CONTRACT LAW SEMINAR

DAMAGES FOR BREACH OF CONTRACT

THE DIFFICULTY OF APPLYING THE PRINCIPLES TO REAL CASES

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Introduction

1. This paper primarily considers 2 recent decisions in the United Kingdom courts. Both illustrate the difficulties which can arise in applying the established general principles concerning the assessment of awards of damages for breach of contract. Both are relevant to a jurisdiction such as ours in which the common law principles are applied to the assessment of damages. The nature of the framework provided by those principles means that factual situations may well arise in which experienced commercial lawyers will disagree on the monetary compensation which is required to meet the central requirement for an award of damages in contract – namely to award the plaintiff the sum of money which best reflects the value of the defeated contractual expectation[1]. In this area, it is as well to remind oneself that there are probably no absolutely fixed rules which produce an answer in the same way as the application of a mathematical formula.

> In such a case as this it also appears important to keep in mind and pay more than lip service to a warning contained in a number of leading judgments, among which it is sufficient to mention the well-known speech of Lord du Parcq in *Monarch Steamship Co Ltd v Karshamns Oljefabriker (A/B)* [196, 232-233; [1949] 1 All ER 1, 19. The essence of Lord de Parcq's observations and of the observations quoted by him in his speech is that in the end the assessment of damages is a question of fact. Rules capable of meeting all cases are unlikely to be devised and, as Wilde B said, '…it will probably turn out that there is no such thing as a rule, as to the legal measure of damages, applicable to all cases'."[2]

2. Before turning to the cases which reveal the uncertainties in this area of contract law (and there are many more cases in the text books and journal articles on damages in contract[3]), it should also be noted that, in most commercial situations, the established principles, which have been developed and refined over many years by the courts, will permit commercial parties (and their advisers) to predict with a measure of certainty the compensation which will be payable as damages for breach of contract.

3. In more difficult economic times, it is inevitable that commercial advisers will be called upon to assess the consequences of breaches of contract with greater frequency, and that this exercise may involve taking into account matters such as the significant, perhaps unexpected, movements in various commercial markets. While the two cases which are discussed come from the market in which ships are chartered internationally, they provide good examples of the kind of issues which can arise in many different commercial situations. In New Zealand,

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[1] *Robinson v Harman* (1848) 1 Exch 850 at 855 per Parke B.
[2] *Stirling v Poulgrain* [1980] 2 NZLR 402.
[3] See eg., *Some issues in the assessment of expectation damages* by Professor David McLauchlan, New Zealand Law Review, Part IV [2007], page 563. This article contains a helpful review of decisions in areas such as the assessment of damages where post-breach gains by the plaintiff have to be considered. It also contains a discussion of the case of *The Golden Victory* which is referred to later in this paper.

many of the decisions involving the assessment of damages and the application of the principles of remoteness come from disputes over real property. While this means that the commercial and factual context is different, the issues which can arise have much in common with those which arise in other markets around the world.

General principles

4. Various principles define and delimit the damages which will be awarded to compensate a plaintiff for breach of contract. Equitable remedies are concerned with requiring performance of obligations, while the common law provides for compensation in monetary terms to compensate the plaintiff for loss of bargain.[4] In New Zealand, while section 9 of the Contractual Remedies Act 1979 provides a wide discretion for relief to be granted where a contract is cancelled, the common law principles are still applicable to the assessment of damages in this area and in other claims for damages for breach of contract.[5]

5. The economic consequences of a breach of contract may well be far reaching and various kinds of loss may ensue. Causation and the principles governing remoteness control the extent of recovery. Where a kind of loss is held to be recoverable, further principles govern the assessment and quantification of that loss.

6. The two cases which are examined below concern the principle that damages are to be assessed and measured as at the time of breach of contract (unless there are exceptional reasons to depart from this approach) and the principles of remoteness which seek to identify the types of loss which can be recovered as a consequence of a breach of contract. The factual situations in the disputes show how the way in which the principles are applied can make significant differences to the award of damages which is said to meet the requirement of compensating the plaintiff for its lost contractual expectation.

The "breach date" rule

7. The general rule is that the sum of money which the plaintiff should recover as damages has to be assessed at the time when the contract is broken. However, the rule is not universal and yields to the interests of justice where that is required to meet the general aim of an award of damages.[6] The reason for the rule appears to be that it allows for parties to a contract to know where they stand as at the time of breach as far as the assessment (and payment) of

[4] While a damages award can encompass what is termed "reliance" loss and "restitution" damages, the central focus of an award of damages in contract is to compensate the plaintiff for the lost bargain, to award "expectation damages".
[5] See sections 9 and 10 Contractual Remedies Act 1979; for a discussion of the role of section 9, see *Law of Contract in New Zealand,* 3rd Edition, Burrows Finn and Todd, pages 726 – 731, and *Newmans Tours Ltd v Ranier Investments Ltd* [1992] 2 NZLR 68, for a consideration of the wide potential scope of relief under section 9 of the Act.
[6] *James v Moolla Dawood Sons & Co* [1916] AC, 175, 179.

damages is concerned. Such a rule permits commercial parties to quantify the damages, settle and move on.

The principles on remoteness

8. If a loss can be linked to a breach of contract in a causative sense, the next question is whether the type of loss sustained is recoverable. The losses caused by a breach of contract can be extensive, and the law has to control the economic consequences of a breach so that the innocent party is not over-compensated for the lost bargain. This involves an assessment of the kind of loss that would be reasonably contemplated by the parties as a consequence of a breach of contract. There have been various attempts to formulate and refine "tests" in this area. While different approaches have been postulated, in various common law jurisdictions, the starting point remains, for most Judges and contract lawyers, the celebrated *dictum* in *Hadley v Baxendale*[7] (as refined, developed and applied in later decisions). It is, perhaps, worth reading and setting out in full the well known statement from Alderson B in *Hadley v Baxendale.*

> Now we think the proper rule in such a case as the present is this: 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. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. But, on the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he, at the most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract. For, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to the damages in that case, and of this advantage it would be very unjust to deprive them. Now the above principles are those by which we think the jury ought to be guided in estimating the damages arising out of any breach of contract. [pages 354-355]
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> ….
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> But it is obvious that, in the great multitude of cases of millers sending off broken shafts to third persons by a carrier under ordinary circumstances, such consequences would

[7] (1854) 9 Exch 341 at pages 354 -355

> not, in all probability, have occurred, and these special circumstances were here never communicated by the plaintiffs to the defendants. It follows, therefore, that the loss of profits here cannot reasonably be considered such a consequence of the breach of contract as could have been fairly and reasonably contemplated by both the parties when they made this contract. [page 356]

9. This test has been refined and considered in later decisions. The general position reached is that the phrase "would arise" imposes too high a hurdle, and should be replaced by "not unlikely to arise" or "liable to result". There have been attempts to assimilate the approach to remoteness in contract to that which applies in tort. While this has more attraction in cases involving a contractual duty of care, most decisions of the higher Courts in the common law world retain the distinction in approach between contract and tort, particularly where a claim for breach of the express terms of contract is concerned. To an extent, the second decision of the House of Lords which is referred to below, reflects some differences as to the formulation of the starting point for the inquiry in assessing the remoteness of losses, although the different starting points make no difference to the result in the case. In the New Zealand Courts similar dissenting views on the continuing applicability of the *Hadley v Baxendale* "test" in New Zealand have been expressed.

10. In *McElroy Milne v Commercial Electronics*[8] Cooke P expressed the view that the "test" in *Hadley v Baxendale* did not necessarily reflect the law in New Zealand. The element with which the President was, perhaps, most concerned was the requirement that the damages "would arise" in most cases of the kind, when something less such as reasonable foresight should be required, and there were different statements as to what was required in the English cases. His judgment also refers to the possibility that there should be no difference between remoteness in the tort of negligence and remoteness where there is a negligent breach of contract.

11. The President proposed a more general approach to the assessment of the recovery of a type of loss which aims to reach a common sense, practical result by approaching remoteness as a question of fact, and by considering a range of factors to assess the reasonable foresight of the type of loss. He did not seek to formulate any new test, but rather expressed a preference for an approach based on practical justice. In the case the different approach made no difference to the outcome. McKay J used the established test in *Hadley v Baxendale* as his starting point in the case and reached the same result.

12. The general approach to remoteness is still guided by the dictum in *Hadley v Baxendale* which provides for the important difference between ordinary, expected losses arising from a contract and losses which can only arise in special circumstances. However, as noted, the process of analysing whether a particular type of loss is recoverable can only begin with the general principles. The exercise requires a close analysis to determine what type of loss has

[8] [1993] 1 NZLR 39

been caused by the breach, and whether it is, as a matter of fact, recoverable. Once a type of loss is not too remote, it will be recoverable in full as quantified (subject to arguments on such matters as failure to mitigate and, possibly, contributory negligence).

The Golden Victory in the House of Lords – the time at which damages are to be assessed

13. The case concerned the application of the well established principles of contract law concerning the assessment of damages for breach of contract in a commercial context – the chartering of a ship. While the facts of the case were straightforward, a point arose on which the House of Lords divided three to two in dismissing the shipowner's appeal.[9] The different views in the House of Lords represent, in a general sense, a division between those who favoured the application of an established general rule which they saw as promoting commercial certainty, and those who were of the view that the established rule should give way to a more flexible approach so as to produce what they regarded as a just assessment of damages for breach of contract which did not over-compensate the plaintiff.

Facts

14. A charterer wrongfully repudiated (terminated) a charterparty which had four years to run. The owner accepted the repudiation and chartered the vessel out again into the market. The owner claimed damages from the charterer assessed as at the time of the breach by reference to the losses on the balance of the charter. By the time the matter came to hearing before a maritime arbitrator under the arbitration clause in the charterparty, the second Gulf war had broken out. At the time of the breach of contract by the charterer, the arbitrator found that the outbreak of the Gulf war was no more than a "possibility". If the charterer had not wrongfully repudiated the charterparty, and the charter had continued, the charterer would have been entitled to bring the charterparty to an end on the start of the war by relying on a "war clause" in the charterparty. The arbitration found that the charterer would have brought the charter to an end (if it had not repudiated and the charter had continued). The question for the courts was whether the owner could claim damages assessed by reference to the whole of the charterparty period disregarding the outbreak of the war and the right to terminate under the contract, or whether the amount of damages had to be reduced because, by the time of the hearing, it was known that the charterparty could have been terminated by the charterer.

15. The general principles have been noted. An award of damages seeks to put the innocent party in the same position as it would have been in had the contract been performed – to compensate for the value of the lost contractual rights. Generally, damages for breach of contract are assessed as at the date of breach, unless there are exceptional circumstances which justify a departure from this approach. How are the principles to operate here? The

[9] The case began as a London maritime arbitration. The arbitrator had found in favour of the charterer of the *Golden Victory*. This decision had been upheld by the High Court and Court of Appeal.

assessment of the value of the contractual expectation lost by the owner turns on the time when the question is examined.

Minority view

16. Lord Bingham (with whom Lord Walker agreed) would have decided the case by reference to the established principles by assessing damages as at the date of repudiation. He would have allowed the owner to claim damages without a reduction to take account of the fact that the war would have allowed a legitimate termination of the charterparty. Where the charterer was in repudiatory breach, the owner was entitled to have the damages assessed as at the time of the breach unless, at that time, it was clear that the contractual rights would be diminished or be of no value, or there was a recognised chance that this would occur[10]. In this case the outbreak of the war had been held to be "merely a possibility" at the time of the charterer's repudiation by the arbitrator, with the consequence that the value of the contract rights at the time of repudiation was not diminished on account of the event. The owner was entitled, in Lord Bingham's view, to be compensated for the value of the rights lost at the time of the repudiation. This application of the general rule accorded with the need for certainty and finality in a coherent system of contract law, and it was contrary to principle to find that the accrued rights to claim damages vested in the owner at the time of the repudiation could be changed by subsequent events. Assessment of damages by reference to the position at the time of repudiation, promoted certainty, and allowed commercial parties to assess and pay damages as at the time of repudiation. Disagreeing with the majority, Lord Bingham distinguished the cases where the courts have taken subsequent events into account in assessing damages as not being concerned with the assessment of damages for breach of contract where there had been repudiatory breach. He did not agree that earlier authority in the High Court had bound the arbitrator to reject the owner's arguments which were, in his view, well established on principle.[11]

Majority view

17. The central point made by the majority of their Lordships[12] was that the assessment of damages in contract seeks to value the rights lost, and that the rule that the lost rights have to valued as at the date of breach should not be applied inflexibly. The majority held that, to apply the "date of breach" rule in the manner in which the minority would have applied it, was inconsistent with the general principle and the authorities. They held that, where subsequent events clearly showed that the value of the contractual rights of the innocent party under a

[10] See, eg. *The Mihilis Angelos* (1971) 1QB 164 a case of anticipatory repudiatory breach where it was held that a party could only recover nominal damages for anticipatory breach of contract where the evidence established that, had the contract continued, the innocent party would not have performed its obligation (to provide a ship) under the contract.
[11] *The Seaflower* [2000] 2 Lloyd's Rep 37 a decision which Lord Bingham regarded as a decision in which the established principles were applied to assess damages.
[12] Lords Scott, Carswell and Brown

long term contract had, **in fact**, diminished in value by the time of the hearing, the court had to take this loss in value into account in assessing damages, even if, at the time of breach there was only a slight possibility of the event happening. The majority relied on a number of authorities where, in particular circumstances, the Courts had not applied the general rule that damages had to be assessed at the time of breach in order to arrive at a fair assessment of damages. However, none were directly on point. The opinion of the majority rested on the basic premise that, if contract damages could be reduced to take into account events which might happen after the date of breach where assessment was carried out at the time of breach, there should be no question that, if events had, in fact, happened after the breach which reduced the value of the contract rights, they could be relied on to reduce the damages awarded. Where there was no need to try and look into the future, the court should be able to look at the facts of what had happened to value the contract rights lost.

18. The decision reflects a tension between certainty and flexibility which is present in many hard cases. There is no "right" or "wrong" answer. It does seem difficult to justify a flexible approach to the time for assessment of damages, if one of the main objectives of the "breach date" rule is to allow commercial parties to make prompt decisions as to their contractual rights and obligations. As Lord Bingham pointed out, the effect of the decision is to make the situation where there is a repudiatory breach of a long term contract, fluid and more uncertain.

19. It should be kept in mind that, even if damages are assessed at the time of breach, it may be necessary to discount the value of the contract rights lost where a long term contract has been repudiated where future events which would devalue the contract are more than a "possibility" at the time of the breach. Similarly, where a contract which has been broken could have been performed in different ways, damages will be assessed by reference to the mode of performance which would have been least onerous to the party in breach.

20. The Contractual Remedies Act 1979 does not affect this basic common law position on the assessment of damages for breach of contract, and a similar question for decision as that which arose in *The Golden Victory* could come before our courts, probably not on a long-term charterparty but, in some other form of commercial long-term contract. It is interesting to ask how our Supreme Court might decide such a case. Historically, many decisions of the higher courts in the United Kingdom have emphasised the need for certainty in the rules relating to contract and mercantile law[13]. As has been outlined, the decision in *The Golden Victory* could be seen as creating some uncertainty in an important area. Where a party wrongly repudiates a long term contract, there may now be little incentive for it to settle up and pay damages. The New Zealand Supreme Court has shown a preference for certainty in the rules relating to commercial dealings (admittedly in very different contexts) and it may be that the court would be reluctant to depart from the date of breach rule for the purposes of assessing damages in a similar situation.

[13] Going back to the judgment of Lord Mansfield CJ in *Vallejo v Wheeler* (1774) 1 Cowp 143, 153.

***Transport Shipping Inc of Panama v Mercator Shipping Inc of Monrovia* (*The Achilleas)*[14]**

21. The decision concerned a claim for damages arising as a result of large movements in the market price for the chartering of ships. This market, which has produced many leading contract law cases, goes up and down (like all others). In *The Achilleas* a large and unusual change in the daily charter rate for bulk carriers meant that the owners of a ship which had been redelivered late by a charterer, brought a significant damages claim which raised fundamental issues concerning the operation of the rules relating to remoteness in contract.

Facts

22. The *Achilleas* was a single decker bulk carrier which the owners chartered to the charterers for a duration of 5 to 7 months at a daily rate of $16,750. The latest date for redelivery was 2 May 2004. By April 2004, market rates had more than doubled compared with the previous September. On 20 April 2004, the charterers gave notice of redelivery between 20 April and 2 May 2004. After the notice had been given, the owners fixed the vessel for a new 4 to 6 month charter to another charterer at a daily rate of nearly US$39,500. Under the new arrangements, the new charterers were entitled to cancel the charterparty, if the vessel was not delivered to them by the owners by 8 May 2004.

23. With about a fortnight of the old charter to run, the charterers fixed the vessel to make a final voyage from China across the Yellow Sea to discharge at two Japanese ports. The owners might possibly have objected to this voyage on the basis that it was not a legitimate last voyage as one that would finish outside the charter period, but did not do so.[15] In the event, the vessel was delayed at one of the Japanese ports and not redelivered to the owners until 11 May 2004. By 5 May 2004 it had become clear to the owners the vessel would not be available to the new charterers by the cancelling date of 8 May 2004. By that time rates in the market had fallen suddenly in a manner which was described as highly unusual. In order to save the following charter, the owners had to negotiate an extension of the cancellation date until 11 May 2004, and had to agree to reduce the rate of hire for the entire period of the new fixture to $31,500.

24. The charterers were in breach of contract by the late redelivery of the vessel. The owners claimed damages for loss during the full period of the new charter, being the difference between the original rate and the reduced rate which they had had to negotiate when the vessel was late. The charterers contended that the owners were not entitled to damages on this basis, which were calculated by reference to their dealings with the new charterer, and were only entitled to the difference between the market rate at the time of late delivery and the charter rate for the 9 days, during which they were deprived of the use of the vessel by the

[14] [2008] UKHL 48, [2008] All ER 117
[15] *The Gregos* [1995] 1 Lloyd's Rep 1.

late delivery on 11 May 2004. The difference in the sums was, of course, considerable. Owners claimed US$1,364,584.37, while the charterers said that the owners were only entitled to US$158,301.17.

The arbitration and Courts below

25. In the London arbitration, the arbitrators found, by a majority, that the owners were entitled to recover their full losses on the basis that the loss arising on the new fixture fell within the first limb of *Hadley v Baxendale*, as a loss which arose naturally, ie. according to the normal course of things, from the breach of contract. This was based on the finding that it was reasonably foreseeable by those in the market that a lost fixture was "not unlikely" to follow from a breach by way of the late redelivery of the vessel. As a consequence, the full extent of loss on the further charter was recoverable. The Commercial Court and the Court of Appeal agreed with the arbitrators. The charterer's case throughout was that this type of loss, occasioned by an unusual market movement which was not one which those who advised the market would ever have thought was recoverable, was too remote as a matter of law, whether considered under the first or second limb of *Hadley v Baxendale*.

The House of Lords decision

26. In the House of Lords, their Lordships unanimously reversed the decision in favour of the owners, and held that the claim was limited, as the charterers contended, to the loss caused in the period in which the vessel was not available to be chartered out by reason of the failure to redeliver as required by the charterparty (ie. 9 days).

27. The judgments of the House of Lords contain different approaches to the question of remoteness. Lord Hoffman considered that the appeal raised a question as to whether the contractual rules on remoteness were an external rule of law applicable to every contract, or a presumption about what the parties intended, which could be rebutted by showing that in a particular contractual context, there was no liability assumed for the type of losses sustained. He referred to extensive academic discussion on this point of principle which appeared to favour a proposition that the scope of liability is determined by the nature of the particular contract interpreted as a whole so as to arrive at the presumed intention of the parties. This meant that, even if a type of loss might fall within the "ordinary" foreseeability rules, it might not be recoverable in the circumstances of a particular contract. Lord Hoffman then went on to approach the issue as one of determining whether the contract breaker had assumed liability for this particular type of loss in the particular context, even if it was foreseeable, applying an approach to remoteness based on that adopted by the House to the recovery of damages for a breach of an implied contractual duty to take reasonable care. He held that the losses in the follow-on fixture, although foreseeable in *Hadley v Baxendale* terms, were not the kind of losses for which liability was assumed in the particular circumstances of this contract and market.

28. The remainder of the judgments are more conventional in their approach. While Lord Walker finds the analysis based on "assumption of responsibility" for a type of loss helpful in reaching the same conclusion as Lord Hoffman, the judgments proceed in a more conventional way by adopting the approach to remoteness which has its origins in *Hadley v Baxendale*, and do not adopt the approach of Lord Hoffman. Their Lordships hold that the loss on the follow-on fixture caused by unusual market movements was not one which was recoverable in terms of either the first or second limb of the *Hadley v Baxendale* formulation. Lord Walker found that the losses claimed were analogous to the extraordinary profits lost in the *Victoria Laundry* case.[16] It was too crude an analysis to say that, because a "not unlikely" result of the delay in redelivery was the loss of a fixture, the charterers were liable for the exceptionally large loss sustained by the owners on a particular replacement fixture by reason of unusual market variation. In considering the case under the *Hadley v Baxendale* approach, Lord Rodger found that this could not be said to be a loss arising naturally under the first limb or one which was recoverable under the second limb. It was a different kind of loss which would only be recoverable if, at the time of the contract, the charterer had more specific knowledge of particular circumstances relating to a follow-on fixture.

29. The approach of Lord Hoffman in this particular case had the attraction of meeting the argument for the owners that the determination by the arbitrators was a question of fact which ought not to be interfered with on appeal by allowing the conclusion, that if the remoteness principle is one of objective interpretation, then it is a point of law. In more conventional terms, the flaw in the approach in the Courts below, as found by their Lordships, was to equate the foreseeability of a lost fixture by reason of late delivery with the foreseeability of losses caused by an unusual market movement.[17] It does, however, make sense to say that the kind of unusual market movement which caused such large losses on the follow-on fixture (which arose as a result of the owner's renegotiation) can properly be seen as a different kind of loss which was not recoverable under either the first or second limb of *Hadley v Baxendale.*

Concluding comments

30. Both cases provide good examples of the difficulties which arise in establishing the boundaries of recoverable types of loss and in assessing and quantifying the measure of damages for losses. There is no easy answer in some situations. It can be difficult to say whether there is one kind of loss or two, and whether a kind of loss is recoverable, or whether the measure of damages will be assessed as at the time of breach, or at some later time, or, whether a plaintiff's claim will be reduced to take into account a gain made after the date of breach. It seems quite likely that disputes over the entitlement of contracting parties to damages in various commercial situations will increase, where economic conditions fluctuate and markets become more volatile. A sound knowledge of the general principles of contract

[16] [1949] 2 DB 528

[17] On this approach the *Achilleas* is another illustration of the difficulties in distinguishing between different kinds of loss for the purposes of applying the approach in *Hadley v Baxendale*.

law which guide the Courts in the task of assessing the appropriate award of damages, and of decisions which illustrate the application of principles in different (and difficult) commercial situations, remain fundamental tools for all lawyers who are required to advise commercial parties on their rights and obligations.

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