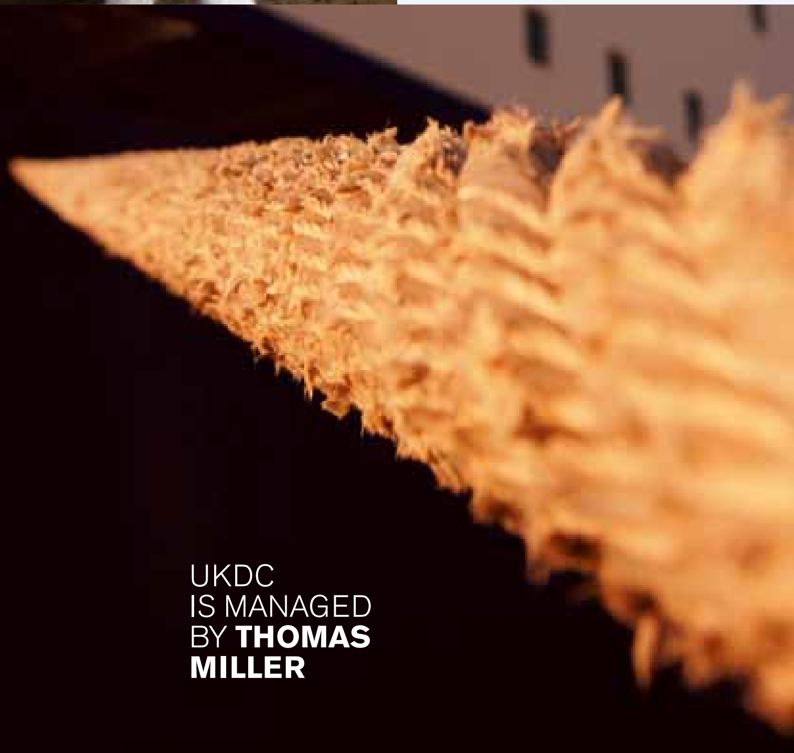
UK DEFENCE CLUB

Counterparty Risk – Claims for Damages



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IS MANAGED
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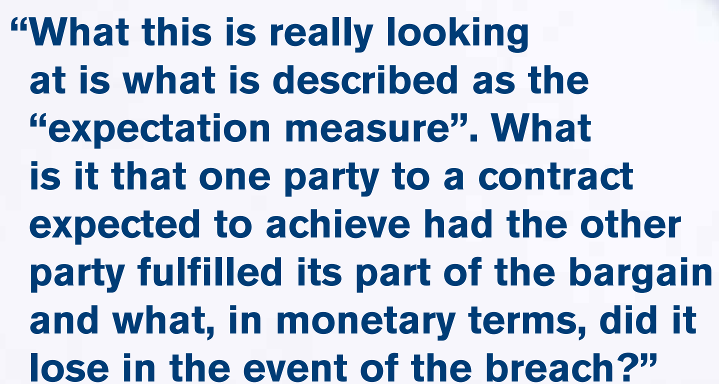


"What this is really looking at is what is described as the "expectation measure". What is it that one party to a contract expected to achieve had the other party fulfilled its part of the bargain and what, in monetary terms, did it lose in the event of the breach?"

Development of the Law

When asking himself what damages a claimant would be expected to recover for breach of contract, Parke B gave what is now regarded as the classic answer that:

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

This passage, from Robinson v Harman (1848) 1 Exch, 850, 855 comes from a case relating to the lease of a house. It is, however, equally applicable to all breaches of contract, including those in the shipping context. What this is really looking at is what is described as the "expectation measure". What is it that one party to a contract expected to achieve had the other party fulfilled its part of the bargain and what, in monetary terms, did it lose in the event of the breach. As it will be seen, that prima facie measure is not always the one that is applied, but the rule holds good for the most part.

More fundamentally, however, in practice one party often receives nothing like what it expected to. The owner of a laundry has ended up badly out of pocket while unable to take advantage of lucrative cleaning contracts, just as the owners of ships who have not been able to enter into subsequent fixtures which would have earned them considerable amounts of money, have had to make do with much less.

Why is this? The reason is that before even looking at the measure of damages there are a number of hurdles to get over.

Causation

“The innocent party has to show that, but for the breach, the loss would not have been made. That is a question of causation.”

The first of these is really very straightforward and largely goes to questions of evidence. The innocent party has to show that, but for the breach, the loss would not have been made. That is a question of causation.

As said above, to a large extent the question of causation is not going to be a matter of complicated legal principle, but a question of fact. Indeed in the leading case on this question, which is Galoo Limited v Bright Grahame Murray [1994] 1 WLR 1360, the Court of Appeal said that the way to answer the question was:

"By the application of the court's common sense".

This was against the situation where a company of auditors had, in breach of contract, performed a negligent audit. The position actually was that the claimant company was insolvent. They went on trading and said that, but for the breach of their auditors, they would have stopped and not gone on to make substantial losses. The claim for damages on these grounds was, however, dismissed.

Essentially, what the court was saying was that, although the performance of the auditors set a background against which the company could make its losses, common sense dictated that the actual reason for those losses was not breach on the part of the auditors, but arose because of the decision to go on trading.

In this, though, the Court of Appeal was aware that simply applying common sense would not be enough to give a definitive answer.

First you had to look at to what extent an underlying event caused by a breach could be said to lead on to a claim in damages. In any set of circumstances, there are very likely to be several different underlying causes. The position that the law takes is that the breach of the contract must at least be either the effective cause or one that has substantially contributed to the loss.

In the Galoo case the Court of Appeal reviewed the lines of reasoning in an earlier shipping case in reaching its conclusions.

This is Monarch Steamship Company Limited the Karlshamns Oljefabriker [1949] AC 196. As originally intended the ship was going to carry cargo from Manturia to Sweden. The owner had given the usual undertaking that the ship was seaworthy, but breached this because the boilers were defective.

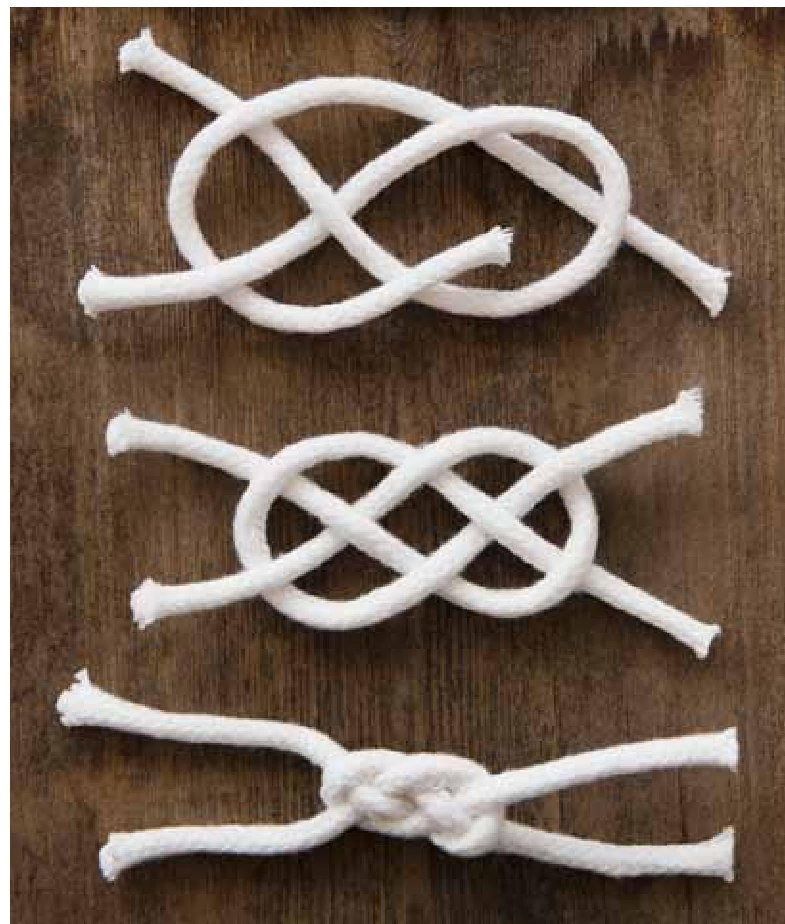
That led to delays meaning that the ship could not proceed on its voyage, having transited the Suez Canal, until the 24th September 1939. That date is significant because by then the Second World War had commenced.

The British Authorities, therefore, ordered that the ship could not proceed directly to Sweden and required her instead to go to Glasgow where the cargo had to be transhipped onto a neutral ship. The claimants sought to recover the costs of this based on the owner's breaches.

The owner's position was that the losses had not been caused by any breach of the unseaworthiness obligations on its part, but simply because the Second World War had prevented the voyage from being completed.

On the case's way up to the House of Lords the facts were reviewed in some detail. Comparisons were drawn. It was said that, if the unseaworthiness had resulted simply, by way of example, because necessary medical equipment had not been supplied, then a cargo owner would not have been able to say that there was any causal link between loss of the cargo and that breach, had the ship foundered in a storm.

Taking, though, the actual facts in question, not only was the outbreak of war a likely event at the time the contract was actually concluded, it could be said to be an effective cause of the loss.



Remoteness

"The second hurdle has caused a great deal more difficulty over the years and has been the subject of considerable debate and legal controversy in recent years. This is the question of whether particular types of loss can be said to be too remote to recover. English law had struggled with this concept for centuries."

The second hurdle has caused a great deal more difficulty over the years and has been the subject of considerable debate and legal controversy in recent years. This is the question of whether particular types of loss can be said to be too remote to recover. English law had struggled with this concept for centuries. There is an amusing example of what was characterised as being "absurd" quoted in a case from 1854 where these hypothetical facts were given:

"Where a man going to be married to an heiress, his horse having cast a shoe on the journey, employed a blacksmith to replace it, who did the job so unskilfully that the horse was lamed, and, the rider not arriving in time, the lady married another; and the blacksmith was held liable for the loss of the marriage."

That same year, however, produced the case that has gone on to lay down the general principles for what is and is not too remote a loss to be recovered.

This is the well-known case of Hadley v Baxendale (1854) Exch 341.

The facts as understood are relatively straightforward. A mill owner's operations came to a standstill because of a broken crank shaft. It employed a carrier to take it for repair but, in breach of contract, instead of reappearing the next day it was delayed. The result was that the mill remained idle for a full 5 days more than originally anticipated.

Perhaps unsurprisingly, therefore, the mill owner tried to recover the losses arising from those 5 days.

The Exchequer Court, however, laid down the test for this in the often-quoted section from the judgment of Alderson B:

"Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, ie according to the usual course of things, from such breach of contract itself, or such as may 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."

Academic debate on this rages but, for all practical purposes, it is a two limb test. The first are matters that arise in the ordinary course of things. Under the second limb, however, the Court said that, even if losses did not arise naturally or in the usual course of events, they could be recovered if they were within the reasonable contemplation of both parties when the contract was made.

In Hadley v Baxendale it was found that the carriers of the crank shaft had not been informed that its delay would result in the halting of production altogether such that, although it would have been in the contemplation of the mill owner, it would not be in the contemplation of the carrier.

This test saw considerable refinement in the 20th century, particularly in relation to the first limb of the test – what is meant by losses occurring in the usual course of things. The first of these cases is Victoria Laundry v Newman [1949] 2 KB 528. This is always a confusing case in that the judgment talks of there being only one general test rather than two limbs, but when read certainly treats the law as divided into these two different areas.

Again the facts are relatively simple. The claimant was a laundry. It purchased a boiler from engineers who

delivered it late – in fact something like 5 months late. As a result, the laundry lost the opportunity to make enhanced profit from dyeing contracts it had entered into with the Ministry of Supply. Essentially what the Court of Appeal said was that it would be able to recover, what might be described as, losses of profit from "normal" contracts, but it could not recover the more lucrative services it would have been able to provide to the Ministry of Supply. The difference was really quite substantial. £16 a week for new customers it might contract with in the ordinary course of events, but £262 a week in respect of the dyeing contracts. In looking at this the Court of Appeal said there were a number of main points emerging from the decided law – taking the Court's own numbering:

"(2) In cases of breach of contract the aggrieved party is only entitled to recover such part of the loss actually resulting as was at the time of the contract reasonably foreseeable as liable to result from the breach.

(3) What was at that time reasonably so foreseeable depends on the knowledge then possessed by the parties or, at all events, by the party who later commits the breach.

(4) For this purpose, a knowledge "possessed" is of two kinds; one imputed, the other actual. Everyone, as a reasonable person, is taken to know the "ordinary course of things" and consequently what loss is liable to result from a breach of contract in that ordinary course… But to this knowledge, which the contract breaker is assumed to possess whether he actually possesses it or not, there may have to be added in a particular case knowledge which he actually possesses or special circumstances outside the "ordinary course of things" of such kind that breach in those special circumstances would be liable to cause more loss.

(6) Nor, finally, to make a particular loss recoverable, need it be proved that upon a given state of knowledge the defendant could, as a reasonable man, foresee that a breach must necessarily result in that loss. It is enough if he could foresee it was likely so to result. It is indeed enough…if the loss (or some factor without which it would not have incurred) is a "serious possibility" or a "real danger". For short, we have used the word "liable" to result. Possibly the colloquialism "on the cards" indicates the shade meaning with some approach to some accuracy."

The broadness of that case was, to some extent, reined in by a subsequent case from the shipping world. Koufos v Czarnikow, the Heron II [1969] 1 AC 350, which went to the House of Lords on appeal. Their lordships, in particular, did not like the phrase "on the cards", particularly as they felt this would open up the test of remoteness in damages in the contract context to the broader manner in which it is applied in tort.

In particular on this Lord Reid held:

"It has never been held to be sufficient in contract that loss was foreseeable as a "serious possibility" or "a real danger" or as being "on the cards". It is on the cards that one can win £100,000 or more for a stake of a few pence – several people have done that."

Overall, however, the House of Lords was broadly supportive of the Victoria Laundry case. Of the judgments, Lord Reid's is the most user friendly stating that:

"The crucial question is whether, on the information available to the defendant, when the contract was made, he should, or the reasonable man in his position would, have realised that such a loss was sufficiently likely to result from the breach of contract to make it proper to hold that the loss flowed naturally from the breach or that loss of that kind should have been within his contemplation."

Remoteness and Shipping – The "Achilleas"

The three cases quoted previously made it at least tolerably possible to advise what, in the shipping context, were and were not likely to be found by arbitrators and judges as too remote to be recovered. That position, at least in the short term, was pushed into a position of considerable flux by the House of Lords decision in Transfield Shipping Inc v Mercator Shipping Inc (The Achilleas) [2008] UKHL 48. That case considered what damages an owner could be expected to recover where, in breach, its charterer redelivered the ship late.

It is probably worth setting the general context so as to avoid any confusion. Many charterparties will contain a margin within which redelivery can be made. Indeed, even where a date for redelivery is set, some measure of tolerance will normally be implied. In those circumstances, even if the ship is redelivered late there is no breach of contract on the part of the charterer. The owner will not have any claim in damages. It will be entitled to recover at the charter rate for the period of overlap, but this is essentially an action for debt. It is not a claim for damages.

What though is the position where a charterer is undoubtedly in breach of contract in redelivering late and this results in the owner suffering loss on follow-on fixtures?

This was of particular significance in the Achilleas because the very volatile market conditions meant that the owner had secured a follow-on fixture at what would have been extremely lucrative rates. Because the owner could not meet the delivery date the subsequent charterer took the opportunity to renegotiate the charter rates, bringing them down from the originally agreed amounts to considerably lesser rates.

What could the owner recover as a result of its original charterer's breach? Naturally they had suffered considerable loss ($1,364,584) and wanted to be compensated at the difference between the reduced hire and the originally agreed hire for the entirety of the follow-on fixture. The charterer said that was not correct and that its liability was restricted to the difference between the rate in its contract and the market rate for what were a very few days of over run. The differences between the parties' respective calculations were, therefore, substantial.

The owner's arguments as to quantum succeeded in arbitration and then on appeal all the way through to the Court of Appeal. The House of Lords, however, saw matters differently. All the judgments in the Achilleas are difficult to construe. Two of the judgments could certainly, however, be said to have adopted an orthodox approach to the question, essentially finding that the loss complained of could not have been said to have occurred in the ordinary course of events, but occurred through the extreme volatility of the market. In passing, however, that gives rise to difficulties of its own. What the court is perhaps saying is that it was not so much the type of loss that could not have been foreseen, but the amount of that loss. This runs contrary to the general proposition in contract law that if a

"It is fair to say, therefore, that the Achilleas cannot be ignored."

Remoteness and Shipping – The "Achilleas" (continued)

type of loss is not found to be too remote you do not then go on to question the extent of that loss. Simply because it is a very large amount, does not prevent recoverability.

Lord Hoffmann took a very different approach in his judgment.

Rather than ask whether the loss would follow in the ordinary course of events he concentrated on whether the charterer could have been said to have assumed responsibility for the loss in question. The question which Lord Hoffman raised was whether the orthodox rule that a party could recover damages for foreseeable consequences of a breach was one to be imposed in all contracts or only a prima facie assumption which could be rebutted in certain circumstances where "context, surrounding circumstances or general understanding in the relevant market shows that the party would not reasonably have been regarded as assuming responsibility for such losses".

That, therefore, would impose a further gloss on the orthodox approach. Not only is it necessary, in certain circumstances, to show that the loss was a not unlikely consequence of a breach occurring in the ordinary course of events, but the party seeking to recover the damages has to show that his counterparty had assumed contractual liability for the loss in question.

To justify this approach Lord Hoffmann made two relevant observations.

Firstly he said it was "logical to found liability for damages upon the intentions of the parties (objectively as attained) because all contractual liability is voluntarily undertaken". Then he went on to say "it must be in principle wrong to hold someone liable for risks which people entering into such contract in their particular market would not reasonably be considered to have undertaken".

The criticism which this approach has given rise to is that it can result in great uncertainty. The cases leading through from Hadley v Baxendale might, at least, be said to have established an objective test. Deciding on whether or not there is then also an assumption of responsibility on the part of the party in breach, it could be said, introduces enormous subjectivity.

Nonetheless, as a subsequent case has confirmed, Lord Hoffmann's views were in the majority in the House of Lords and cannot be ignored.

The position remains, however, that there were considerable restrictions on the Achilleas decision.

They were premised, for example, on findings that as a matter of fact the "understanding in the shipping market is that liability was restricted to the difference between the market rate and the charter rate for the overrun period". That is also against a background where there is no other decided case on the exact point in question.

In the immediate aftermath of the Achilleas the view was also given in at least one first instance case The Amer Energy [2009] 1 Lloyds Rep 293 that it was unlikely that the Achilleas was intended to introduce a completely new test and would be confined to its facts. Subsequently in Sylvia Shipping Co Limited v Progress Bulk Tankers Limited [2010] 2 Lloyds Rep 81 the case was also distinguished, albeit that the facts were relatively similar.

Nonetheless, it is worth quoting Lord Hoffmann from an article he subsequently published in The Edinburgh Law Review, where he said:

"If the effects of the Achilleas is, as I hope, to free the common law from the need to explain its decisions on contractual remoteness of damages by the single criterion of probability and to enable it to recognise that liability for damages may be influenced by common sense distinctions between different commercial relationships, it will be the result of a combination between judicial decision making and academic writing."

Accepting repudiatory breaches

The impression given from the above may be that an innocent party is bound to accept a repudiatory breach by the other party and confine its remedy to a claim for damages. In fact nothing could be further from the truth.

As Asquith L J said in Howard v Pickford Tool Co. Ltd. [1951] 1 KB 417:

"An unaccepted repudiation is a thing writ in water and of no value to anybody: it confers no legal rights of any sort or kind."

In the leading case of White and Carter (Councils) Ltd v McGregor [1962] AC 413 Lord Reid sets the implications of this in somewhat clearer terms:

"The general rule cannot be in doubt. It was settled in Scotland at least as early as 1848 and it has been authoritatively stated time and again in both Scotland and England. If one party to a contract repudiates it in the sense of making it clear to the other party that he refuses or will refuse to carry out his part of the contract, the other party, the innocent party, has an option. He may accept that repudiation and sue for damages for breach of contract, whether or not time for performance has come; or he may if he chooses disregard or refuse to accept it and then the contract remains in full effect".

Although this was a Scottish case it is a House of Lords authority and has equal applicability to English law. It is quite clear from reading the judgments that their Lordships were in fairly serious disagreement as to the way this general concept should have been applied to the particular facts and it was decided by a three to two majority. It is a case that has seen considerable criticism, particularly in academic circles.

Nonetheless, the case did set down the general rule and the scope of exceptions to it. Its influence has been extremely profound in the shipping context and it is regularly cited in seeking an answer to the thorny question of whether or not an owner is obliged to accept early redelivery, in repudiatory breach of charter, of a ship or whether it can insist on continued performance of the charter such that it can continue to claim hire, as opposed to accepting that the charter has been brought to an end and claiming damages.

The facts of White & Carter are quite intriguing as is the fact that only £196 was in dispute which, even in 1962, was an extremely modest sum given the amount of court time that must have been involved. In this case, an advertising agency was in the habit of letting advertising space out on litter bins. The sales manager of a garage business concluded a contract by which its advertisements would appear on the litter bins. In the next few days, the proprietor of the business, who had not wished his sales manager to make the contract in the first place, cancelled the contract. The local agency simply refused to accept this and went ahead in displaying the adverts for the agreed three year period claiming the agreed price of £196. As will have been gleaned from the above, the House of Lords found in the agency's favour.

In the course of their judgments, however, their Lordships also considered what would be the limits to this general principle. In attempting to set out what would be an exception to this general rule Lord Reid commented that;

"It may well be that, if it can be shown that a person has no legitimate interest, financial or otherwise rather than claiming damages he ought not to be allowed to saddle the other party with an additional burden with no benefit to himself. If a party has no interest to enforce a stipulation, he cannot in general enforce it: so it might be said that if a party has no interest to insist

on a particular remedy, he ought not to be allowed to insist on it. And, just as a party is not allowed to enforce a penalty, so he ought not to be allowed to penalise the other party by taking one course when another is equally advantageous to him."

A feature of this judicial comment is that, on first sight, it was made by way of a general observation rather than determining the underlying principles on which the case was decided. Lord Reid did not go on to explain from where he had derived this legal principle of "legitimate interest".

Nonetheless, later cases have concentrated on the idea of "legitimate interest" and also largely ignored the last sentence quoted above. It has been very much treated as the underlying principle of the decision despite the fact that it was a minority comment.

It has, therefore, been used by defendants to argue that the circumstances of their particular case fall outside the general rule confirmed by White and Carter.

Naturally, that has given rise to considerable debate as to exactly what "legitimate interest" means. At first sight, one might have thought that the approach taken in subsequent cases would be to apply a straightforward standard of reasonableness. Much, however, along the lines of the dissenting judgment in the Golden Victory (considered below) from Lord Bingham the courts have seen no particular reason why a party choosing to breach the contract should receive generous treatment.

Certainly, and what must be perfectly sensible, the decided cases have not found that an innocent party should act entirely reasonably in such circumstances. Equally, however, there do have to be boundaries and it has proved a particularly thorny question as to what these should be.

A quote often cited by a charterer seeking to argue that an owner is obliged to accept a repudiatory breach is found in Clea Shipping Corp v Bulk Oil International Ltd (the Alaskan Trader) 2 Lloyds Rep [1983] 645 where Lloyd J said that:

"There comes a point at which the court will cease, on general equitable principles to allow the innocent party to enforce its contract according to its strict legal terms."

That quote rather overlooks the context in which it was set. It was against a background where he is accepting that this point in time was extremely difficult to set. He had already quoted from earlier cases where, essentially, it had been said that the point was reached where the owner's decision could not be justified "in all reason" or was "wholly unreasonable, quite unrealistic, unreasonable and untenable". Nonetheless, in the Alaskan Trader Lloyd J had found against the owner in circumstances where it had chartered what was described as an old ship to the charterer for a two year time charter in circumstances where, ten months into that charter, the ship had suffered a serious engine breakdown.

Repairs took several months and were eventually completed at a cost of $800,000. Naturally, during the period of repair the ship was off hire. The owner, however, then said that the ship came back on hire after completion of the repairs and left it anchored off Piraeus until the expiry of the charterparty period, when it was sold for scrap. The charterer had stated, in what was a clear repudiatory breach, that it was terminating the charter after the repairs were completed. The owner's position was that it was entitled to treat the contract as continuing such that it could claim hire rather than damages. At the arbitration stage the arbitrator had said "I am satisfied that this commercial absurdity it not justified by a proper interpretation of the decided cases" and, essentially, Lloyd J supported this.

Naturally, however, the debate has still raged on as to when the point is reached at which an owner loses the right to treat the contract as subsisting and the circumstances in which it can do this.

In a considered judgment in a recent case, Isabella Shipowner SA v Shagang Shipping Co Ltd (the Aquafaith) [2012] EWHC 1077, Cooke J undertook a concise review of the important decided cases and may well have gone a long way forward in answering these questions.

The facts were very different. In the Aquafaith, the ship was time chartered on terms that it would not be redelivered before a minimum period of 59 months. Something like four months before the minimum redelivery date Shagang announced that it would be redelivering the ship on completion of its then current voyage. It accepted that this amounted to a repudiatory breach but argued that the owner was obliged to accept this and claim for damages. The owner disagreed and claimed that the charterer was obliged to honour the contract and pay hire for the balance of the charter period.

In giving judgment following his review of the existing case law Cooke J stated that:

"The effect of the authorities is that an innocent party will have no legitimate interest in maintaining a contract if damages are an adequate remedy and his insistence on maintaining the contract can be described as "wholly unreasonable", "extremely unreasonable" or perhaps, in my words "perverse"".

Looking at the facts before him he went on to say: "With only 94 days left of a five-year time charter in a difficult market where a substitute time charter is impossible, and trading on the spot market very difficult, it would be impossible to characterise the owners' stance in wishing to maintain the charter and a right to hire as unreasonable, let alone beyond all reason, wholly unreasonable or perverse."

> **"A more subtle distinction arises when looking at different types of charterparty."**

Read as a whole, the judgment also stresses the need to show that there are extreme circumstances if the general rule in White and Carter is to be departed from. On this, he said:

"The arbitrator should have been asking himself whether or not this was an extreme case of the kind where damages were an adequate remedy and the owners' conduct was so beyond the pale that they should not be allowed to keep the contract alive."

Although this may be more of an example of the operation of the general principles set out above, what has been characterised as a second exception to the usual position, that an innocent party is not obliged to accept a repudiatory breach, arises where the contract could only be expected to operate if co-operation would be required from the party in breach.

A clear example of this would be where an owner has agreed a contract of employment with a master but that person then refuses to honour this. Plainly it would be completely impractical for the English courts to compel the master to board the ship and take command, quite apart from anything else non or recalcitrant performance of his duties on board might then render the ship unseaworthy. Equally, it might be said that, in insisting on the master fulfilling his contract, the owner was acting wholly unreasonably or even, in the words of Cooke J, perversely.

A more subtle distinction arises when looking at different types of charterparty. There is said to be a general rule that an owner cannot insist on performance of the contract, as opposed to accepting a repudiatory breach, in the bareboat charter situation. For the most part this must certainly hold good because, by the very nature of the bareboat charter, the charterer will have most of the operational duties of an owner – particularly in respect of manning and operating the ship.

A good example of the position in relation to bareboat charters is found in the court of appeal decision in Attica Sea Carriers Corporation v Ferrostaal Poseidon Bulk Reederei GmbH, the Puerto Buitrago) 1 Lloyds Rep [1976] 250. This involved the bareboat charter of the ship for a period of around 17 months. Six months into the charter a serious engine breakdown took place. During submissions in the case it was estimated that the cost of the repairs would be $2 million and, even after those repairs, the ship's actual value would be about half of this. At the time the engine difficulties arose the ship was laden with a cargo of soya bean meal from Brazil bound for Gdynia in Poland. Although the ship attempted to make the voyage under its own power the problems with the engine (or in fact the boiler tubes) made it clear that this was impractical and it had to be towed to Gdynia and onto Kiel for repairs.

The charterer accepted that it would be liable for some measure of the repairs. At the same time, however, it purported to terminate the charterparty leaving it with only a caretaker on-board. The owner refused to accept this position and said that, not only was the charterer obliged to repair the ship regardless of the cost, it was also obliged to pay the charter hire until repairs had taken place.

Although the case was decided on other grounds the Court of Appeal also looked at this question and expressed the view that the owner would have been obliged to accept the early redelivery as a repudiatory breach and confine its remedy to one for damages. By way of more general comment on the overall principles Lord Denning M.R, said as follows:

"What is the alternative which the shipowners present to the charterers? Either the charterers must pay the charter hire for years to come, whilst the ship lies idle and useless for want of repair. Or the charterers must do repairs which would cost twice as much as the ship would be worth when repaired – after which the shipowners might sell it as scrap, making the repairs a useless waste of money. In short, on either alternative, the shipowners seek to compel specific performance of one or other provisions of the charter – with most unjust and unreasonable consequences – when damages would be an adequate remedy. I do not think the law allows them to do this. I think they should accept redelivery and sue for damages. The charterers are, we are told, good for money. That should suffice."

More specifically on the point that the very nature of the bareboat charter requires considerable co-operation from the charterer, Orr L.J said in his judgment after reviewing the general law that:

"The present case differs… in that here it cannot be said that the owners could fulfil the contract without any co-operation from the charterers and also because in this case the charterers have set out to prove that the owners have no legitimate interest in claiming the charter hire rather than claiming damages."

There is something of an echo here with Lord Reid's comments in White & Carter in that they were made very much by way of observation rather than as the bed rock of the decision. Equally, Orr L.J. did not elaborate on his comments or set out the legal principles on which he based them.

Nonetheless, these comments have been used, particularly by practitioners, as the basis for a general rule that bareboat charters are an exception to the usual position that the innocent party cannot be compelled to accept a repudiatory breach. For the most part that must be a sound basis to work on.

It has also been argued by time charterers that what can be said as being a general principle in relation to bareboat charterers ought to be applied to time charters. Particular emphasis has been made on the need for co-operation from the time charterers in the sense of providing bunkers. Although each case needs to be looked at on its precise facts, it is certainly true to say that the Aquafaith provides strong guidance that there is no such general rule applicable to time charters. On this Cooke J said as follows:

"The question, to my mind, is very simple. Could the owners claim hire from the charterers under this time charter without the need for the charterers to do anything under the charter? The answer is yes. If the charterers fail to give orders, the vessel would simply stay where it was, awaiting orders but earning hire. Although the master is under the orders of the charterer, the master and crew are the servants of the owners and the ship is available to the charterers for any order they wish to give. Hire continues to be earned. Although the charterers are obliged under the terms of the charter to provide and pay for fuel, should the bunkers run out whilst awaiting orders, it is open to the owners to stem the vessel and to charge that to the charterers' account. In order to complete their part of the bargain, the owners do not need the charterers to do anything in order for them to earn the hire in question. The earning of hire after purported redelivery is not dependent on any performance by the charterers of their obligations."

As can be seen, the question of whether English law will depart from the general rule that an innocent party faced with a repudiatory breach is not obliged to accept this, but can insist on performance, is a difficult one to answer. In practice the best approach is ask whether the factual circumstances are extreme and, against that background, whether the innocent party's approach could be characterised as wholly unreasonable or even perverse. A further factor to bear firmly in mind is whether performance of the contract is going to require such a degree of co-operation from the party in breach that it is really not practically possible for the contract to continue in operation.

Certainly, however, the recent Aquafaith decision can be taken as a warning shot that charterers cannot simply walk away from time charters and leave an owner with a potentially long and complicated process of seeking to recover damages instead. That will be of particular comfort to an owner where, as at present, difficult market conditions leave it in doubt as to whether its charterer will have the financial strength to honour any awards or judgments eventually made against it.

Finally, one further thought should be borne in mind. It is not for the innocent party to show that it is not acting wholly unreasonably or even perversely in the circumstances it is placed in. It is for the other party to show that it is. That is likely to be a high burden to overcome.

Mitigation

A further restriction on the extent to which losses can be recovered as damages revolves around the question of mitigation. The innocent party is obliged to take reasonable steps to minimise its losses – if it does not then it has no right to recover losses over and above this.

This doctrine or rule is best set out in short form in British Westinghouse Co v Underground RY [1912] AC 673 where it was said that it:

"imposes on a plaintiff the duty of taking all reasonable steps to mitigate the loss consequent upon the breach, and debars him from claiming any part of the damage which is due to his neglect to take such steps."

It is worth, however, concentrating on "reasonableness". It is not necessary to go outside a party's normal and reasonable business activities and start involving themselves in complex and potentially disadvantageous alternative steps. In British Westinghouse a passage from another case was quoted with approval where it was said that:

"The law is satisfied if the party placed in a difficult situation by reason of the breach of a duty owed him has acted reasonably in the adoption of remedial measures, and he will not be held disentitled to recover the cost of such measures merely because the party in breach can suggest that other measures less burdensome to him might have been taken."

Great care needs to be taken with this. It may, for example, be that an owner in the shipping context fails to mitigate where it does not take up the offer of an alternative fixture from the party in breach, even though that may still lead to some measure of loss.

Date that damages are assessed

The next important point to consider is the date at which damages will be assessed. The longstanding usual rule is that damages will be assessed as at the date of breach.

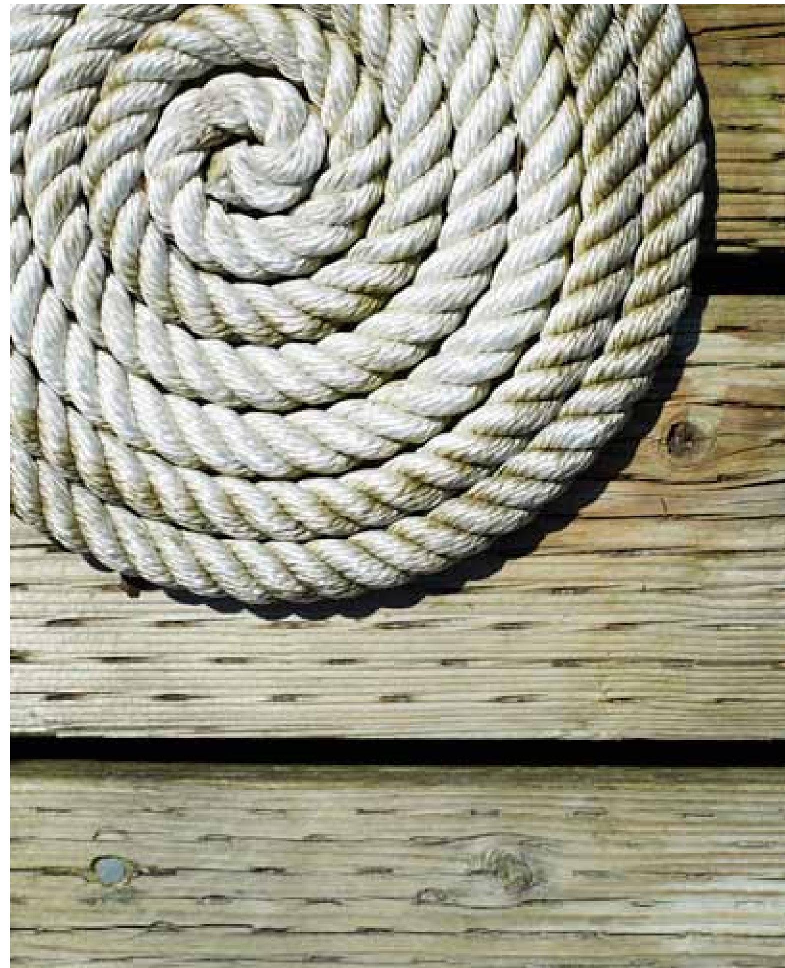
That rule does not always apply. Golden Straight Court v Nipon Yusen Kubishika Kaisha, the Golden Victory [2007] 2 AC 353 is a good example of this in circumstances where a shipowner might have expected a greater recovery than it achieved. This case related to a charterparty that was originally intended to run for seven years.

Three years into this the charterparty was terminated by reason of a repudiatory breach on the part of the charterer. Fifteen months after this repudiation the second Gulf War broke out which would have entitled the charterer to cancel the contract. This left a very simple question on the assessment of damages: should they be assessed at the date of the breach with four years remaining of the charterparty or should, instead, damages be assessed on the fifteen months up to the outbreak of war? Naturally, the charterer argued that it should be fifteen months.

The charterer's arguments on this succeeded all the way up to the House of Lords, which also then found by a 3 to 2 majority in the charterer's favour. The court's reasoning for departing from the usual rule was that the overall objective when assessing damages would be to ensure that the owner had been put in the position which it would have been if the charter had been performed. In this particular case, they felt that was best reflected by limiting damages to a period up to the outbreak of war.

There was, however, an extremely strong dissenting judgment in the House of Lords from Lord Bingham who robustly rejected the concept that the owner would be achieving more than that to which it would have been entitled to. On this he said:

"The thrust of the charterer's argument was that the owners would be unfairly over-compensated if they were to recover as damages sums which, with the benefit of hindsight, it is now known they would not have received had there been no accepted repudiation by the charterers. There are, in my opinion, several answers to this. The first is the contracts are made to be performed not broken. It may prove disadvantageous to break a contract instead of performing it. The second is that if, on their repudiation being accepted, the charterers promptly honoured their secondary obligation to pay damages, the transaction would have been settled well before the Second Gulf War became a reality. The third is that the owners were… entitled to be compensated for the value of what they had lost on the date it was lost, and it could not be doubted that what the owners lost at that date was a charterparty with slightly less than four years to run. This was a clear and, in my opinion, crucial finding, but it was not mentioned in either of the judgments below, nor is it mentioned by any of my noble and learned friends in the majority."



"The longstanding usual rule is that damages will be assessed as at the date of breach."

He also then went on to stress that the great advantage of assessing damages from the date of breach was that it brought certainty and finality to the situations.

Assessment of damages

The first point to make is that the parties are perfectly free to make their own assessment of what damages will follow on from a particular breach in their contracts. Demurrage is a prime example of this. Where, in a voyage charter, a charterer exceeds the laytime contractually allowed to it to complete loading and discharge operations, then it has committed a breach of charter.

There are a variety of instances where a monetary sum for damages can be agreed rather than this having to be assessed against general legal principles.

There are limitations on this.

English Law looks for a genuine pre-estimate of losses reached between the parties. Where that assessment is considerably in excess of what could be said to be a sensible and reasonable estimate of the losses then it may be considered to be a penalty. The basic concern being that an oppressive figure completely unrelated to the actual loss has been included. The wording of many contracts is often unhelpful in that it will include phrases like “penalty for non-performance”. In fact, if the figure included thereafter is found to amount to a genuine pre-estimate it will not fall foul of the general principles relating to the assessment of damages. If, on the other hand, it amounts to a penalty, English law will not support it.

In the absence of the parties having already agreed contractually the assessment of damages then these fall to be decided according to general principles.

As can be seen from the quote from Robinson v Harman right at the beginning of this section English law concentrates on the financial loss to the claimant. For the most part, a very narrow approach has been taken to this in the decided cases and it is fair to say that for the foreseeable future that is likely to remain the position.

A good example of the thinking underlying this approach is illustrated by an extract from the judgment of Lord Bingham, when he considered the basic formulation laid down in Robinson v Harman in a case called White Arrow Express Ltd v Lamey’s Distribution Ltd [1996] Trading Law Reports 69, 73, where he said in strong terms that this:

“Formulation assumes that the breach has injured the (claimant’s) financial position; if you cannot show that it has you will recover nominal damages only”.

In other words it will recover little or nothing.
As part of that, recovery will be based on the principle of calculating the net loss to the claimant. If it has made some kind of financial benefit out of the breach then this will be deducted from the damages that can be recovered. A good example, in the shipping area, would be where there is a salvage value for goods that had been damaged by reason of a breach of the contract of carriage. The sums realised from that salvage process must be deducted before the claim can be presented.

This principle has no limitations. The position can sometimes be reached where sums realised through alternative steps taken following the breach reduce the losses to the innocent party to nothing. Again in that situation it would only be entitled to recover nominal damages.

Wasted expenditure as basis for damages

Despite this concentration on financial loss English law has recognised that this does not always provide either a fair or sensible remedy such that a measure of flexibility has to be introduced. Whether, in fact, these different approaches amount to exceptions to the general rule or are simply one part of the overall concept has given rise to considerable judicial and academic debate which, for the most part, can be ignored in terms of practical application.

A clear example, however, is the situation where a claimant is concentrating not on the financial gain it expected to make out of a bargain but on the cost and expense thrown away by it in expectation that the other party was going to fulfil the contract. This is sometimes described as a "reliance" measure of damages rather than the classic expectation loss.

The general principles relating to protecting an innocent party's reliance interest arise out of two cases from the film world.

The first of these includes important observations from Lord Denning in Anglia TV v Reed [1972] 1 QB 60.

In this case, a television company had contracted with an actor, Robert Reed, to take the lead part in a play intended for television. Mr Reed pulled out of the contract shortly after it had been concluded. The TV company was unable to find an alternative actor and abandoned the project. Its claim was not, however, one for any loss of expectation in the sense of the profits which might have been made but, instead, was for its wasted expenditure. On this Lord Denning said:

"It seems to me that a plaintiff in such a case as this has an election: he can either claim for loss of profits; or his wasted expenditure. He must elect between them. He cannot claim both. If he has not suffered any loss of profits – or if he cannot prove what his profits would have been – he can claim in the alternative the expenditure which has been thrown away, that is, wasted by reason of the breach."

As an aside, one interesting feature of the case is that Lord Denning said the TV company was able to recover not just expenditure incurred after the contract was entered into but also pre-contract expenditure. There are limits on this in that Lord Denning said this was on the basis that Mr Reed "must have contemplated – or, at any rate, it is reasonably to be imputed to him – that if he broke his contract, all that expenditure would be wasted, whether or not it was incurred before or after the contract. He must pay damages for all the expenditure so wasted and thrown away."

That case was followed up by CCC Films (London) Ltd v Impact Quadrant Films Ltd [1985] QB 16 affirming that a claimant was granted the right to choose whether to claim for loss or damages arising out of the bargain, broken breach or for wasted expenditure.

There are, however, limits on this. It may well be that a claimant knows full well that it has entered into an extremely bad bargain and will never make a profit out of this. If, instead, it seeks to recover wasted expenditure that will not always be recovered. A classic example comes out of the property world where a party leasing a property may make improvements to it, despite knowing that, under the terms of a lease, it would not be compensated for these improvements and that it would have to remain in place at the termination of the lease. When, in brief, the landlord terminated the lease in breach the claimant's action failed because he would simply have been left in the same position had the contract been terminated contractually. One important restriction on this, however, is that cases do make it clear that it is for the defendant in an action to show that it was a bad bargain rather than for the claimant to establish that it was not.

A case from the shipping world illustrates how difficult in practice it can be to differentiate between dividing damages up into sub-categories of either profits, which would have been made had the contract been performed as intended, or expenses, which are wasted because it was not. This is Omak Maritime

Wasted expenditure as basis for damages (continued)

Ltd v Mamola Challenger Shipping Co, the Mamola Challenger [2011] 1 Lloyds Rep 47.

In that case Teare J rejected the concept that there were two different bases on which damages should be assessed stating:

"I consider that the weight of authority strongly suggests that the reliance losses are a species of expectation losses and that they are neither "fundamentally different" nor awarded on a different "juridical basis of claim"."

The facts are unusual in that the charterer, having entered into a long term charterparty on what were favourable rates, in that they were below the market, repudiated the contract. The owner's position was that it was entitled to recover as damages expenses it had incurred in preparing to perform the charterparty. It said that it was irrelevant that those expenses had been entirely mitigated because, following the repudiation, it went on to earn enhanced rates of hire at the market rate.

The dispute was initially arbitrated and the arbitrators accepted these arguments. On appeal, however, Teare J overturned the award saying that the tribunal had erred by regarding the claim for loss of wasted expenses and claim for loss of profits as two separate and independent claims which could not be mixed together. As he said:

"I am not therefore persuaded that the right to choose or elect between claiming damages on an expectancy basis or on a reliance basis indicates that there are two different principles at work. Both bases of damages are founded on, and are illustrations of, the fundamental principle in "Robinson v Harman…" I am, therefore, unpersuaded that the expectation loss principle cannot provide a rational and sensible explanation for the award of reliance losses. The reasons regarding the expectation loss principle as explaining an award of reliance losses have been set out in American, Canadian, Australian and English cases. They are substantial reasons. Moreover, they illustrate that the principle in Robinson v Harman is what it has been declared to be, namely, the fundamental principle governing damages for breach of contract."

“Cost of Cure” basis of assessment

Despite this, there are other areas of law where it appears to be accepted that a pure application of these principles does not provide the claimant with an adequate remedy in damages.

This is where the claimant is seeking to recover damages on what has been called a “cost of cure” basis. The leading case here relates to a swimming pool but examples given below will show that it does have considerable relevance to the shipping world.

The case in question is Ruxley Electronics & Construction Ltd v Forsyth [1996] AC 344. In this case, a swimming pool constructed for the defendant by the claimant was intended to be 7ft 6ins deep at its deep end. In the event, however, it was a mere 6ft 9ins. The claimant wanted to recover the cost of re-building the pool so that it was in accordance with the originally agreed depth. This would cost £21,560 and it is perhaps remarkable in itself that such a relatively small amount of money ended up being the subject of a House of Lords decision.

The House of Lords rejected the cost of cure basis for damages. What is important, however, is they did not reject this as a matter of principle. What they said was that, on the particular facts of this case, it was not reasonable to work on this basis. An important point made was that the costs of the work was going to be out of all proportion to the benefit to the defendant of increasing the depth. Much revolved around whether the pool was going to be safe for diving or not.

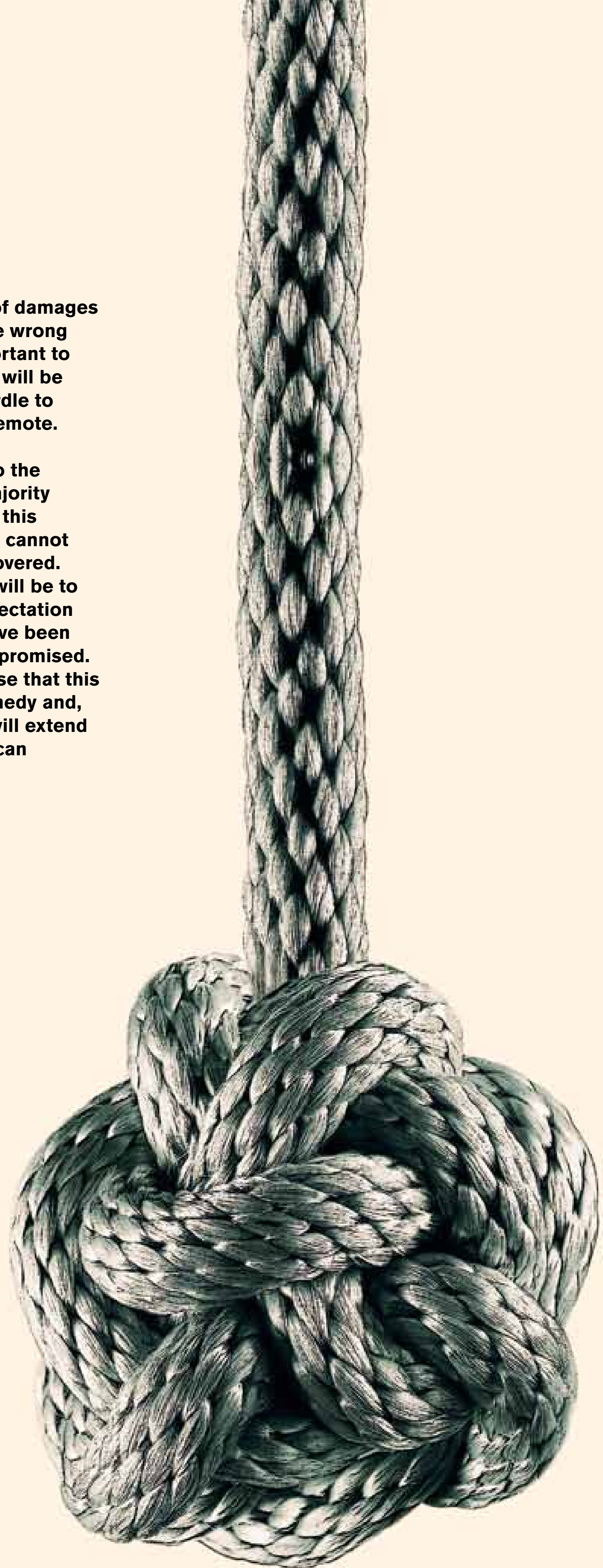
It had been intended to use the deep end to dive into, but not from a diving platform - simply from the edge of the pool. It was found that the lack of depth caused no unsafety for this. Another telling point was that the claimant did not have any intention of actually increasing the depth of the pool – it simply said that damages should be assessed on the basis of what it would cost it had it chosen to.

What the case does not decide, therefore, is that damages can never be assessed on a cost of cure basis. From the shipping world one can think of some examples. By way of illustration, there is the situation where a ship is redelivered to its owner after a long-term bareboat charter in breach of maintenance warranties. As is often the case, it may well be that the owner’s intention on redelivery was to scrap the ship. In these circumstances, it would normally be the case that defects have little or no impact on scrap values. As such, it would be plainly unreasonable to award the costs of remedying the defects against the charterer.

Equally, however, the facts may show that the owner quite reasonably intended to then trade the ship for its own account and that remedying the defects was essential in order to do this. Even so, it might be that the costs of repairs outweigh the impact on the market value of the ship. In those circumstances, it is likely that damages would be awarded on the basis of the cost of making good the defects rather than the difference in the market rate. It should be said, however, that this bald statement should be treated with some caution.

“What the case does not decide, therefore, is that damages can never be assessed on a cost of cure basis. From the shipping world one can think of some examples.”

Summary



In conclusion, therefore, the question of damages often seems to be approached from the wrong initial perspective. In practice it is important to establish whether certain types of loss will be recoverable in any event. The major hurdle to this is to show that they were not too remote.

Only then does the claimant move on to the assessment of damages. In the vast majority of cases, the courts will look to assess this purely in terms of monetary loss. If this cannot be shown then no damages will be recovered. Equally, the general principle adopted will be to look at the innocent party's loss of expectation – what financial position they would have been in had the contract been performed as promised. Nonetheless, English law does recognise that this cannot always provide an adequate remedy and, despite many attempts to rein this in, will extend this to other bases on which damages can be assessed.

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