THE COMPENSATORY PRINCIPLE OF DAMAGES IN VOYAGE CHARTERS

By

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A common problem in arbitrations involving claims by owners for breach of voyage charter parties is the assessment of the losses that they are entitled to recover. In cases where the breach of the charter party by charterers involves complete non-performance of the contract these difficulties arise (even where liability may be clear) because:

(i) It may take some time for the owners to find new employment;

(ii) Any substitute employment found may be of a different type or duration to the original charter, and

(iii) The substitute voyage may take the vessel to an entirely different area, one that may be more or less advantageous to the owner than the original charter in finding follow-on employment.

The Compensatory Principle

What, therefore, are the principles that are applied in assessing damages in such cases?

At the root of all cases involving the assessment of damages is the fundamental "*compensatory principle*". This principle was affirmed by the House of Lords (as it was

then known) in the well known case of the "*Golden Victory*" (2007) where it was said:

"*The fundamental principle governing the quantum of damages for breach of contract is long established and not in dispute. The damages should compensate the victim of the breach for the loss of his contractual bargain. The principle is succinctly stated by Parke B* Robinson v Harman *1 Ex 850 at 855 and remains as valid now as it was then. 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.*"

Damages in voyage charter cases

In the case of voyage charter parties the principle to be applied in assessing damages was first set out in the case of *Smith v M'Guire* (1858) where it was said:

"*The real damage is the loss arising from the breach of contract. That is to be ascertained by calculation of the freight to be earned, and the deduction of expenses which the ship owner would be put to in earning it; and what the ship earned (if anything) during the period which would have been occupied in performing the voyage, ought also to be deducted.*"

The level of freight that would have been earned if the original charter had been performed is, of course, easily calculated. Similarly, the expenses which would have been earned in performing the voyage should also be known or calculable by the owners. Where the difficulty often arises is in calculating what, if anything, the vessel earned during the period which would have been occupied in performing the voyage.

What needs to be established first is how long it would have taken to perform the repudiated voyage charterparty. This may be the subject of expert evidence.

Clearly, if no employment at all is found by the owners during this period, there is no credit to be given against the freight for substitute earnings, (provided the owners can show proper attempts to find employment during that period in mitigation of loss). Where, however, employment is found that extends beyond the anticipated duration of the original voyage the practice has developed of pro-rating the earnings under the substitute employment for the period of the original charter, often by calculating daily time charter equivalent figures and comparing those under the original and substitute charters.

Until recently this was the accepted method of calculating the owners' loss. Thus account might be taken of the vessel's earning beyond the contract period in order to determine what credit should be given but without extending the calculation of actual loss beyond that period. The view taken in this respect was that it is necessary to draw a line and establish a limit in assessing the loss caused by a charterers' breach. If attempts were made to consider losses beyond the original charter period, the concern expressed by the Courts was that "*one would be involved in calculations to the end of the ship's working life*" (Staughton LJ in the "*Noel Bay*" (1989)). Indeed, the "*Noel Bay*" (together with the "*Concordia C*" (1985)) was almost always referred to by the parties in arbitration submissions in such cases.

The question as to whether credit had to be given for any benefit obtained from steps taken in mitigation of any breach after the date when the contract would have come to an end arose in the case of the "*Elbrus*" (2009). That

case involved a time charter trip which, at least for these purposes, may be regarded as the equivalent of a voyage charter. There, the charterers breached the charter party by redelivering the vessel early. If the vessel had been redelivered at the proper time it would have missed the laycan on its next employment which had been fixed at a high rate. Because, however, of the early redelivery the vessel was able make the laycan and earn the high rate of hire under that fixture. The owners contended that their loss was to be assessed up to the date when the vessel would have been redelivered deducting only what they had in fact earned during that period, namely the first few days of the high level of hire under the next employment. The arbitrators, however, concluded (and the High Court agreed) that credit had to be given for the benefit of being able to perform the next employment and that (on the facts) the value of this benefit was to extinguish the owners' claim. This was described as an application of the *compensatory principle* as it reflected the owners' true loss.

The "MTM Hong Kong"

In the very recent case of *Louis Dreyfus Commodities Suisse SA v MT Maritime Management BV* (in which judgment was delivered on 1st September 2015), the "*MTM Hong Kong*" was chartered to carry a cargo of vegoil on voyage charter from South America to Europe. The vessel ran aground during its previous employment and this led to some delay and correspondence between the parties during the course of which the charterers repudiated the charter

party and the owners accepted the reputidatory breach as bringing the charter to an end.

After the charter came to an end the owners continued to sail towards South America which they considered to be the most promising area in which to find substitute business. The vessel arrived in South America on 2nd February but was not fixed for new employment until 24th February when it was chartered to Glencore to perform a voyage from Argentina to Rotterdam. If the original voyage charter had been performed the voyage would have taken 43.6 days completing on 17th March. The evidence was that the vessel would then have carried a cargo from the Baltic to the United States followed by a further voyage from the United States to Europe, rates in the North Atlantic being higher than from South America.

The owners claimed damages for the difference between (a) the profit which the vessel would have earned (not only on the contract voyage but also the next two voyages from the Baltic to the United States and back) and (b) the profit actually earned on the Glencore substitute charter to Europe.

It is relevant in this respect to note that the performance of the contract voyage plus the next two voyages would have brought the vessel back to Europe at about the same time as completion of discharge under the Glencore fixture.

The arbitrators accepted the owners' claim. In doing so they found that the loss claimed by the owners had been caused by the charterers' breach and ought therefore to be awarded to compensate the owners and that there was no

rule of law which prevented the full application of the compensatory principle by limiting damages by reference to the period when the contract voyage would have come to an end. They said:

"*In principle we agreed with the submission made on behalf of the owners that there is no rule of law which requires that assessment of the damages due to an owner must be made simply by reference to what would have been earned under the repudiated charter party and that it is therefore permissible to look beyond the date on which the repudiated charter party would have ended if to do so enables an arbitration tribunal to more fairly judge the loss actually suffered by the innocent party for the purposes of applying the compensatory principle.*"

As the Court noted, in reaching this conclusion the arbitrators were compensating the owners for loss of the follow-on fixtures and the consequent delay in being able to earn higher rates available in the North Atlantic market.

The Court found that the *Smith v M'Guire* measure represents the *prima facie* measure of damages for the loss of profit which would be obtained by a ship owner from performance of a repudiated charter and that in most cases it will not, therefore, be necessary to look beyond the damages resulting from the application of that measure. However, in appropriate cases it may be necessary to depart from it in order to give full effect to the compensatory principle.

The Court referred to the "*Elbrus*" as involving a case where the owner received a benefit from mitigation that needed to be taken into account to reduce their damages. The Court went on to state that it would be difficult to imagine circumstances where an owners damages for loss of profits could exceed the net freight and demurrage which

would have been earned if that charter had been performed because as a matter of logic an owner cannot lose more by way of lost profit from repudiation than the freight they would have earned by performing the charter. In that sense the net freight and demurrage represents a cap on the owners' damages. The only question in such cases is what, if any, deductions should be made from the freight in consequence of mitigating employment which the owner obtained or ought to have obtained. This was the approach of the "*Noel Bay*". To that extent there is no change in the law.

What was, however, new, is that the Court went on to state that the position is different if an owner suffers a different kind of loss, that is to say something different from the loss of profit which would have been obtained from the performance of the repudiated charter.

In such a case, the Court said that there is no reason why such loss should not be recoverable in damages *in addition* to damages for loss of profit from performing the charter, subject to principles of causation, mitigation and remoteness. On the contrary, failure to award such damages would be contrary to the compensatory principle.

The Court did stress that caution needed to be exercised in considering such claims and that where proof of such losses required complex hypothetical calculations about the future employment of the vessel the likelihood is that tribunals will conclude that such losses are too speculative to be recovered: the more complex the calculation the less likely the claim is to succeed.

The Court described a typical example of a situation where such a different kind of loss arises as being when a vessel is redelivered to an owner in the wrong location or when a substitute fixture is completed at a discharge port which is not, or which is some distance from, the discharge port under the contract voyage. The Court recognised that the ability of a vessel to earn freight for an owner depends to a large extent on the vessel being in a place where appropriate cargoes may be found. Some areas command higher rates of freight than others. These are important commercial considerations which the Court said the law of damages needs to recognise. As the Court put it:

"*The package of rights for which an owner contracts when concluding a voyage charter includes not only the freight to be earned from performance of that charter but also the right to have his vessel back again and ready for her next employment of the stipulated discharge port or range. The* Smith v M'Guire *range of damages compensates the owners for loss of the freight, but does not address any loss which may be suffered if the vessel is less advantageously positioned as a result of the charterers' repudiation.*"

On the facts of this case, the Court found that the owners not only lost the charter freight and had to make do with the lesser freight earned under the Glencore charter but they also suffered a delay in re-positioning the vessel in Europe and thereby lost the benefit of the two trans-Atlantic voyages which, on the arbitrators' findings, the vessel would have been able to perform in about the same time as was taken up by the actual performance of the Glencore charter. These were two distinct heads of loss, both of which were caused by the Charterers' breach. Thus, whereas the measure of damages calculated in accordance with the "*Noel Bay*" amounted to

US$478,386.80, the Tribunal's decision to award them US$1,212,360.50 for their additional losses was upheld as correct by the Court.

Note of caution

Having made this rather bold departure from the position as it was generally understood previously, the Court did go on to stress that a similar conclusion would not be reached in every case and that there were three factors that were important to the owners' success in the arbitration and on appeal:

(i) That the owners acted reasonably in sending the vessel to South America where, as it turned out, there was no employment for the vessel for a considerable period;

(ii) There was no suggestion that the losses claimed were too remote, that is to say beyond the reasonable contemplation of the parties (which might have been the case if a loss was only suffered as a result of a wholly unexpected delay in obtaining substitute employment which is beyond the reasonable contemplation of the parties), and

(iii) On the facts here it was possible to predict the vessel's immediate future employment if the contract had been performed, which employment would have taken the vessel back to the same location at about the same time as completion of the actual substitute voyage so that the damages claimed could be calculated with a reasonable degree of confidence. That may not always be the case.

Notwithstanding the three points mentioned by the Court (and most importantly the third of these) this decision is undoubtedly likely to see a change in the way in which damages are claimed and awarded in arbitration in the future.

It has often been a complaint of owners that an award of damages that took no account of the interruption to their intended trading pattern failed to apply the compensatory principle of damages to their losses. The decision in the case of the "*MTM Hong Kong*" may now put a smile on some of those owners' faces.