The Golden Victory and Beyond

What next for the Compensatory Principle?

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<u>Introduction</u>

1. The compensatory principle of damages has been described as "*the overriding rule*"[1] of damages and "*the bedrock of every assessment of damages*"[2]. It was succinctly stated by Parke B in Robinson v Harman (1848) 1 Exch 850 at 855:

   "The rule of the common law is, that where a party sustains a loss by reason of a 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"

2. The compensatory principle has attracted various specific rules or applications, such as the principles relating to mitigation, remoteness of loss and causation, but none of these principles is inconsistent with it: they are devised to give effect to the fundamental need to distinguish between losses that are causally irrelevant and losses that are relevant and thus recoverable.

3. In the *Golden Victory*[3] in 2007, the House of Lords considered one particular principle which falls for consideration as an application of the compensatory principle: namely the "*breach date*" rule. A rule which acts as a general guideline for an assessment of damages, the main aim of which is to exclude from consideration on grounds of causation, mitigation and incidental benefits, the effect of the claimant's particular post-breach conduct on the assessment of his loss resulting from a breach of contract. In other words, the principle holds that a claimant's loss should be calculated from the date of breach, that being the date at which his damages can fairly be crystallised.

4. However, as with many legal principles, there are exceptions to this rule and the facts of the *Golden Victory* (so held the majority of 3 to 2) gave rise to one such exception. But how far did that exception extend, was it of more general application, and when might it be applied have all been questions which have dogged this area of the law ever since. In this paper I shall

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[1] Per Bingham LJ in *County Personnel (Employment Agency) Ltd v Alan R Pulver & Co]1987] 1 WLR 916* at 925-926.
[2] See for example *Livingstone v Rawyards Coal Co (1880) 5 App Cas 25*, per Lord Blackburn at 39 and *Johnson v Agnew [1980] AC 367*, per Lord Wilberforce at 400-401.
[3] *Golden Strait Corpn v Nippon Yusen Kubishika Kaisha [2007] 2 AC 353.*

be exploring some of these questions and examining the answers arrived at in the years since the *Golden Victory*.

<u>The Decision in the Golden Victory</u>

5. The facts of the *Golden Victory* were straightforward, even if the application of the compensatory principle to those facts was not. In July 1998 some shipowners chartered their vessel Golden Victory to the charterers for 7 years. The charterparty provided that in the event of war or hostilities breaking out between any two or more of a number of countries (including the United States of America, the United Kingdom and Iraq), both owners and charterers would have the right to cancel the charter. In December 2001, the charterers repudiated the charter by redelivering the vessel to the owners who accepted the repudiation. The owners claimed damages, asserting that the charter had nearly four years left to run and that they were entitled to damages which reflected the loss of the charterparty over the four year period. The charterers did not accept the claim and the matter went to arbitration, where some preliminary rulings were made before the question was posed as to whether the outbreak of the Second Gulf War in March 2003 placed a temporal limit on the damages recoverable by the owners such that no damages were recoverable for the period from March 2003 onwards.

6. The arbitrator found in the charterers favour, accepting that the owners' damages should be limited to the period between the date of repudiation and March 2003. The issue before the House of Lords was whether he was right to do so. Specifically, was he right to take account of an event that had occurred <u>after</u> the date of breach in carrying out an assessment of loss.

7. The House of Lords was divided on this issue. The majority (Lords Scott, Carswell and Brown) held that the principle that damages should be assessed as at the date of breach was subject to the overriding compensatory principle that the damages assessed should represent no more than the value of the contractual benefits of which the claimant had been deprived; that if at the date of breach there had been a real possibility that an event would happen terminating the contract or otherwise reducing those contractual benefits the quantum of damages might need to be reduced proportionately to reflect the estimated likelihood of that possibility materialising; but that where such an event had already happened by the time the damages were assessed the court should have regard to what had actually occurred so that estimation was no longer necessary. Since war had broken out prior to the assessment of damages and since that would have allowed the charterers to terminate the charterparty had it still been on foot (and it was common ground that they would have exercised that right),

the owners were not entitled to recover the hire rate or profit share provided for by the charterparty in the period after the outbreak of war.

8. Lord Scott pointed out that the fundamental principles of the common law relating to the assessment of damages were no different for charterparties or commercial contracts in general, than for contracts which do not bear that description. It was his view that the owners' contention attributed to the assessment of damages at the date of breach rule an inflexibility "*which is inconsistent with principle and with the authorities*" and he went on to point out that while the date of breach rule was "*particularly apt*" to cater for cases where a contract for a sale of goods in respect of which there is a market had been repudiated (because the loss caused by the breach can be measured by the difference between the contract price and the market price at the time of the breach) it was not so apt where the contract for sale of goods "*is not simply a contract for a one off sale, but is a contract for the supply of goods over some specified period*". In an oft-quoted passage he said that "*the lodestar is that damages should represent the value of the contractual benefits of which the claimant had been deprived by the breach of contract, no less but also no more*" and applying that principle (as articulated in *Bwllfa and Merthyr Dale Steam Collieries 1891) Ltd v Pontypridd Waterworks Co [1903] AC 426*[4]*)* he concluded that the owners' arguments offended the compensatory principle because they were seeking compensation which exceeded the benefits of which they were deprived.

9. Lords Bingham and Walker gave powerful dissenting judgments, distinguishing *Bwllfa* on its facts, focussing on the entitlement of the owners to be compensated for the loss as at the date of breach of a charterparty with slightly more than 4 years left to run and emphasising the importance of certainty, consistency and coherence in the dealings of the parties with each other. Lord Bingham noted that "*the importance of certainty and predictability in commercial transactions has been a constant theme of English commercial law…*".

10. The need for certainty was recognised by the majority but at the same time they thought that a suspensive condition such as a war clause brought inherent uncertainty into the bargain of the parties in any event – the charter was in this sense always uncertain[5]. Lord Carswell put the point well when he said that "*considerations of certainty and finality have in this case to*

[4] The gist of the Bwllfa principle as understood by the majority in the Golden Victory is that, if the assessment of damages on a given date depends on a contingency, it makes no sense for the courts to confine themselves to what was a matter of guess or estimate at that date (usually the date of breach or the date of acceptance of breach) if the actual outcome in relation to the contingency is known by the time of the hearing – as Lord Bingham described it in non-judicial discourse: "*you need not gaze into the crystal ball when you can read the book*". But Lords Bingham and Walker, dissenting, took the view that the *Bwllfa* principle was not a broad principle, that it was limited to its own facts and could not be applied to a case involving the repudiation of a commercial contract where there was an available market.
[5] See Lord Mance in the Court of Appeal at para 23.

yield to the greater importance of achieving an accurate assessment of the damages based on the loss actually incurred".

Continuing Uncertainty after the Golden Victory

11. Unfortunately, the decision in the *Golden Victory* did not itself bring certainty to the law of damages. The *Bwllfa* principle has always appeared to have an inherent limit in scope. That case was not concerned with damages for breach of contract but with the award of statutory compensation payable under a notice preventing a coal mine from mining a seam. The House of Lords emphasised that compensation was payable for the loss of the use of the coal mine and "*not the price on a transaction of sale*". Similarly, in the *Golden Victory*, damages were being assessed for the loss to be suffered over a period, i.e. the charter term (subject to the suspensive condition of the war clause) and not the loss of the sale of the vessel with the benefit of the charterparty.

12. Could the speech of the majority be regarded as applying to all breaches of contract, regardless of the underlying facts, or was it limited only to damages which by their very nature occurred over time? In what circumstances could the exception to the *prima facie* rule identified by the majority apply? Further and more fundamentally, perhaps, was the majority's view correct[6] – did it attach sufficient weight to the commercial value of certainty?

The introduction of the theory of contractual allocation of risk

13. Some of the questions identified in 12 above were considered by Popplewell J in *Ageas (UK) Ltd v Kwik-Fit (GB) Ltd [2014] Bus LR 1338*. Ageas purchased an insurance business from Kwik-Fit in 2010 subject to a cap on liability for breach of warranty of £5m. In order to cover any loss in excess of £5m it entered into a Warranty and indemnity Insurance Policy with AIG and the dispute was as to the sum which Ageas was entitled to recover from AIG (which had admitted liability under the policy). Kwik-Fit breached the warranty that the accounts gave a true and fair view in the way that it posted 'Time on Cover Bad Debts'[7] (TOCBD) with the result that revenue was overstated in the final year of audited accounts and in management accounts.

14. Popplewell J identified the basic principle that the measure of loss for breach of warranty in a share sale agreement is the difference between the value of the shares as warranted and the

[6] There was considerable academic comment criticising the reasoning of the majority in the *Golden Victory*, including from Professor Treital.

[7] These were bad debts which arose out of customers remaining on cover for a period for which they had not paid the premium.

true value of the shares[8]. The dispute was what value was to be attributed to the error in relation to TOCBD. Ageas contended that in order to calculate the true value, it was necessary to apply to the true figures for revenue the same discounted cashflow analysis model that had been used to calculate the price. This model effectively projected that TOCBD levels would remain constant post-acquisition. AIG argued that this approach overcompensated Ageas because the actual TOCBD figures between the date of purchase in June 2010 and the date of trial were in fact much lower than those assumed by Ageas' expert. Despite the facts of the case involving a one-off sale, AIG relied upon the *Golden Victory* principle.

15. Popplewell J accepted that, in principle, where the assessment of loss as at a particular date turns on a contingency, it may be necessary to take into account what is known to have happened by the time of the trial in order correctly to apply the compensatory principle[9], but said that in his view, there were two qualifications to the adoption of such an approach:

"*The first is that it can only be justified where it is necessary to give effect to the overriding compensatory principle. The prima facie rule, from which departure must be justified, is that damages are to be assessed at the date of breach and that only events which have occurred at that date can be taken into account. Secondly it is important to keep firmly in mind any contractual allocation of risk made by the parties. Party autonomy dictates that an award of damages should not confound the allocation of risk inherent in the parties' bargain. It is not therefore sufficient merely that there is a future contingency which plays a part in the assessment. It is necessary to examine whether the eventuation of that contingency represents a risk which has been allocated by the parties as one which should fall on one or other of them. If the benefit or detriment of the contingency eventuating is a risk which has been allocated to the buyer, it is not appropriate to deprive him of any benefit which in fact ensues: it is inherent in the bargain that the buyer should receive such benefit*" [38]

16. In the *Golden Victory*, the contractual allocation of risk formed no impediment to the majorities' assessment of damages: the contingency was the outbreak of war and the charterparty provided for termination by either party in the event of that contingency occurring. However, on the facts of the case before him, Popplewell J held that the risks associated with the performance of the business, including the levels of the TOCBD had been allocated to the buyer, Ageas: "*If the business did better than the parties projected when*

[8] *Lion Nathan Ltd v CC Bottlers Ltd [1996] 1 WLR 1438*

[9] "*In an appropriate case, the valuation can be made with the benefit of hindsight, taking account of what is known of the outcome of the contingency at the time that the assessment falls to be made by the court. This is so not merely as a cross-check against the reasonableness of prospective forecasting…it is so whatever view might prospectively be taken at the breach date of the outcome of the contingency*" [35].

calculating a price, that was for Ageas' benefit. If it did worse, that was its loss" [50] and "*What happened to TOCBD after the acquisition was therefore part and parcel of the way Ageas chose to run the business following acquisition and the interaction between those business decisions and the effect of the market and macro-economic conditions on the business. These contingencies are all matters which the parties agreed are for Ageas' risk*" [52]. Accordingly, there was no justification for departure from the *prima facie* rule and Ageas' arguments succeeded.

17. This approach was followed by Blair J in *The Hut Group Limited v Oliver Nobahar-Cookson & Others [2014] EWHC 3842 (QB)*, another case concerning (amongst other things) the assessment of damages for breach of warranty on the sale of shares. Having identified the key principles set out in the *Ageas*, Blair J noted that "*Hindsight cannot be used to confound the allocation of risk under the bargain. It is inappropriate for the court to deprive a buyer of the benefit of a contingency from which, under the contract, he is intended or entitled to benefit. In a share purchase agreement involving a once and for all exchange of consideration, the party which received the business or a shareholding in the business assumes the risks, or the rewards, of its subsequent performance or failure to perform*" [184].

18. He went on to reject the argument of the buyer (made by reference to the *Golden Victory*) to the effect that since the agreed calculation of loss was by reference to the deferral of a planned IPO, the court had to consider what reduction on a notional purchase price would fairly compensate for the period of deferral, knowing (as was known at trial) that the planned IPO had been deferred but not lost. Blair J held that this was nothing more than an invitation to reduce the damages payable because the seller still had shares in the company in question and the company was doing well: *"…it is common ground that such a contention cannot affect the quantification of damages. The loss was suffered at the time of breach and must be assessed at the time of breach…Improvements in the state of the company following the breach and the knock-on effect on the value of the shares do not affect that conclusion*" [217].

19. The decisions in the *Ageas* and *The Hut Group* have been relied upon subsequently to support the proposition that the principle expounded by the majority in the *Golden Victory* can never apply to a 'one off sale', but that it is limited to contracts of supply over a period of time. However, this issue (together with the question-mark over the correctness of the majority view) has now been put beyond doubt by the recent decision of the Supreme Court in *Bunge SA v Nidera BV [2015] Bus LR 987.*

<u>Clarification from the Supreme Court in Bunge v Nidera</u>

20. In *Bunge v Nidera* a seller committed an anticipatory breach by prematurely invoking a right to cancel a standard form contract used in the grain trade. The right to cancel was based on a prohibition of export, blockade or hostilities clause. The buyer accepted the breach, terminated the contract and sued for damages being the difference between the contract price and the market price at the date of default (i.e. when the buyer accepted the breach and terminated). This claim was made under the Default Clause which is found in GAFTA[10] Form 49, which had been incorporated into the contract and which made provision for the consequences of a default by either party.

21. The seller relied upon the *Golden Victory* and argued that at common law it was necessary to take account of events occurring after the breach which showed that the same loss would have been suffered even without the repudiation – that at the time when delivery was due, the prohibition against export was in fact still in place such that it would have been entitled to cancel in any event such that the buyer could not be said to have suffered any loss.

22. The Supreme Court (Lord Sumption giving the lead judgment) identified that the reasoning in the *Golden Victory* has "*to some extent been obscured by the focus on the implications of the so-called 'breach date rule' and on the competing demands of certainty and compensation*" and articulated clearly the real difference between the majority and the minority in that case which "*turned on the question what was being valued for the purpose of assessing damage*" [21]. The majority were valuing the chartered service that would actually have been performed if the charterparty had not been wrongfully brought to a premature end. The minority on the other hand were valuing the charterparty itself assessed at the time it was terminated, by reference to the terms of a notional substitute concluded as soon as possible after the termination of the original. The possibility of war would have been factored in to that substitute contract.

23. Lord Sumption confirmed that in his view the majority's view was correct because the correct approach (both under the Sale of Goods Act and at common law) was to look at the price of the goods or services which would have been delivered under the contract. He went on also to reject the argument that Lord Scott's speech in the *Golden Victory* was to be taken to suggest a distinction between a contract for a one off sale and a contract for the supply of goods or services over a period of time:

[10] Grain and Feed Trade Association

"*I do not think that Lord Scott was suggesting that the underlying principle was any different in the case of a one off sale. Where the only question is the relevant date for taking the market price the financial consequences of the breach may be said to crystallise at that date. But where, after that date, some supervening event occurs which shows that neither the original contract (had it continued) nor the notional substitute contract at the market price would ever have been performed, the concept of crystallising the assessment of damages at that price is unhelpful. The occurrence of the supervening event would have reduced the value of performance, possibly to nothing, even if the contract had not been wrongfully terminated and whatever the relevant market price. The nature of that problem does not differ according to whether the contract provides for a single act of performance or several successive ones. Nor as it seems to me is there any principled reason why the majority's solution should be any different in the two cases…The most that can be said about one-off contracts of sale is that the facts may be different. In particular, if the injured party goes into the market and enters into a substitute contract by way of mitigation, it will not necessarily be subject to the same contingencies as the original contract."*[22].

24. Further Lord Sumption made very clear that he was unconvinced by the academic criticisms of the *Golden Victory* and he described the principle applied by the majority in that case as "*neither new nor heterodox*". He expressed the view that "*there is no principled reason why, in order to determine the value of the contractual performance which has been lost by the repudiation, one should not consider what would have happened if the repudiation had not occurred. On the contrary this seems to be fundamental to any assessment of damages designed to compensate the injured party for the consequences of the breach*" [23]. On the subject of certainty, Lord Sumption said that "*Commercial certainty is undoubtedly important, although its significance will inevitably vary from one contract to another. But it can rarely be thought to justify an award of substantial damages to someone who has not suffered any*" [23].

25. The decisions in *Ageas* and *The Hut Group* were not cited to the Supreme Court and not considered, so it remains unclear whether the additional caveats placed on the application of the principle in those cases at first instance would be approved by the Supreme Court.

26. Finally, it was argued in *Bunge v Nidera* that the terms of the Default Clause excluded the application of the compensatory principle at common law, an argument which the Supreme Court rejected. Essentially this depended upon the interpretation of the relevant clause. Some damages clause might be intended as a complete code for the assessment of damages

such that "*it was inherent in the clause that it may produce a different result from the common law*" [26], but this would require clear words. As Lord Sumption made clear: "*A damages clause may be assumed, in the absence of clear words, not to have been intended to operate arbitrarily, for example by producing a result unrelated to anything which the parties can reasonably have expected to approximate to the true loss*"[11] [26]. The Default Clause in this case could not be regarded as a complete code for the assessment of damages: it fixed the contract price/market price differential but did not purport to deal with subsequent events such as the continued prohibition of export.

<u>Where are we now?</u>

27. The *Golden Victory* (as explained by Lord Sumption in *Bunge v Nidera*) remains good law on the subject of the application of the compensatory principle and the breach date rule. But arguments inevitably remain as to its scope and as to the precise circumstances in which it will be appropriate effectively to apply the benefit of hindsight in assessing the correct level of damages[12]. What is likely to matter most is the nature of the breach and the damages to be assessed. This will of course depend on the individual facts of any particular case.

28. In *OMV Petrom SA v Glencore International AG [2016] EWCA Civ 778*, a case concerning the measure of damages for deceit, the Court of Appeal considered a *Golden Victory* type argument as to the need to take account of events after the date of acquisition of blended crude oils which had been falsely described as an established brand but which were in fact untried. The Claimant was entitled to damages representing the difference between the price paid for the oils and their true market value at the date of acquisition. The true market value was identified by applying a discount to reflect the risks of using untried blends in a refinery, but the events following acquisition showed that nothing untoward had happened and so the Defendant argued that no discount should be applied.

29. The Court of Appeal rejected this submission identifying the following reasons for doing so: first it involved taking account of risks which did not materialise to eliminate the discount which purchasers would have required at the date of acquisition to take account of those risks (at that stage unknown): "*It is not in other words, an assessment of the value of the blends at*

[11] This raises the interesting prospect of arguments as to the application of the penalty doctrine in circumstances where a clause did purport to exclude any consideration of subsequent events. This was not a factual scenario that was considered by the Supreme Court in *Cavendish v Makdessi [2015] UKSC 67*.

[12] For other recent cases in which the *Golden Victory* principle has raised its head in varying different contexts see *Fulton Shipping Inc of Panama v Globalia Business Travel Sau [2016] 1 WLR 2450* – a case concerning the question of whether a benefit that accrues to a claimant as a result of the breach (but not as a result of any action which the claimant was required to take to mitigate his loss) should be taken into account to reduce his loss – the Court of Appeal held that it should citing the *Golden Victory* and *Bunge v Nidera*; *Glory Wealth Shipping Pte Ltd v Flame [2016] EWHC 293 (comm)* and *Bacciottini v Gotelee and Goldsmith [2016] 4 WLR 98*.

the date of acquisition"; second an assessment on this basis would mean that the Defendant recovered a price which he would never have recovered if he was honest, third, if the claim had been brought in contract any sub-contract would be *res inter alios acta*; fourth the Defendant had not pleaded or proved that there were in fact no deleterious consequences as a result of the use of the previously untried blends (per Christopher Clarke LJ at [42]-[47]). The Court of Appeal approved Popplewell J's qualification (in the *Ageas*) to the principle in the *Golden Victory* that it can only be justified "*where it is necessary to give effect to the overriding compensatory principle*" and said that on the facts there was no need to depart from the overriding principle. The exercise required in this case "*does not require consideration of what alternative transaction the claimant would have entered into if not deceived or a hypothetical negotiation between the actual parties*" [59].

30. *OMV* shows that arguments as to the compensatory principle and its application will continue to arise in numerous different factual scenarios and (by reference to the *Golden Victory* and *Bunge v Nidera*) there will continue to be scope to argue that the court should take account of post breach events when assessing loss.

31. What is clear is that (i) these post breach events must be pleaded and proved if they are to influence the court, (ii) they will only be viewed as relevant if taking them into account is necessary in order properly to give effect to the overriding compensatory principle and (iii) they are unlikely to be considered relevant in cases involving dishonesty. The jury remains out on the question of whether the correct allocation of contractual risk is also a relevant feature.