

# CONTRACTUAL REMOTENESS AND PSYCHIATRIC INJURY IN THE HIGH COURT

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## I INTRODUCTION

The origin of the modern doctrine of remoteness of damage in the law of contract is Alderson B's famous dictum in *Hadley v Baxendale* ('*Hadley*').<sup>1</sup> That dictum stipulates that, absent 'special circumstances', loss resulting from a breach of contract is recoverable only when it arose 'according to the usual course of things', or could 'reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it'.<sup>2</sup> Persistent questions nevertheless remain regarding the precise content of the *Hadley* rule, and its most plausible justification, particularly following the House of Lords' decision in *Transfield Shipping Inc v Mercator Shipping Inc* ('*The Achilles*').<sup>3</sup> A majority of that Court arguably there endorsed the proposition that, rather than being an externally imposed default rule, the contractual remoteness rule gives effect to an 'assumption of responsibility' derivable from the parties' contract.

The recent appeal in *Elisha v Vision Australia Ltd* ('*Elisha*')<sup>4</sup> afforded the High Court of Australia an opportunity to re-examine the foundations of the Australian law of contractual remoteness. It is thus unfortunate that, in consequence of the way that the appeal was argued, the Court's reasoning was directed principally towards reconsidering earlier judicial statements regarding the degree of specificity with which a recoverable loss must be described, and the degree of probability with which it must (reasonably) be foreseen. It is argued below that the transparency and justifiability of Australian law would be improved if judges generally avoided these kinds of unhelpful semantic debates since the likelihood, assessed at contract formation, of the relevant adverse consequence occurring is not the true determinant of whether damages are (or should be) recoverable. The principal focus should instead be on determining the scope of recoverable loss

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<sup>1</sup> (1854) 9 Ex 341; 156 ER 145, 151 ('*Hadley*').

<sup>2</sup> *Ibid.*

<sup>3</sup> [2009] 1 AC 61 ('*The Achilles*').

<sup>4</sup> (2024) 421 ALR 184 ('*Elisha*').

that is dictated by the requirement of ensuring next-best conformity with (the reasons that justify) the parties' obligations, as created by their agreement.

## II BACKGROUND

Mr Elisha was employed at Vision Australia ('Vision') under a written contract of employment. He was accused of inappropriate behaviour towards the owner of a hotel where he stayed during travel for his work duties and, following a disciplinary meeting, his employment was terminated. Vision had a disciplinary process that was incorporated into Mr Elisha's employment contract. In contravention of that process Vision failed to put to him all the reasons that influenced the decision to dismiss him in proceedings that the primary judge described as a 'sham'.<sup>5</sup> Following his dismissal, Mr Elisha developed a severe depression that affected his capacity for work in the foreseeable future. He succeeded in receiving a settlement for statutory damages for unfair dismissal, but when his condition failed to improve, he brought alternative claims against Vision for breach of contract and in negligence.

Mr Elisha's claim for damages for breach of contract succeeded at trial, with Vision ordered to pay \$1,442,404.50 in damages. But his alternative claim for breach of his employer's alleged duty to take reasonable care to avoid injuring an employee in implementing its employment termination process was dismissed on the basis that Australian law does not presently recognise such a duty. On appeal, the Victorian Court of Appeal affirmed the absence of the alleged common law duty of care, and allowed an appeal against the award of damages for breach of contract, (1) relying upon the House of Lords' decision in *Addis v Gramophone Company Ltd* ('*Addis*')<sup>6</sup> for the proposition that that this type of loss was not recoverable; and (2) holding that Mr Elisha's psychiatric injury was too remote.

## III DECISION

Following a further appeal, a majority of the High Court of Australia (Gageler CJ, Gordon, Edelman, Gleeson and Beech-Jones JJ) reversed the Court of Appeal's decision in relation to the breach of contract claim, holding that (1) *Addis* does not preclude an award of damages for diagnosed psychological harm flowing from a contractually wrongful dismissal; and (2) Mr Elisha's psychiatric injury was not too remote. Their Honours further held that it was unnecessary to decide upon the existence of Mr Elisha's negligence claim in the absence of comprehensive submissions regarding the 'coherence between the scope of the duty of care to

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<sup>5</sup> See *Elisha* (n 4) 186 [1] (Gageler CJ, Gordon, Edelman, Gleeson and Beech-Jones JJ).

<sup>6</sup> [1909] AC 488 ('*Addis*').

provide a safe system of work and employment law'.<sup>7</sup> Separately, Jagot J concurred in the result, while Steward J, the lone dissident, held that Mr Elisha's psychiatric injury was too remote to be recoverable and agreed with the courts below that Australian law does not recognise the duty of care contended for by Mr Elisha. For his Honour, 'the need for coherence' mandated that the Victorian Court of Appeal was correct to reject any such duty because, applying *Sullivan v Moody*,<sup>8</sup> its recognition 'would subvert ... other principles of law, and statutory provisions'.<sup>9</sup>

*Elisha* raises several important issues, including the possibility of a novel common law duty of care. But the focus of this comment will be the justifiability of the award of substantial damages for breach of contract. One central issue on appeal was whether *Addis* precluded damages for psychiatric injury arising from the manner of termination of an employment contract. The Court unanimously — and convincingly — held that it did not. According to the majority, this was because *Addis*: (1) does not in fact establish that liability for psychiatric injury arising from the manner of dismissal is beyond the scope of an employer's contractual duty; (2) was 'decided more than a century ago in a different social context and has been overtaken substantially by more recent decisions in the United Kingdom and Australia'; and (3) is in tension with *Baltic Shipping Co v Dillon*,<sup>10</sup> which established that 'damages for psychiatric injury were available for breach of contract without any suggestion of an exception for employment contracts'.<sup>11</sup>

An issue of broader significance was whether Mr Elisha's psychiatric injury was 'too remote' to justify recovery. According to the *Hadley* formulation, the question is whether the particular adverse consequence arose 'according to the usual course of things' or could 'reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it'.<sup>12</sup> The *Elisha* majority confirmed that this is the appropriate starting point,<sup>13</sup> and that when applying the *Hadley* rule to specific facts, two principal issues arise.

The first issue is 'at what level of generality should the damage, and the process by which it occurred, be described for the purposes of assessing whether the damage could reasonably have been contemplated as "on the cards"'.<sup>14</sup> Here their Honours observed that 'it is well established that the precise damage and the precise manner of [its] occurrence ... need not be contemplated',<sup>15</sup> whilst also recognising that the more particularly the damage, and the manner of its occurrence, is described, the more likely it is that it will be found to be 'too

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<sup>7</sup> *Elisha* (n 4) [76].

<sup>8</sup> (2001) 207 CLR 562.

<sup>9</sup> *Elisha* (n 4) [94].

<sup>10</sup> (1993) 176 CLR 344.

<sup>11</sup> *Elisha* (n 4) 199 [51].

<sup>12</sup> *Hadley* (n 1) 151.

<sup>13</sup> *Elisha* (n 4) 202 [61].

<sup>14</sup> *Ibid* 202 [62], citing *Koufos v C Czarnikow Ltd* [1969] 1 AC 350, 390 (Lord Reid).

<sup>15</sup> *Elisha* (n 4) 202 [63].

remote'.<sup>16</sup> The second issue is 'the degree of relevant knowledge or contemplation' denoted by the requirement that the damage be 'on the cards'.<sup>17</sup> After observing that the alternative 'serious possibility' test constitutes a 'better formulation' of the relevant standard, the majority confirmed the well-accepted proposition that the requirement of a serious possibility is 'more stringent' than the reasonable foreseeability test employed in the law of torts.<sup>18</sup>

According to the majority, when applying *Hadley* to a specific fact pattern, one must first 'identify the circumstances of the breach', described here as 'serious', and then consider 'the general type of damage that occurred', and its 'general manner' of occurrence.<sup>19</sup> Invoking the notion that a person's employment 'is usually one of the most important things in ... her life',<sup>20</sup> their Honours concluded that both 'the "unfathomable nature" of what occurred' given Vision's failure to explain the reasons for dismissal, and its 'grave effect' on Mr Elisha, could be supposed to have been in Vision's reasonable contemplation at contract formation.<sup>21</sup> Accordingly, even if the precise psychiatric injury that Mr Elisha suffered may not have been (reasonably) contemplated, recovery was justified because there was 'a serious possibility' of psychiatric injury.<sup>22</sup>

## IV ANALYSIS

### A *The Inadequacy of the Hadley Rule*

The majority's observations regarding contractual remoteness are relatively uncontroversial, reflecting the orthodox view in England, at least prior to *The Achilles*. These observations nevertheless reveal the significant indeterminacy of the 'reasonable contemplation' standard. Not only is it possible to describe 'the type of damage' suffered at different levels of specificity, as occurred in *Elisha* itself,<sup>23</sup> but there is also room for significant disagreement regarding what degree of likelihood is denoted by the 'serious possibility' test. The result is a substantial degree of judicial discretion in deciding whether any specific adverse consequence of a contractual breach is too remote.<sup>24</sup>

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<sup>16</sup> Ibid.

<sup>17</sup> Ibid 202 [62].

<sup>18</sup> Ibid 203 [64].

<sup>19</sup> Ibid 203 [65].

<sup>20</sup> Ibid 204 [67], quoting *Johnson v Unisys Ltd* [2003] 1 AC 518, 539 (Lord Millett).

<sup>21</sup> *Elisha* (n 4) 204 [69].

<sup>22</sup> Ibid 204–5 [69].

<sup>23</sup> Compare the majority's characterisation of the damage as 'psychiatric injury': ibid 204 [66] with their own later characterisation of it as 'serious psychiatric injury': at 205 [69]. The latter characterisation was also adopted by Steward J and Jagot J, at 208–9 [86] and 223–4 [132] respectively.

<sup>24</sup> See Julius Stone, *Legal System and Lawyers' Reasonings* (Maitland Publications, 1964) 265–6.

A more fundamental difficulty with the *Hadley* rule, consistent with its substantial indeterminacy,<sup>25</sup> is that the justification for its use is unclear.<sup>26</sup> Fuller and Perdue may accordingly have been correct in postulating that the rule ‘is less a definite test itself than a cover for a developing set of tests’<sup>27</sup> to determine the proper limits of contractual liability.

## B The Need for an ‘Agreement-Centred’ Approach

Given these difficulties, it is unfortunate that so little progress has been made in rationalising the law. Enter *The Achilles*, where (at least) Lord Hoffmann and Lord Hope explained the contractual remoteness rule as upholding an objective ‘assumption of responsibility’ derivable from the parties’ agreement. Considering the substantial academic and judicial commentary that has subsequently ensued, it is unfortunate that the parties’ submissions in *Elisha* did not refer to the decision, particularly given the majority’s assertion that ‘remoteness of damage in contract is separate from the scope of a contractual duty’.<sup>28</sup>

### 1 Normative Appeal

The main attraction of an ‘agreement-centred’ analysis of contractual remoteness is that, in contrast to the *Hadley* rule, it identifies a plausible justification both for restricting — and for awarding — damages following a contractual breach. Expressed at a high level of generality, this justification is the necessity of achieving ‘next-best conformity’ with the reasons that justify the breaching party’s primary obligations.<sup>29</sup>

A common objection to an ‘agreement-centred’ approach is that it is artificial because contracting parties’ do not invariably contemplate what losses should be recoverable in the event of non-performance. But this objection misunderstands the legal concept of an agreement, which, once made, can have effects independent of the parties’ subjective intentions.<sup>30</sup> One striking example of this, considered further below, is the High Court’s decision in *Burns v MAN Automotive (Aust) Pty Ltd* (‘*Burns*’).<sup>31</sup>

<sup>25</sup> See Lord Hoffmann, ‘*The Achilles*: Custom and Practice or Foreseeability?’ (2010) 14(1) *Edinburgh Law Review* 47, 53.

<sup>26</sup> See Andrew Tettenborn, ‘*Hadley v Baxendale* Foreseeability: A Principle beyond Its Sell-by Date?’ (2007) 23(1) *Journal of Contract Law* 120, 126–33.

<sup>27</sup> LL Fuller and William R Perdue, ‘The Reliance Interest in Contract Damages’ (1936) 46(1) *Yale Law Journal* 52, 85.

<sup>28</sup> *Elisha* (n 4) [60].

<sup>29</sup> See, eg, John Gardner, ‘What is Tort Law for Part I: The Place of Corrective Justice’ (2011) 30(1) *Law and Philosophy* 1.

<sup>30</sup> See Robert Stevens, ‘What is an Agreement?’ (2020) 136(Oct) *Law Quarterly Review* 599.

<sup>31</sup> (1986) 161 CLR 653.

A secondary concern with an ‘agreement-centred’ analysis is that it is also somewhat indeterminate, requiring judgement to determine the agreement’s proper construction. But this alone is not a sufficient reason to reject this approach because some indeterminacy, and the concomitant need for judgement, is a universal feature of all legal rules.<sup>32</sup>

## 2 Explanatory Power

Of greater practical significance is that an ‘agreement-centred’ analysis can explain certain decisions that are otherwise irreconcilable with the *Hadley* rule. One notable English example is *Siemens Building Technologies FE Ltd v Supershield Ltd* (‘*Supershield*’),<sup>33</sup> where the defendant defectively performed its contractual obligation to install a valve in a storage tank in order to prevent flooding. The tank overflowed causing substantial damage to electrical equipment. At contract formation, damage of this kind was highly improbable due to the existence of an additional safety feature — drains designed to take excess water away upon the occurrence of such an event — which (unfortunately) were blocked. It was nevertheless held that the damage that eventuated was within the potential scope of recovery because the sole purpose of installing the valve was to prevent such damage, however unlikely its occurrence may have been. The decision is accordingly best rationalised on the basis that, properly construed, the parties’ agreement assigned responsibility to the defendant for the specific circumstances that eventuated.

*Supershield* demonstrates how the content of the parties’ agreement may extend liability to include unlikely damage. More commonly, however, the parties’ agreement will restrict the recovery of reasonably foreseeable loss, as occurred in *Burns*. There Mr Burns acquired a prime mover via a hire-purchase arrangement under which MAN provided an enforceable warranty regarding the state of the vehicle’s engine. The engine was not as warranted, but Burns’ repair request was refused. As Burns could not afford the necessary repairs, he continued to use the vehicle, albeit in a more limited way than originally envisaged, operating his business at a loss. When the vehicle later broke down and was repossessed, Burns sued for breach of contract seeking, *inter alia*, the profits he expected to make over the four-year period that the machine should have operated. Significantly, the loss of such profits was found to be within MAN’s reasonable contemplation because it had reason to know that Burns intended to use the vehicle for interstate haulage and should also have appreciated his limited financial circumstances. The Court’s majority nevertheless held that Burns’ projected, but unrealised, profits for the period following discovery of the defect were too remote. The critical fact

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<sup>32</sup> See, eg, HLA Hart, *The Concept of Law* (Oxford University Press, 3<sup>rd</sup> ed, 2012) 124–36.

<sup>33</sup> [2010] 2 All ER (Comm) 1185 (CA). The Court’s decision was limited to assessing the reasonableness of a settlement offer.

said to justify this conclusion was that Burns had a statutory entitlement, via *Hire Purchase Act 1959* (Qld) s 12, to terminate the hire–purchase agreement at any time, which was held, by necessary implication, to exclude such recovery.

*Burns* is an unusual case, but it starkly demonstrates how the legal effect of an agreement is determined independently of the parties' subjective intentions. It is also not an isolated example of liability being limited by reference to the content of the parties' agreement. Another decision preferably explained in these terms is *Stuart Pty Ltd v Condor Commercial Insulation Pty Ltd*.<sup>34</sup> Despite paying lip service to the need for 'reasonable contemplation' at contract formation of the lost profits claimed, the substance of the Court's reasoning there was that these profits were sufficiently disproportionate to the value of the parties' contract to conclude that the defendant could not have assumed responsibility for them.<sup>35</sup>

### C Explaining Elisha

Returning to *Elisha*, the majority emphasised both the personal significance of one's employment and Vision's failure to explain its reasons for dismissal in concluding that Vision should have contemplated, as a serious possibility, that Mr Elisha 'would suffer a serious psychiatric injury' due to the manner of its wrongful dismissal.<sup>36</sup> Concurring in the result, Jagot J also focussed upon 'the relationship between ... the kind of breach that occurred and the kind of resulting injury',<sup>37</sup> but placed particular emphasis on the fact that Vision's 'actions fundamentally undermined the very purpose of those procedures — to enable an employee's side of the story to be heard and taken into consideration'.<sup>38</sup>

Stepping back, one sees that both of these analyses are ultimately grounded in the content (or purpose) of the parties' agreement. While the majority obviously focussed principally on the contract's overall purpose, Jagot J placed greater emphasis on the purpose of the specific obligation breached. The decision accordingly reinforces the central thesis here advanced that, when determining the proper extent of a breaching party's reparative responsibility, 'ritual incantation'<sup>39</sup> of *Hadley* should be replaced with a focus on identifying the scope of recoverable loss dictated by the parties' agreement.

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<sup>34</sup> (2006) Aust Contract Reports ¶90–245.

<sup>35</sup> See *ibid* 89,482–7 [74]–[106] (Beazley P).

<sup>36</sup> *Elisha* (n 4) 205 [69].

<sup>37</sup> *Ibid* 222 [128].

<sup>38</sup> *Ibid* 223 [131].

<sup>39</sup> See *McElroy Milne v Commercial Electronics Ltd* [1993] 1 NZLR 39, 42 (Cooke P).

## V CONCLUSION

The aim of this brief comment has been to highlight the necessity of commencing any examination of the justified limits of a contracting party's reparative responsibility following breach with an objective construction of the parties' agreement. That this proposal is in any way controversial appears to stem from misconceptions regarding: (1) the utility of the *Hadley* rule; and (2) the implications that follow from the common law's wholly objective concept of 'agreement'.

Finally, it is noteworthy that the remoteness test applicable to the tort of negligence is arguably also unsatisfactory.<sup>40</sup> Whilst it is not possible to substantiate this claim here, that doctrine's coherence may similarly be improved by avoiding, so far as is possible, unhelpful semantic debates about what kind of damage was 'reasonably foreseeable' at the date of breach. An alternative, and more justifiable, focus of analysis would be to ask whether part of the justification for imposing the relevant duty breached was to prevent damage of the kind that occurred.<sup>41</sup> Whilst such an approach also necessitates judicial consideration of which interest(s) justify the imposition of the relevant duty, it would at least facilitate a more principled resolution of certain difficult cases.<sup>42</sup>

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<sup>40</sup> See, eg, Alexander Waghorn, 'Remoteness in the Supreme Court' (2024) 140(Oct) *Law Quarterly Review* 502.

<sup>41</sup> See, eg, E Anthony Machin, 'Negligence and Interest' (1954) 17(5) *Modern Law Review* 405.

<sup>42</sup> See, eg, *Arsalan v Rixon* (2021) 274 CLR 606.