DAMAGES FOR LATE DELIVERY UNDER TIME CHARTERS: CERTAINTY AT LAST?

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Introduction

In *Transfield Shipping Inc v Mercator Shipping Inc* (*Transfield*),[1] the House of Lords examined the circumstances in which a defaulting charterer would be liable to the ship owner for lost profits when redelivering late under a time charter. On the facts of the case, the court held that the charterers were not liable. However, views differed between the judges as to the correct approach to be adopted when examining this issue. One approach was based on assumption of risk,[2] while the other looked to losses that were 'within contemplation' as being the relevant test.[3]

To what extent has *Transfield* given ship owners and charterers certainty in respect of their potential liabilities? This paper examines how the decision has affected the law relating to remoteness of damage in cases of late delivery under time charters. Each of the tests relied on by the judges will be analysed to see if either should be adopted as the best approach in future cases.

Background to *Transfield*

Mercator was the owner of the ship *Achilleas*. In January 2003, Mercator entered into a time charter with Transfield in respect of *Achilleas*. Pursuant to the time charter, *Achilleas* was to be redelivered on 2 May 2004.

A legitimate final voyage was approved by Mercator. This voyage was still expected to allow delivery by 2 May 2004. As fate would have it, there were delays discharging the cargo of the final voyage and redelivery did not occur until 11 May 2004.

In the meantime, Mercator, having received notice from Transfield that redelivery was expected to take place on or before 2 May 2004, entered into a follow-on time charter with another party. Under that forward charter, the charterer was entitled to cancel the charterparty if the *Achilleas* had not arrived at the delivery point by 8 May 2004. When it became apparent that the *Achilleas* would not be available by this date, the subsequent charterer threatened to cancel the charterparty.

In order to avoid the follow-on charter being cancelled, Mercator negotiated an extension of the cancellation date to 11 May 2004, but was forced to accept a review of the contract price. Unfortunately, by that time the market rate for the hire of the ship had fallen by approximately US$8,000 per day. The follow-on charter was ultimately renegotiated, however, it was at the lower rate.

Mercator subsequently claimed damages from Transfield of approximately US$1.3m, representing their loss of profit as a result of having to reduce the daily rate of hire under the follow-on charter by US$8,000 per day. Transfield contended that their liability in damages was confined to the difference between the market rate of hire and the charterparty rate for the period from 2 May to 11 May 2004, which was calculated to be approximately US$158,000.

Mercator succeeded at arbitration. This decision was appealed to a single judge and then to the Court of Appeal, both of whom upheld the decision of the arbitrators. Transfield then appealed to the House of Lords. The appeal turned on a single point: Could the damages claimed by Mercator fit within the accepted principles of remoteness as laid down in *Hadley v Baxendale*[4] and other subsequent cases?

The development of remoteness in contract law

The general principle governing damages for breach of contract is that where a party sustains a loss by reason of a breach of contract, he or she 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.[5] However, not all damages are recoverable on this basis. Only those damages which, in the eyes of the law, are not considered to be too remote will be awarded by the courts.

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[1] [2008] UKHL 48.
[2] Lord Hoffmann and Lord Hope.
[3] Lord Rodger and Baroness Hale in particular.
[4] [1843-60] All ER 461 (*Hadley*).
[5] *Robinson v Harman* (1848) 1 Ex 850 at 855 per Parke B.

When discussing the development of remoteness in contract law, all roads inevitably lead to Rome, or at least to Gloucester, where Hadley once operated a flour mill.[6] One day, the main crankshaft for the mill broke, and had to be transported to Greenwich to be used as a template for a replacement crankshaft. Baxendale undertook to transport the crankshaft from Gloucester to Greenwich. However, he delivered the crankshaft some five days late. Hadley then sued for the loss of profits which would have otherwise accrued had the crank shaft been delivered on time.

The court refused to allow Hadley to recover the loss of profits.[7] In what has become one of the most famous expositions of the law of contract damages, Alderson B laid down the following guidelines as to when such damages would be recoverable:

(a) 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 those which can fairly and reasonably be considered as either arising naturally 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 (also known as the 'first limb');

(b) if special circumstances under which the contract was actually made were communicated and thus known to both parties, the damages which would be reasonably contemplated would be the amount of injury which would ordinarily follow from a breach of contract under the special circumstances so known and communicated (also known as the 'second limb');

(c) if these special circumstances were wholly unknown to the party breaking the contract, he or she could at most only be supposed to have had in his or her contemplation the amount of injury which would arise generally, as 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. [8]

These principles were not extensively reviewed until the later case of *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd*.[9] In that case the plaintiff ordered a large boiler from the defendant in order that they might take up certain profitable dyeing contracts. These contracts were never mentioned to the defendant. The delivery of the boiler was delayed and the plaintiff sued for the loss of profits they would have otherwise made from the dyeing contracts.

The court rejected the plaintiff's claim for the loss of profits, holding that it did not fall under either of the limbs outlined by Alderson B in *Hadley*. However, this was not the end of the matter. Although no special amounts were recoverable, the plaintiff was nonetheless entitled to recover normal business profits in respect of dying contracts to be reasonably expected, as these were losses arising 'naturally' from the breach.[10] This was so notwithstanding that these 'losses' were not actually suffered. As Asquith LJ observed:

> We agree that in order that the plaintiffs should recover specifically and as such the profits expected on these contracts, the defendants would have had to know, at the time of their agreement with the plaintiffs, of the prospect and terms of such contracts. We also agree that they did not in fact know these things. It does not however, follow that the plaintiffs are precluded from recovering some general (**and perhaps conjectural**) sum for loss of business in respect of dyeing contracts to be reasonably expected, any more than in respect of laundering contracts to be reasonably expected.[11] [emphasis added]

Of difficulty, however, was that Asquith LJ went on to say that all those amounts which were reasonably foreseeable as liable to result from the breach of the contract would be recoverable.[12] The concern with this statement is that the expression 'reasonably foreseeable', at least as it had developed in the law of tort, has a far wider reach than the notion of 'within the contemplation of the parties' as espoused in *Hadley*.

This introduced an unnecessary complication into the approach under the first limb. A question mark arose as to whether damage which was 'arising naturally' included any type of damage which was reasonably foreseeable.

This point was taken up by Lord Reid in *Koufos v C Czarnikow Ltd (The Heron II)*.[13] In that case, the plaintiffs chartered the defendant's ship to carry a load of sugar to Basrah. The ship made deviations along the way which caused

[6] This starting point was universally accepted by each member of the House of Lords. See Lord Hoffman at [21] ; Lord Hope at [30]; Lord Rodger at [47]; Lord Walker at [66]; Baroness Hale at [89].
[7] *Hadley* at 461.
[8] Ibid at 465.
[9] [1949] 2 KB 528 (*Victoria Laundry*).
[10] Ibid at 543.
[11] Ibid.
[12] Ibid at 539.
[13] [1969] 1 AC 350 (*The Heron II*).

delivery of the sugar to be delayed by nine days. The plaintiff intended to sell the sugar into the market at Basrah. Due to the delayed arrival of the ship, the market price achieved was lower than the plaintiff had originally expected. The charterer sued for the loss of profit.

Although utilising a multitude of different expressions,[14] the principle arising from the case was that since prices in a commodity market would fluctuate, shipowners could reasonably contemplate that is was not unlikely that, if their ship was delayed, the market for the goods may decline against the charterer. The appropriate measure of damages was therefore the difference between the price the goods would have achieved if delivered on time, and the price actually achieved. Again, no specific knowledge had been given to the defendants and the case was therefore limited to the first limb of the rule in *Hadley*.

The Heron II was a good example of the correct operation of the first limb in *Hadley*. The amount of the losses would have been unknown to the shipowner (and potentially very large). However, this was not considered to be relevant, as once it could be said that the type of loss (namely, the loss of profit from selling into a falling market) was one which the parties must have reasonably contemplated, then the charterer was entitled to recover. If one was to apply the reasoning of *Transfield* to the facts of *The Heron II*, it is possible that a different result would have been reached. This anomaly is discussed further below.

Lord Reid also specifically moved to resolve the uncertainty which had arisen from the use of the term 'reasonably foreseeable' by Asquith LJ in *Victoria Laundry*. His Lordship stated:

> To bring in reasonable foreseeability appears to me to be confusing measure of damages in contract with measure of damages in tort. A great many extremely unlikely results are reasonably unforeseeable: it is true that Lord Asquith may have meant foreseeable as a likely result, and if that is all he meant I would not object further than to say that I think that the phrase is liable to be misunderstood.[15]

This statement has, for many years, been accepted as correct in Australia.[16] In *Transfield*, a majority of the judges made it clear that, as far as English law is concerned, what Asquith LJ said in *Victoria Laundry* was wrong, and what Reid LJ had said in *The Heron II* was right.[17] However, beyond this, the judges in *Transfield* differed in their approach to the question of how the limits of contractual liability should be determined. The differing approaches are discussed below.

The assumption of risk approach

Lord Hoffmann outlined the assumption of risk model as follows:

> It seems to me logical to found liability for damages upon the intention of the parties (objectively ascertained) because all contractual liability is voluntarily undertaken. It must be in principle wrong to hold someone liable for risks for which the people entering into such a contract in their particular market, would not reasonably be considered to have undertaken.[18]

Lord Hope agreed that the critical question was whether the parties can be assumed to have contracted on the basis that the charterer had assumed responsibility for the consequences of the shipowner missing its next engagement as a result of late redelivery.[19]

The starting point, according to Lord Hoffmann, was not that damages should put the innocent party in the position as if the contract had not been breached. Rather, it was first necessary to decide whether the loss for which damages are claimed was the type which the party in breach could be said to have assumed responsibility.[20] In an earlier case of *Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd*,[21] his Lordship (with the concurrence of the other members of the court) had said:

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[14] Among the expressions used are: 'not unlikely' (at 388 per Lord Reid); 'liable or not unlikely' (at 406 per Lord Morris); 'liable to be' (at 410 per Lord Hobson); 'serious possibility or real danger' (at 414-5 per Lord Pearce; at 425 per Lord Upjohn).
[15] [1969] 1 AC 350 at 389
[16] *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 199 CLR 413; *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64; *Burns v MAN Automotive (Aust) Pty Ltd* (1986) 161 CLR 653.
[17] At [31] per Lord Hope; at [52] per Lord Rodger; at [84] per Lord Walker.
[18] At [12].
[19] At [30].
[20] At [15].
[21] [1997] AC 191.

> Before one can consider the principle on which one should calculate the damages to which a plaintiff is entitled as compensation for loss, it is necessary to decide for what kind of loss he is entitled to compensation. A correct description of the loss for which the valuer is liable must precede any consideration of the measure of damages.[22]

Put another way, the approach when assessing damages in a breach of contract case is to first determine what types of damages for which the contract breaker can be fairly said to have assumed responsibility. If responsibility can be said to have been assumed, the court then looks to *Hadley* to assess the amount of damage which would ordinarily flow from the breach.

The problem with this approach is that it treats the first limb in *Hadley* as governing the amount of the loss recoverable, rather than the type of losses recoverable. With respect, this does not accord with the wording of Alderson B in *Hadley*. It is submitted that on its proper construction, *Hadley* provides that the types of damage recoverable (under either limb) are limited to those which would ordinarily follow from a breach (including where the special circumstances are communicated), but there is no limitation on the amount of damage recoverable once the type of damage is identified as being covered by either of the two limbs.[23]

In approaching the question with the preliminary investigation, Lord Hoffmann has placed a different construction on *Hadley*, and thereby treats *Hadley* as controlling the amount of damages payable, rather than the types of damage for which the contract breaker is liable.

Lord Hoffman said that the question of whether a given type of loss is one for which a party can be said to have assumed responsibility involves the interpretation of the contract as a whole against the commercial background of the transaction.[24] However he then refused to allow Mercator to recover the larger amount on the basis that the risk would be one which was completely unquantifiable.[25]

With respect, this is a curious result. If it is accepted that both the parties would have regarded it as likely that the ship owners would at some time during the currency of the charter enter into a forward fixture, it would seem that a late delivery which would jeopardise that forward fixture would be very much a type of loss which the parties could be said to have had within their contemplation. Lord Hoffmann appears to have conceded that this was the case.[26] In those circumstances, it should make no difference that such losses were unknown to the contract breaker or were otherwise unquantifiable. What is important is that losses of that type were contemplated by the parties. It ought to make no difference to the outcome if, once the parties can be said to have contemplated a particular type of loss, the amount of that loss may be larger than the contract breaker might have thought reasonable.

It is therefore submitted that this approach is unduly complicated and introduces an unnecessary step into the reasoning process. On its proper construction, the first limb in *Hadley* says that a party will be assumed to be liable for those types of damages which are the usual consequences of a breach, even where the amount of those losses is large. Where the type of damage is not the usual consequence of a breach, a contract breaker will only be liable for those types of damage when they have been made specifically aware of some special circumstances. The assumption of risk approach deviated from this by looking to whether the parties could be said to have assumed responsibility for unquantifiable losses, rather than looking only to the types of damage for which the parties had clearly assumed liability.

Reasonable contemplation

Lord Rodger did not feel it necessary to examine the preliminary point raised by Lord Hoffman, and therefore did not approach the issue as one of assumption of risk. His Lordship instead kept squarely to the words of Alderson B in *Hadley*, and in particular whether or not the losses claimed could have been reasonably contemplated by the charterer. Baroness Hale expressed agreement with this approach.[27] This analysis draws directly on the wording used by Alderson B under the first limb in *Hadley*.

Lord Rodger accepted that the charterers would have reasonably contemplated, at the time they entered into the charter, that the ship owners were likely to suffer loss if the ship was redelivered late.[28] However, he did not allow recovery for

[22] Ibid at 211.
[23] This is expressly acknowledged by Lord Hoffman at [21], where his Lordship notes:
'It is generally accepted that a contracting party will be liable for damages for losses which are unforeseeably large, if loss of that type or kind fell within one or other of the rules in *Hadley v Baxendale*.'
[24] *Transfield* at [25].
[25] *Transfield* at [23] per Lord Hoffman; and see also at [36] per Lord Hope.
[26] At [23].
[27] At [93].
[28] *Transfield* at [54] per Lord Rodger; at [83] per Lord Walker.

these losses. Instead, he looked to the extremely volatile market conditions which existed at the time the ship owners entered into the forward charter, and concluded that those conditions produced losses which were not the 'ordinary consequence' of a breach of the charterparty.[29]

With respect, this confuses the type of damage which is within the contemplation of the parties with the amount of damage which is within their contemplation. As noted by Lord Hoffmann, it is irrelevant that a loss may be unusually large as long as it is the type of damage which would flow naturally from the breach.[30] There is little doubt in *Transfield* that the loss of profit on the forward charter flowed naturally from the late delivery.

A large loss may not be the ordinary consequence of a breach of a charterparty, however, losses of that type are clearly contemplated by the parties when they enter into the charterparty agreement. It would be absurd to hold otherwise. The anomaly created by Lord Rodger means that where market conditions are 'normal', the ship owner may be able to recover lost profits it would have earned on a forward charter at the 'ordinary' market rate, but be unable to recover if the market was volatile and its losses were thereby enlarged. What would be the 'ordinary' rate in any given case would clearly be a question of fact, and one which is unlikely to provide any certainty to contracting parties.

Resolving the differences

With respect to both Lord Rodger and Baroness Hale, the 'reasonable contemplation' approach which they have formulated is likely to lead to more disputes, and provides precious little certainty for charterers and shipowners alike. Those judges appear to be saying that the volatility of the market was the factor which could not have been within the contemplation of the parties. Unfortunately, this begs the question: In what circumstances will the market be sufficiently volatile so as to allow a defaulting charterer to avoid paying for the shipowner's losses?

Similarly, Lord Hoffmann's approach based on assumption of risk is not helpful, as it confuses the role of *Hadley* in identifying the types, rather than the amount, of losses which may be recovered. It is submitted that the correct interpretation was stated by Lord Reid in *The Heron II* where his Lordship said:

> [A] type of damage which was plainly foreseeable as a real possibility but which would only occur in a small minority of cases cannot be regarded as arising in the usual course of things or be supposed to have been in the contemplation of the parties: the parties are not supposed to contemplate as grounds for the recovery of damage any type of loss or damage which on the knowledge available to the defendant would appear to him as only likely to occur in a small minority of cases. … The crucial question is whether, on the information available to the defendant when the contract was made, he should, or the reasonable man in his position would, have realised that such loss was sufficiently likely to result from the breach of contract to make it proper to hold that the loss flowed naturally from the breach or that loss of that kind should have been within his contemplation.[31]

There was also reliance in the judgments on the fact that the charterer would have no knowledge of the terms upon which the forward charter was entered into, and that any losses would therefore be unquantifiable.[32] This is, with respect, an irrelevancy. By their very nature, unliquidated damages for breach of contract will rarely be quantifiable by the contract breaker against whom they are notoriously awarded. If this logic were to be applied to contract claims generally, the law relating to the recovery of unliquidated damages may have to be completely rewritten. That is an unacceptable outcome.

It is submitted that of the two approaches put forward by the House of Lords, the approach of Lord Rodger based on notions of losses which 'flow naturally' or are 'within contemplation' is to be preferred to that of the assumption of risk model endorsed by Lord Hoffmann and Lord Hope. However, it is also submitted that those judges adopting the former approach erred in its application to the facts of this case.

Under the first limb in *Hadley*, only those types of losses which flow naturally from the breach should be recoverable, however, there should be no monetary limit imposed on those damages. To construe *Hadley* otherwise is to impose a value judgment on the assessment of damages which is unfair to the non-breaching party. In any given case, it would become arguable that because a loss was large, it was thereby not 'within the contemplation' of the contracting parties, and therefore not recoverable. This is what occurred in this case. Such complexity is unwarranted and can only encourage further litigation.

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[29] *Transfield* at [60] per Lord Rodger; and see Baroness Hale at [91].
[30] At [21].
[31] [1969] 1 AC 350 at 385.
[32] At [23] per Lord Hoffmann; at [36] per Lord Hope; at [62] per Lord Rodger; and at [86] per Lord Walker.

Importantly, the approach adopted in *Transfield* is contrary to earlier observations that the appropriate measure of damages for late redelivery where the market rate has increased is the difference between the charter rate and the market rate for the period between the contractual redelivery date and the actual redelivery.[33] But that situation does not consider circumstances where a forward charter is lost in consequence of the late redelivery. But logically it follows that if the owners of the *Achilleas* had been unable to secure any forward charter for, say, six months, and the market had remained very high, the charterer could not complain that his breach had caused the loss of any profit (and at the higher rate) for the whole six month period until a further charter was obtained. Such claims in contract are common.

Although perhaps less favourable to charterers, a construction of *Hadley* which does not limit the amount of damages provides greater certainty and may in consequence encourage charterers not to breach the terms of the charterparty by redelivering late. If this is not considered reasonable, then the parties are at liberty to negotiate the terms of the charterparty to exclude liability for such losses.

Summary and conclusion

In *Transfield*, the House of Lords has had an opportunity to properly define the operation of the first limb in *Hadley*. It is submitted that it has failed to do so. Only time will tell if the decision has proved beneficial to shipowners, charterers, and any other contracting parties (of whatever nature) who may seek to rely on its findings.

Two separate approaches have emerged. Neither has been satisfactorily applied to the facts of the case. Although the losses claimed were large, it is submitted that there was no compelling reason in principle why the charterers should not have been held liable. The court made overtures as to the specialised nature of charterparties, but with respect, a charterparty is just another contract and should not attract such special treatment. The rules laid down in *Hadley* are applied almost universally in claims for contractual damages, and *Transfield* appears to have thrown open a new and uncertain approach to the application of those rules.

Overall, it is submitted that the 'within contemplation' approach formulated by Lord Rodger and Baroness Hale is to be preferred over the assumption of risk model put forward by Lord Hoffmann. The former approach is consistent with the rules laid down by Alderson B in *Hadley*. However, it is the writer's view that the subject matter of what must be 'within contemplation' is the type of damage, rather than the amount, and in this respect, the correctness of the decision must be doubted.

Conveniently, perhaps, the case may be read down in time and categorised as applying only to time charters where late redelivery occurs in a volatile market. If, however, the case is relied on more generally, then certainty may continue to lie somewhere over the sea and beyond the horizon.

[33] *Hyundai Merchant Marine Co Ltd v Gesuri Chartering Co Ltd (The Peonia)* [1991] 1 Lloyd's Rep 100 at 108 per Bingham J; *Alma Shipping Corpn of Monrovia v Mantovani (The Dione)* [1975] 1 Lloyd's Rep 115 at 117-8 per Denning MR.