

THE EFFECT OF MARKET CONDITIONS ON REPUDIATION AND DAMAGES: ZODIAC MARITIME AGENCIES LTD V FORTESCUE METALS GROUP LTD [2010] EWHC 903 (COMM)

Joel Meehan*

Fortescue Metals Group Ltd (FMG) entered into a consecutive voyage charterparty (CVC) with Zodiac Maritime Agencies Ltd (Zodiac) for the carriage of bulk cargoes of iron ore on the vessel *Kildare*. The charter was dated 5 December 2007 and was to be for a period of five years. FMG purported to suspend its contractual obligations as a consequence of unfavourable market conditions. Zodiac claimed that FMG repudiated the contract through a series of communications and conduct between 23 November 2008 and 2 January 2009. At that stage the charter had almost four and a half years left to run. FMG in turn claimed that Zodiac's purported acceptance was itself repudiatory. FMG initially asserted the defences of frustration and force majeure, but abandoned them shortly before trial. Justice David Steel of the Commercial Court presided over the matter.

The Facts

On 20 November 2008 Mr Saxon, chartering manager of FMG, informed Zodiac that under the 'current circumstances', it would be unable to honour its freight commitments as of 1 December 2008. FMG restated a request it made in an earlier meeting that the freight rate be reduced from US\$16 pmt to US\$6 pmt, and that the charterparty be extended from five to 10 years. Zodiac told FMG that the proposals were 'totally unacceptable' and that 'a change in market conditions is not a permissible excuse for failing to perform a contractual obligation under English law'.¹

Mr Andrew Forrest, CEO of FMG, telephoned Captain Rami Zingher, Managing Director of Zodiac, on 2 December. The parties dispute the contents of that conversation. Zodiac claimed that Mr Forrest was advising Zodiac that it was terminating the CVC because they were no longer in a financial position to honour their obligations under it. FMG argued that Mr Andrew Forrest merely said that FMG had to 'temporarily suspend or delay the CVC'. On 4 December, Mr Forrest sent a fax to Zodiac stating that due to 'events beyond the control of [FMG], including but not limited to complete refusal by our customers... to continue CFR shipments', it would be exercising its right to suspend or delay performance of its contractual obligations. Mr Forrest sought to rely on clause 32 of the charterparty, which he contended excused FMG from loss, damage, delay or failure to perform its contractual obligations as a result of unforeseen circumstances. Zodiac argued that the clause applied for the purposes of laytime and demurrage only, and that FMG had no right to suspend or delay its contractual performance.²

FMG followed this with an announcement to the Australian Stock Exchange on 5 December 2008, stating that it would be suspending 'all its long term CFR shipping Contracts of Affreightment and Consecutive Voyage Contracts on the basis of unforeseen circumstances'.³

Zodiac's Australian solicitors requested clarification from FMG on 10 December 2008. It asked how long FMG intended to suspend its contractual performance, the precise cause for doing so and whether it was as a result of any particular event or market development. FMG replied on 15 December 2008, stating that it was unable to load the vessel, and that through no fault of its own, performance had become radically different to that originally contemplated in the contract. It also informed Zodiac that it was assessing whether the market conditions had frustrated performance of the contract.

While the vessel was bound for Port Hedland to receive her next cargo, FMG's port agents Sea Corporation Pty Ltd informed Zodiac that the vessel would not be loading cargo at FMG's terminal at Port Hedland. Zodiac requested clarification on the matter on 27 December 2008, asking whether FMG intended to load at a different berth, and if not, when it would resume loading at Port Hedland. FMG's London solicitors did not respond until 2 January 2009, and then simply restated its position, reserving its right to rely on clause 32 with regard to demurrage. By this stage, the vessel had arrived at Port Hedland and tendered notice of readiness. Based on a

* Student editor, A&NZMLJ 2010.

¹ *Zodiac Maritime Agencies Ltd v Fortescue Metals Group Ltd* [2010] EWHC 903 (Comm), [10].

² *Ibid.*, [15].

³ Fortescue Metals Group Ltd, *Announcement to the Australian Stock Exchange*, 5 December 2008.

load rate of ‘80 000 metric tonnes per weather working day’, laytime expired on 1 January 2009. FMG failed to load any cargo at all, and remained on demurrage from 1 January 2009.⁴

On 9 January, Zodiac accepted FMG’s conduct as repudiation of the contract. FMG claimed that this itself was repudiatory, which it purported to accept on 12 January.

Repudiation

Both Captain Zingher and Mr Forrest gave evidence regarding the contents of the 2 December phone call.⁵ A witness statement Captain Zingher had prepared the following day formed the basis of his evidence in chief. He stated that Mr Forrest told him that FMG was terminating the charterparty, that he was telephoning out of courtesy but written confirmation would follow.⁶ Mr Forrest said he told Captain Zingher that FMG intended to only suspend its obligations, and was merely giving Zodiac advanced notice.⁷

In light of these conflicting statements, His Honour considered the words of Goff LJ in “*The Ocean Frost*”: ‘where there is a conflict of evidence... reference to the objective facts and the documents, to the witnesses’ motives and to the overall probabilities can be of very great assistance to a judge in ascertaining the truth’.⁸ Steel J considered the market background to the conversation.⁹ In October 2008 the spot price of steel fell, resulting in FMG’s customers refusing to accept its shipments of iron ore, advising that the contracts needed to be suspended and prayed in aid force majeure clauses. His Honour then considered Mr Saxon’s email of 23 November 2008. Mr Saxon stated that ‘under the current circumstances we are unable to honour our freight commitments from 1 December 2008’.¹⁰ Mr Saxon requested a large reduction in freight and extension of the charterparty to 10 years. Failing a response to the proposal, Mr Saxon said he saw ‘no other way forward’.¹¹ His Honour considered Zodiac would have needed to accept the offer in order for the charterparty to continue to be performed.¹² For these reasons, and the contemporaneous nature of Mr Zingher’s notes, Steel J preferred Captain Zingher’s evidence to Mr Forrest’s.¹³ His Honour considered that the email was ‘wholly consistent’ with an apparent intention of FMG not to perform its obligations.¹⁴ He said that ‘any fair and objective reading of the entirety of the exchanges between the parties... is only consistent with FMG evincing an intention not to be bound by the charterparty’.¹⁵

FMG submitted that its position was based on a genuine but mistaken understanding of the contractual terms and that a party relying solely on those terms without manifesting conduct of an ulterior intention to abandon it was not to be treated as repudiating it.¹⁶ His Honour rejected the argument for a number of reasons, including the fact that FMG never identified the provision to which it relied upon for suspending its contractual obligations. Steel J cited *Federal Commerce and Navigation Co Ltd v Molena Alpha* as authority that even if FMG honestly misunderstood its position, that was no excuse for repudiating the contract.¹⁷ In any case, Steel J was unconvinced that even FMG genuinely believed in the legitimacy of their reliance on the terms.

Steel J concluded that FMG showed an intention to no longer be bound by the contract and therefore repudiated it.

Quantum

Steel J concluded that the vessel would have traded for a further 1552.3 days over the remaining charter period earning a daily income of US\$89 875.¹⁸ However, determining whether there was a market for the vessel post-repudiation was a more vexed issue. His Honour cited a passage from *Shearson Lehman Hutton Inc v Maclaine Watson & Co Ltd*, where Webster J said that there

⁴ Above n1, [24].

⁵ Ibid [30].

⁶ Ibid [31].

⁷ Ibid [38].

⁸ [1985] 1 Lloyd’s Rep 1, 57.

⁹ Above n1, [42].

¹⁰ Ibid [44].

¹¹ Ibid [43].

¹² Ibid [44].

¹³ Ibid [46].

¹⁴ Ibid [46].

¹⁵ Ibid [47].

¹⁶ Ibid [48]. FMG sought to rely on the case of *Woodar Investment Development Ltd v Wimpey Construction UK* [1980] 1 WLR 277.

¹⁷ [1978] QB 927.

¹⁸ Above n1, [54]-[55].

‘is no available market unless there is one actual buyer on that day at a fair price; and that if there is no actual offer for sale... there is no available market unless on that day there are in the market sufficient traders potentially in touch with each other to evidence a market in which in which the actual or notional seller could if he wished sell the goods’.¹⁹

Steel J noted that ‘[i]f it existed the relevant market must have been for a four and a half year consecutive voyage/time charter on equivalent terms (other than freight/hire) for the carriage of bulk cargo including iron ore’.²⁰ He also said that the market substitute should have similar trading limits.²¹ He was persuaded that there was no available market for such a long-term charter at the time of repudiation, noting that the market rate had dropped from \$US160 000 to \$US24 000 for spot fixtures following the financial collapse. The fact that charterers would have only contracted for the relevant period at a rate unacceptable to shipowners demonstrated to Steel J that there was no available market.²²

However, both parties agreed that by February 2010 there had emerged a market for a three to three and a half year charter. Zodiac and Fortescue disagreed as to how damages should be calculated in light of this.²³ Zodiac submitted that damages should thereafter be assessed by reference to that rate. FMG argued that the rate that was only relevant if a reasonable owner was required to accept the fixture in order to mitigate its losses. Steel J distinguished the case of “*The Elena d’Amico*”,²⁴:

The decision in “*The Elena d’Amico*” was to the effect that the normal measure of recovery in cases of premature termination of a charterparty is the difference between the contractual rate for the balance of the charter period and the market rate. But where there is no market at the time of termination, this measure does not and cannot arise.²⁵

His Honour agreed with FMG in concluding that:

[t]he fact that a term market thereafter emerges for the (yet shorter) outstanding balance of the charter period does not in my judgement import with it the proposition that a decision not to take advantage of that market at that later stage becomes a business decision independent of the wrongful termination. The rationale is that acceptance of the market rate at the date of breach is deemed to constitute reasonable mitigation.²⁶

Steel J cited Toulson J’s reasoning in *Norden v Andre*,²⁷ deciding that the subsequent market should not be considered when calculating damages. He said that:²⁸

[i]t is simply a matter of chance when the vessel completes any spot voyages after the termination date... In short I see no basis for requiring the owner to go back into the term market at the end of every spot voyage or for that matter to disregard short time charters in case the market for longer charters in case the market for longer charters emerges in the meantime.

Following FMG’s repudiation, Zodiac employed *Kildare* in two spot voyages. It also renegotiated an existing CVC, substituting that vessel for *Kildare*. Zodiac argued that the existence of the charter was independent and should not be considered as part of the vessel’s earnings.²⁹ Steel J rejected that argument, preferring FMG’s submission that Zodiac’s decision to employ *Kildare* in the charter was ‘part of a continuous dealing with the situation in which they found themselves’.³⁰ His Honour remarked that FMG’s termination was the cause of the renegotiation ‘as a matter of common sense’.³¹ He went on to further discount the amount of damages for accelerated receipt of income and reduced risk arising from the new charter by a further 1.5%.³²

¹⁹ [1990] 1 Lloyd’s Rep 441.

²⁰ Above n1, [57].

²¹ Ibid, citing the case of *The Golden Victory* [2007] 2 AC 353.

²² Ibid [61].

²³ Ibid [62].

²⁴ [1980] 1 Lloyd’s Rep 75.

²⁵ Above n1 [63].

²⁶ Above n1 [65].

²⁷ *Norden v Andre* [2003] 1 Lloyd’s Rep 287, [42]. The passage cited referred to the decision of *Hadley v Baxendale* (1854) 9 Exch 341. In that case at 354, Alderson B held that damages ‘should be such as may fairly and reasonably be considered either arising naturally... 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’.

²⁸ Above n1, [66].

²⁹ Ibid [70].

³⁰ *British Westinghouse Electric and Manufacturing Co Ltd v Underground Electric Railways Co of London* [1912] AC 673, 692.

³¹ Ibid [72].

³² Ibid [73].

His Honour then concluded the matter by stating that FMG was to pay Zodiac damages in the region of US\$80 – 85 million.³³

Conclusion

This dispute arose against a backdrop of stagnating international trade and tumbling freight rates. After being abandoned by their customers, FMG was left in the undesirable position as a charterer paying way above the market rate. It is worth noting that FMG ‘walked away’ from several other long term shipping contracts in the wake of the global financial crisis. It recently announced that it had concluded settling all of its shipping contracts that it had suspended during 2008 at a total loss of \$US159 million.³⁴ The announcement came after it came to a ‘favourable settlement’ with Singapore shipping company Armada, agreeing to pay the company US\$3.7 million for terminating its contract of affreightment in January 2009.

FMG had clearly repudiated the contract, and Steel J dealt swiftly with the issue. Calculation of damages, on the other hand, took more of His Honour’s time. It was his consideration of damages and whether an available market existed which makes this case of general interest. The global financial crisis will continue to be a relevant factor in shipping disputes not only in terms of repudiation and allegations of frustration, but also for calculating damages. Charterers repudiating long-term contracts in the wake of the financial collapse may find themselves liable for greater damages. This is because there might not be an available market in which the shipowner can mitigate their loss forcing them to accept spot fixtures at the market rate.

³³Ibid [74].

³⁴ Fortescue Metals Group Ltd, *Announcement to the Australian Stock Exchange*, 6 October 2010. See also Barry Fitzgerald, ‘Fortescue squares off damages for \$171 million’, *Sydney Morning Herald* (online), 7 October 2010 <<http://www.smh.com.au/business/fortescue-squares-off-damages-for-171-million-20101006-167x3.html>>.