losses suffered by a third party arising from the defenders' alleged breach of contract. In my opinion, the pursuers are not entitled to such an inquiry. Their pleadings do not, as it seems to me, instruct a sound legal basis for this aspect of their claim.

[95] There are a number of well-recognised exceptions to the general principle of Scots law that a person cannot recover substantial damages for breach of contract where he himself has suffered no loss by reason of the breach, for example in the case of a subrogated claim by an insurer who has paid out to its insured under a policy of insurance. Another exception may be found in the particular circumstances which arose in a case cited by the pursuers: the general principle is subject to relaxation in circumstances where an agent has been sued and elects to bring a counterclaim in a representative capacity on behalf of its principal, whose existence is not initially disclosed. That is the *ratio* of *Craig & Co* v *Blackater* 1923 SC 472 (see Lord Justice Clerk (Alness), 481-482, Lord Ormidale, 485-486 and Lord Hunter, 489).

[96] The pursuers accepted that in Scots law contractual damages cannot "generally speaking" be recovered in respect of a loss which falls on a third party (note of argument para 25). In this the pursuers were correct. It is undoubtedly a basic and clear principle of our law of contract that a person cannot recover substantial damages for breach of contract where he himself has suffered no loss by reason of the breach. Lord Drummond Young acknowledged this to be the case in *McLaren Murdoch & Hamilton v The Abercromby Motor Group Ltd* 2003 SCLR 323, at para [35]. The transferred loss exception is not, as Lord Sumption observed in *Swynson Ltd* v *Lowick Rose llp* [2018] AC 313 at para 16, an alternative to the fundamental principle of the law of obligations that a claimant is entitled to recover only the loss which he has himself suffered. The essential feature of the transferred loss exception is that the contracting party's

right to recover the third party's loss is necessary to give effect to the object of the transaction and to avoid the loss disappearing into a "legal black hole" (Lord Sumption *ibid*). The transferred loss exception therefore applies so as to allow contractual damages to be recovered on behalf of a third party where the contract envisaged that title to property in respect of which the loss arose would be transferred to the third party; in such circumstances it can be foreseen that a breach of the contract would cause loss to the third party rather than to the innocent promisee (*McAlpine Construction* v *Panatown Ltd* [2011] 1 AC 518, Lord Clyde at 530F-G). Lord Diplock was to the same effect in *The Albazero* [1977] AC at 847D-G where he referred to the rule applying in the case of a commercial contract where it was in the contemplation of the parties that the proprietary interest in the goods may be transferred from one owner to another after the contract has been entered into and before it has been breached. In such circumstances, as Lord Diplock explained, an original party to the contract, if such be the intention of both contracting parties, is to be treated in law as having entered into the contract for the benefit of all persons who have or may acquire an interest in the goods before they are lost or damaged, and is entitled to recover by way of damages for breach of contract the actual loss sustained by those for whose benefit the contract was made.

[97] It is not difficult in the type of case described by Lord Diplock to regard the award of damages for loss sustained by the third party as necessary in order to satisfy the objective of the contract. Foresight will not always be necessary, however. Losses may also be recovered, under what has sometimes been referred to as the broader ground (or some version of it), where a party enters into a contract which is intended to be for the benefit of a third party and as a result of a breach of that contract the third party does not receive the benefit in question. In such cases the known third party benefit is an essential component in engaging the principle; in order to succeed the claimant must show that at the time of the underlying contract there was a

common intention and/or a known object to benefit the third party or a class of persons to which the third party belonged (*BV Nederlandse Industrie van Eiprodukten* v *Rembrandt Enterprises Inc* [2020] QB 551, Coulson LJ at para 72).

[98] For my part, I do not read Lord Drummond Young in *McLaren Murdoch* as having expressed the view that Scots law differs from the law applying in England and Wales in regard to the circumstances in which transferred loss is recoverable. He said that Scots law should adopt the same general rule as applied by the majority in the House of Lords in *Panatown*. He referred (para [33]) to recovery being permitted typically in two categories of case: where one family member has concluded a contract on behalf of himself or herself and other members of the family, and where a contract has been concluded by a company forming part of a group and the subject-matter of the contract belongs to or has been transferred to another member of the group. His Lordship was careful in that section of his judgment to state that the underlying contract had to have been concluded on behalf of other family members or that the subject-matter of the contract had to have been transferred to another group company. He returned to the same examples in a later section of his judgment – see para [41]. As I understand his approach, Lord Drummond Young was saying that the principle was limited so as to apply only in such circumstances, although there is perhaps a tension between that limited approach and certain other passages later in his opinion where on one reading he might be taken to have been expressing the rule on a somewhat wider basis. Overall I agree though with the defenders' submission that Lord Drummond Young was not purporting to set out a separate Scots law doctrine. His analysis proceeded on the basis that Scots law should follow the rule set out by the majority in *Panatown*: *McLaren Murdoch* at para [42].

[99] In the present case none of the requirements for permitting the recovery of transferred loss is satisfied on the pursuers' pleadings. The pursuers do not suggest that the defenders

were aware or should at any material time have been aware that failure to carry out the repairing obligations under the lease would cause Lynett to sustain financial loss. The claim is not based on it having been foreseeable that Lynett would sustain loss if the defenders breached any of their obligations under the lease nor is it averred that a failure to allow the pursuers to recover damages on behalf of Lynett would defeat the aim of the contract. It is not said that there was property which was to be transferred to another group company. The pleaded basis of the pursuers' claim, insofar as it relates to the interest of Lynett, is stated in the broadest of terms and appears to me to be put forward at a particularly high level of generality, which has no support in the case law or in principle. Thus in article 1.1 of the condescendence the pursuers simply aver that they sue "on behalf of a third party, which has suffered loss, injury and damage as a result of the defenders' breaches of … the lease, in order to recover such losses on behalf of that third party". In article 6.6 the pursuers plead that as a result of the defenders' continuing refusal to carry out the necessary repairs pursuant to their obligations under clause 13.2 of the lease Lynett has suffered and will continue to suffer loss of profits. The pursuers contend that they are "as a matter of law" bound to account to Lynett as the party suffering the loss for any of Lynett's losses that are recovered for its benefit in this action, but these is no explanation or indication of why they assert that such a legal liability on their part arises. There is nothing to suggest that there would be a legally enforceable obligation to account to Lynett for any damages recovered. The pursuers have not sued for damages to be paid to Lynett. They have chosen not to convene Lynett as parties to the action. In these circumstances, the pursuers would be entitled to retain any damages awarded for loss of Lynett's profits and to apply them as they saw fit; the damages could be attached by the pursuers' creditors. The pursuers merely state that Lynett is not a party to the lease and so

cannot sue the defenders for their breaches of clause 13.2. The pursuers then aver that "in all the circumstances" they are entitled to recover Lynett's losses on its behalf.

[100] From the foregoing summary of the pursuers' case it can be clearly seen that there is nothing pleaded as to the facts that were within the parties' contemplation at the time the contract was entered into (cf. *The Albazero)*. There is equally nothing to suggest that the defenders should have foreseen that Lynett would suffer economic loss (cf. *Linden Gardens Trust Ltd* v *Lenesta Sludge Disposals Ltd; St Martins Property Corporation Ltd* v *Sir Robert McAlpine Ltd* [1994] 1 AC 85*)*. There is no basis in the pleadings on which the court could hold that the contract between the pursuers and the defenders was entered into on the footing that the pursuers would be entitled to enforce contractual rights against the defenders for the benefit of Lynett (cf. Lord Goff *Panatown* 538G). There is no ground on which it could be said that the pursuers contracted for the benefit of Lynett. It cannot be maintained that there was a transaction whose known object was to benefit a third party, namely Lynett or a class of third parties to which Lynett belongs. In short, the pleaded circumstances of the case do not come within the parameters of any of the tests for applying the principle of transferred loss which have arisen in the case law to date either in Scots law or in the law of England and Wales.

[101] The fundamental difficulty with the pursuers' approach is that it places no meaningful limits on the reach of the exception. Counsel for the pursuers, when pressed to explain the limits of the principle for which he contended, submitted that the application of the transferred loss principle would on his approach be restricted to cases involving family groups and corporate groups. This would, he submitted, provide the necessary closeness of connection. He was not able to say how a family group would be delineated or how a corporate group would be defined. I consider that such a formulation of the circumstances in which the principle of transferred loss should apply is substantially too broad and open-ended. It has the potential to

extend the scope of the exception well beyond any case in which it has been applied to date. Given the complete absence of any boundaries, I consider that the Dean of Faculty was right to say that the pursuers' approach would have the effect of transforming the exception into the general rule.

[102] If one considers what the object of the contract of lease was in the present case, it can be seen that there is no basis for holding that an award of damages for Lynett's loss of profits is necessary in order to give effect to the object of the contract. The object of the contract of lease was to permit the pursuers to occupy the premises as tenants on the terms and conditions stipulated in the lease. There was no contractual intention to benefit a third party. There is nothing to suggest that at the time when the pursuers took on the tenancy the defenders knew that Lynett would be trading from the premises or even that Lynett existed. It cannot in these circumstances be suggested that there was a contract entered into between the pursuers and the defenders for the benefit of Lynett. This is important because if known third party benefit is irrelevant for the purposes of engaging the transferred loss principle, it would mean that a main contractor would always be able to claim against the employer for the losses suffered by its subcontractor, even if the employer had no knowledge of the subcontractor, or even that a subcontractor was going to be engaged at all (see *BV Nederlandse Industrie*, Coulson LJ at para 75). In my view this consideration shows that the pursuers' argument goes substantially too far and is unsound.

[103] Lynett traded from the premises by virtue of a licence granted to them by the defenders. The licence provided in clause 4.2.13 that the pursuers would at no time become liable to Lynett for any loss the latter might sustain from any deficiency in the premises or damage to any property (except in the case of negligence by the pursuers). Provision to the same effect appears in clause 8. How then can a liability on the part of the pursuers to account to Lynett for

damages for loss of profits be said to arise in view of the express terms of the licence? The commercial judge dealt with the point by saying that there was a short answer to it: the obligation to account arose from the recovery of damages itself, not from any pre-existing or contractual obligation to account. For my part I am unconvinced by this answer. The mere recovery of damages cannot *per se* create a liability to account, particularly in circumstances where the relationship between the pursuers and their licensee (Lynett) is governed by the terms of the licence. The licence makes clear that absent negligence there is to be no liability owed at any time by the pursuers to Lynett arising from any deficiency in the premises or damage to any property. Since damages for loss of profits due to the effects of flooding would arise from a deficiency in the premises or from damage to property in the premises it follows that the pursuers can have no liability to account to Lynett for any such damages.

[104] The outcome cannot be said to give rise to any injustice. It is reasonable to proceed on the basis that contracting parties can be expected to look after their own interests when they agree to enter into a contract. A party, such as Lynett, who elects to enter into an unauthorised licence of premises does so at its own risk. It has no legitimate cause for complaint when it suffers loss as a result of a breach of contract by a party, the defenders, with whom it has not contracted. Any other approach would be of potentially limitless application.

[105] I would allow the reclaiming motion on the transferred loss point and recall the Lord Ordinary's interlocutor of 13 June 2024 to the extent that he repelled the defenders' seventh plea-in-law. I would sustain that plea.