Remedies: One small step

Gwendoline Davies explores Supreme Court case law on contractual damages

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Commercial parties are generally aware that a breach of contract gives rise, in the majority of cases, to a liability to pay financial compensation to the innocent counter-party/ies. While that is a relatively straightforward proposition, there are some complexities in the law of contractual damages which can have a significant impact on the calculation and quantum of any damages ultimately awarded. In fact, the complexities are such that, in recent years, no less than three contractual damages cases have gone all the way to the Supreme Court, providing parties and practitioners with some much-needed clarity.

The compensatory principle

The fundamental ‘compensatory principle’ underpins the assessment of damages in contract law in England and Wales. The principle provides that the purpose of an award of damages is to compensate the injured party for loss, rather than to punish the wrongdoer. That is, damages should (so far as a monetary award can) place the claimant in the same position as if the contract had been properly performed.

A general rule is that damages are assessed at the date of breach, save where justice requires a departure from that date. However, an earlier House of Lords case, *The Golden Victory* [2007], established that, when assessing damages, the court should take account of the effect of subsequent events on the claimant's loss. *The Golden Victory* has therefore been said to offend the general rule. In the 2015 case of *Bunge SA v Nidera BV*, the Supreme Court confirmed that it is just and necessary to consider post-breach events known at the date of assessing damages, to the extent that they are relevant to and affect the claimant's loss.

Bunge

The parties had entered into a contract for a one-off sale of Russian milling wheat. The contract provided for shipment between 23 and 30 August 2010, but Russia then introduced an embargo on agricultural exports which was to run from 15 August to 31 December 2010. On 9 August, Bunge (the seller) purported to cancel the contract. Nidera (the buyer) argued that the contract was cancelled prematurely as the ban had not yet come into effect, and therefore treated the seller's action as a repudiatory breach.

On the following day, the seller offered to re-instate the contract. The buyer did not agree, and instead brought a damages claim for some $3m. That sum was the difference between the contract and market price as at the date of acceptance of repudiatory breach, as calculated under the contractual clause which attempted to deal with assessment of damages in the event of default. The seller argued that, although it had been in anticipatory breach, the contract would have been cancelled as a result of the embargo in any event, such that the buyer had not suffered a loss as a result of the breach and, under the compensatory principle, was not entitled to any damages.

The case was argued before the relevant First-tier Tribunal, an appeal board, the High Court and the Court of Appeal and it eventually reached the Supreme Court – such is the importance of the proper application of the assessment of damages principles.

‘It is necessary for the court to consider post-breach events known at the assessment of damages if they are relevant to and affect the claimant’s loss.’

The Supreme Court confirmed that:

- Due to the embargo, the contract would never have been performed.
- It is necessary for the court to consider post-breach events known at the assessment of damages if they are relevant to and affect the claimant’s loss.
- The compensatory principle is fundamental to the assessment of damages such that damages must reflect the loss, if any, that the innocent party has suffered.
- Default/damages clauses which attempt to provide a prospective formula for calculating damages in the event of breach may produce a different result from the common law. However, in the absence of very clear words, such clauses may be assumed not to operate arbitrarily, for example by producing a result unrelated to anything which the parties could reasonably have expected to approximate the true loss.
- Default/damages clauses should not, in any event, necessarily be regarded as complete codes for the assessment of damages. It will rarely be possible or appropriate for a contract draftsman to achieve a clause which could be correctly interpreted and applied in such an all-embracing way.

Applying those principles to the case, the claimant was awarded nominal damages of just $5 – very significantly less than the $3m it had claimed!

The New Flamenco

In the 2017 case of *The New Flamenco*, the Supreme Court considered the treatment of collateral benefits and mitigation of loss in the calculation of damages.

This high-profile dispute concerned a charterer's redelivery of a cruise ship to its owners early (in October 2007, instead of in November 2009), in repudiatory breach of charterparty. The owners accepted the charterer's early delivery breach as terminating the contract and claimed loss of earnings for what would otherwise have been the remainder of the term. The owners then sold the vessel towards the end of October 2007, obtaining a better price for it than they would have achieved had they sold it in November 2009 (the date that would otherwise have been the end of the charterparty term), post the global financial crisis.

The question was whether damages payable by the charterers, the breaching party, should be reduced by (and therefore whether the owners should have to give credit for) the value of the benefit that the owners had received by selling in October 2007.

Dancing around mitigation of damages

At an initial arbitration, the case was decided in favour of the charterers. That decision was appealed to the High Court, which found, instead, for the owners. Popplewell J attempted to distil, from relevant authorities, some general principles, which can be summarised as follows:

- In order for the receipt of a benefit by an innocent party to result in the reduction of damages payable by a breaching party, the benefit must be caused by the breach.
- Determining causation is a question of fact and degree, which must be answered taking all relevant circumstances into account, including the nature and effects of the breach and the nature of the benefit obtained and the loss claimed, and forming a common-sense overall judgement.
- The causation test will not be satisfied if the breach merely causes the occasion, trigger or context for the innocent party to obtain the benefit; nor is it sufficient that the benefit would not have been obtained 'but for' the breach.

- A mitigating step may be a reasonable and sensible step taken to reduce the impact of a breach, but that does not mean that the breach is legally causative.
- Benefits flowing from a step taken in reasonable mitigation are only to be taken into account to reduce recoverable damages if and to the extent that they are caused by the breach.
- The causation test is unlikely to be met where and to the extent that the benefit arises from a transaction which the innocent party could have undertaken irrespective of the breach.
- It is not necessary that the benefit is of the same kind as the loss claimed or mitigated.
- Even where the causation test is met, considerations of fairness and public policy may nonetheless preclude the benefit from being taken into account to reduce recoverable damages. In particular, benefits which are the fruits of something that the innocent party has done or acquired should not be taken into account, and therefore be effectively appropriated for the benefit of the wrongdoer, where that would be unfair.

The High Court's decision was then overturned at the Court of Appeal, and the Court of Appeal's decision was, in turn, appealed to the Supreme Court…

Supreme Court clarity: causation is key

… which unanimously overturned the Court of Appeal's decision and found for the owners on the basis that there was an insufficient link between the early redelivery and the sale at a pre-financial crisis price for the causation test to be met. The vessel could have been sold at any time (regardless of whether the charterparty had been terminated or was continuing). At best the breach had prompted a sale – it had certainly not legally caused it – and the sum for which it was sold was dictated by the prevailing market and irrespective of the breach.

The Supreme Court's judgment therefore centred on the causation test. That is, for an innocent party's benefit to be brought into account to reduce damages payable by a breaching party, the benefit must have been legally caused either by the breach or by a successful act of mitigation.

What's the damage(s)?

The majority of commercial contract disputes involves a claimant's pursuit of standard, 'loss-based' damages where the innocent party is put in the position it would have been in if the contract had been properly performed. In certain other types of legal claim (such as claims against fiduciaries, claims for breach of confidence, unjust enrichment claims, and the like), defendants can be ordered to surrender profits (or to 'account') where they have profited from a wrongdoing at the expense of another. In the very recent case of *Morris-Garner v One Step (Support) Ltd* [2018] (a case dealing with a defendant's breach of restrictive covenants), the Supreme Court has addressed the circumstances in which an alternative 'gain-based' type of damages might be available.

The to-ing and fro-ing of 'negotiating damages'

Case law surrounding the availability of gain-based damages has been unclear, and even contradictory, going back to the 1974 first instance property law decision in the case of *Wrotham Park Estate Co Ltd v Parkside Homes Ltd*. Here, a property developer had developed land in breach of a restrictive covenant and although the development had not diminished the value of the claimant's estate 'by one farthing', the court considered that it would be unjust for the claimant not to be compensated at all. The court awarded damages in lieu of an injunction and the amount was such as the claimant might reasonably have demanded as a quid pro quo for relaxing the covenant which had been breached. The underlying principle was that the claimant can recover such sum as the

defendant would have paid to release the relevant obligations – the defendant has received a gain from its breach and the innocent party has lost a sum which it could otherwise have gained from a commercial negotiation.

This type of damages has interchangeably been referred to as a *Wrotham Park* award, hypothetical bargain damages, negotiating damages or release-fee damages.

In the 2000 case *Attorney General v Blake*, the House of Lords decided that this type of damages should only be exceptionally available for breach of contract claims, but in 2016, hearing *Morris-Garner*, the Court of Appeal suggested that negotiating damages could be available where that provided a just result, and that there was no need to establish exceptionality. That decision appeared to mean that negotiating damages would be available to claimants more readily than ever before.

Supreme Court rows back from *Wrotham Park* damages

In a judgment that represents a significant ‘rowing back’ from that position, the Supreme Court has now confirmed the following:

- The award of damages can only be based on legal principle. Judges have no discretion as to, nor can claimants choose, the basis on which damages can be awarded.
- Common law damages for breach of contract are intended to compensate the claimant for loss or damage resulting from the non-performance of the contractual obligation in question. It is therefore for the claimant to establish that a loss has occurred (or that it is in a less favourable position than it would have been had the contract been properly performed). If no loss can be established, then the claimant cannot be awarded more than mere nominal damages.

- Mere difficulty in quantifying loss does not justify an award of damages on anything other than the loss-based, standard basis.
- Similarly, an award of damages on anything other than the loss-based, standard basis is not justified either because the breach was deliberate or to deprive the defendant of profits derived from its breach.
- Negotiating damages can, however, be awarded for breach of contract where the defendant has effectively taken something for nothing, for which the claimant would have been entitled to require payment. The rationale is that the claimant has been deprived of a valuable asset and determining the value of that asset is an appropriate means of quantifying loss.

Practical advice

So, what practical lessons can we learn from the recent Supreme Court authorities on the calculation of contractual damages?

- To avoid a calculation catastrophe similar to the claimant's in *Bunge*, when reviewing your contractual arrangements or any potential claims, keep in mind these top tips:
    - When a breach occurs or a contract is terminated before the contractual date, consider carefully the circumstances in which this has occurred. Assess whether the breach or early termination has actually caused any loss, bearing in mind the surrounding contractual terms and any post-breach events, before taking any action or initiating proceedings.
    - As well as contingent circumstances such as those in the *Bunge* case, there may be other situations in which the date for assessment of damages may be later than the date of breach, such as where there is no market by which the claimant can act to avoid further losses or where the breach is not known to the claimant when it is committed, for example.

- If the parties wish to pre-emptively designate in the contractual terms a formula for assessing damages in the event of a breach, specialist advice will be needed. Great care must be taken to ensure that any such damages clauses do not amount to unlawful penalties (see *Cavendish Square Holding BV v El Makdessi*; *ParkingEye Ltd v Beavis* [2015]) and, if the intention is to exclude the compensatory principle or the claimant's duty, at common law, to mitigate loss (as to which, see below), then the clearest express wording will be required.

- The Supreme Court's *New Flamenco* decision is an important statement of the law on the treatment of collateral benefits and mitigation. Practitioners and commercial contracting parties should bear in mind the following points:
    - The duty to mitigate: a party cannot recover damages for any loss which it could have avoided but failed to avoid through its own unreasonable action or inaction.
    - Where the market affords an option or options for the claimant to minimise its losses, the claimant should take reasonable steps to avail itself of such option(s).
    - The claimant is only required to act reasonably, however, and case law explains that the standard of reasonableness in this context is not high. For example, less will be expected of a claimant who is acting in the heat of a crisis; a claimant's resources will be taken into account when deciding what is reasonable and a claimant need not take risks with its money; and a claimant need not risk its reputation, property or rights in order to mitigate (see: *USA v Laird Line* [1924]; *Wroth v Tyler* [1974]; *Jewelowski v Propp* [1944]; *James Finlay & Co Ltd v NV Kwik Hoo Tong Handel Maatschappij* [1929]; *Elliott Steam Tug Co Ltd v Shipping Controller* [1922]).
    - Where a defendant makes an offer, a claimant must consider carefully. A claimant could be in breach of its duty to mitigate if it unreasonably failed to accept a clear, well-supported and suitable offer, but it would

not be required to tolerate or accept a sub-standard proposal for fear of forfeiting its damages claim.

- A claimant should give credit for any monetary benefit received as a result of mitigating steps taken whether such benefit was anticipated or not, but the burden of proving any such benefit (which may be very difficult) falls to the defendant.
- When let down by a supplier or faced with any breach of contract, a business should always weigh its options before taking any action either to mitigate loss or to initiate legal proceedings. This is particularly the case where alternative means of mitigating may exist. That is not to say that potential claimants have any time to delay, however, because if reasonable opportunities to mitigate are not taken, every minute can mean cost.
- Finally, Popplewell's *New Flamenco* principles (as set out above) should be applied when calculating damages in post-breach/collateral benefit cases.

- The Supreme Court's decision in *Morris-Garner* means that, in practice, negotiating damages may well be available in cases involving the breach of a restrictive covenant over land, an intellectual property or confidentiality agreement, for example, whereby detriment suffered by the claimant is not purely economic, but otherwise this type of gain-based damages for breach of contract is likely to be available only exceptionally after all.
- Overall, and coming full circle back to the *Bunge* case, claimants should, when assessing the likely merits and costs involved in pursuing any claim, also be clear and accurate as to the correct legal basis on which damages can be awarded in their particular claim. In particular, claimants should beware of oversimplifying, and therefore potentially overestimating, their damages claim.

Cases Referenced

Cases in **bold** have further reading - click to view related articles.

- ***Attorney General v Blake & anor* [2000] UKHL 45**
- ***Bunge SA v Nidera BV* [2015] UKSC 43**
- *Cavendish Square Holding BV v El Makdessi; ParkingEye Ltd v Beavis* [2015] UKSC 67
- *Elliott Steam Tug Co Ltd v Shipping Controller* [1922] 1 KB 127
- *Globalia Business Travel SAU of Spain v Fulton Shipping Inc of Panama ('The New Flamenco')* [2017] UKSC 43
- *Golden Strait Corporation v Nippon Yusen Kubishka Kaisha ('The Golden Victory')* [2007] UKHL 12
- *James Finlay & Co Ltd v NV Kwik Hoo Tong Handel Maatschappij* [1929] 1 KB 400
- ***Jewelowski v Propp* [1944] KB 510**
- *Morris-Garner & anor v One Step (Support) Ltd* [2016] EWCA Civ 180; [2018] UKSC 20
- *USA v Laird Line* [1924] AC 286
- ***Wroth v Tyler* [1974] Ch 30**
- ***Wrotham Park Estate Co Ltd v Parkside Homes Ltd* [1974] 1 WLR 798**