UK DEFENCE CLUB

September 2011

soundings

The calculation of damages when no available market

A repudiatory breach of a charterparty allows the innocent party to terminate the contract and claim damages. However, quantifying such damages can give rise to significant difficulties. This is especially true for a time charter for an extended period and when the repudiation takes place early in the contract. A recent arbitration appeal in Glory Wealth Shipping v Korea Line Corporation [2011] EWHC 1819 has helped define the manner in which such damages can be assessed.

Damages for a repudiatory breach (allowing the innocent party to terminate the contract) can be a complex concept. The basic principle in English law is that damages are intended, by the payment of money, to place the injured party in the same position as if the breach had not occurred. However, the quantification of an injured party's loss (and hence the expression of damages) is often difficult. What conceptual framework can fairly place a value on the performance, costs and losses resulting from what has suddenly become a theoretical contract? How can a monetary value be placed on the unexpired portion of a unique time charter?

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Moreover, not only should the contract be quantified, but an innocent party is expected to take reasonable steps to mitigate its losses, usually by going into the market and concluding alternative fixtures for the unexpired period. However, an equivalent charter (for the unexpired period with a similar trading range) may not be available and, if found, may be at a different hire rate. Spot charter rates, if fixed as an alternative to a period charter, may be variable and employment of the ship erratic.

These factors can make it difficult to crystallise losses and assess the reasonableness of any mitigation but are necessary to finalise a claim in damages and allow the parties to draw a line under the dispute.

One solution is for the parties to await the end of the original charterparty contract period and measure the costs of any substitute fixtures taken in mitigation against the costs of the hypothetically completed charterparty. Whilst this allows an accurate assessment of loss, it is not always practical, and may not assist the parties in quickly finalising a claim. For this reason, the courts developed the useful mechanism of assessing damages by referring to the market rate for a similar fixture at the time of the breach (or soon thereafter). This market rate approach deftly combines the quantification of loss and the obligation to mitigate damages. The unexpired charter rate is measured against the market rate

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at the time of the breach and the difference between the two rates is calculated across the duration of the unexpired contract. This allows the contract to be valued and reasonable mitigation assessed.

Thus, if an owner repudiates a four year charter after six months, the charterer's damages would be assessed at the market rate at the time of breach for a three and a half year charter for the same trading range. The measure deems the charterer to have a ship at its disposal and is compensated by the owner for any loss resulting from the difference in hire rates. The principle is regarded as fair, reasonably accurate and allows a speedy resolution of the dispute. It does not require the charterer to fix an alternative ship, but any damages will be assessed against the market rate. The parties are able to finalise their losses, the innocent party can secure a quantified claim as necessary and the parties are rid of the dispute.

This approach, however, assumes the existence of a market at the time of the breach. When there has been a collapse in a particular segment of the chartering market, as has recently occurred, how might the extent of damages be assessed?

One possibility, raised in the recent Glory Wealth v Korea Line Corporation arbitration appeal, is to wait for a market to develop (even if this takes several months) and then apply the market rate to the unexpired charterparty period. During the interim, the innocent party would keep a record of actual losses which are claimed until the market becomes the measure of damages, projected forward. This approach, which found favour with the arbitration tribunal, seemed a reasonable response to the lack of a market. The arbitrators assessed damages on the basis of eight months of historical losses (post-breach) plus two years of estimated losses assessed from the point of the market revival. Importantly, the market rate invoked by the owner was applied for the period prior to the dispute being referred to arbitration.

Although attractive, the court found the arbitrators' approach to be incorrect. It held that when a market is not immediately available at the time of breach, a hybrid approach by combining losses with a subsequent market rate was not correct in law (and raised several practical issues, such as when the market might be regarded as "revived"). Thus, in that case, damages could not be claimed at the emergent market rate assessed by the owner. Rather damages were to be evaluated against the owner's actual trading history until the end of the three year unexpired portion of the original charter.

This analysis suggests, initially at least, a requirement that parties must wait for the contract period to unfurl, whilst recording all losses, before an accumulated damages claim can be brought against the guilty party. However, the court recognised that future losses can still be assessed by reference to a market rate, if necessary, before the end of this period. It is clear that one party cannot unilaterally decide the market has revived and invoke that rate for further quantification of damages. However parties, or arbitrators, may agree that, looking forward, a market rate can be used to assess damages until the end of a contract period. Up to that point, actual losses will remain the best measure of damages.

The case of Glory Wealth Shipping v Korea Line Corporation raised important issues of principle. Given the recent collapse in charter rates it is likely that further cases will continue to develop this area of law. Should Members have any queries then they should approach their usual Club contact.

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