The "NEW FLAMENCO" – Supreme Court decision

The Supreme Court delivered this week its long awaited decision in the "NEW FLAMENCO", holding that the benefit that arose from the sale of the vessel by the owners following the charterers' repudiation of charter could not be taken into account when assessing damages because it was not caused by the breach or by a successful act of mitigation.

The "NEW FLAMENCO" (the "Vessel") was a small cruise ship chartered in 2004 by Globalia Business Travel ("Charterers") from Fulton Shipping Inc ("Owners"). Owners alleged that, in 2007, the parties met and agreed a two-year extension of the charter (up to November 2009). The Charterers, who disputed having reached such agreement, redelivered the Vessel in October 2007, when the Owners sold her for USD 23,765,000.

The arbitrator found that the Charterers had breached the agreement to extend the charter, but that the sale of the Vessel in October 2007 was caused by the breach and was in reasonable mitigation of Owners' losses. If the Vessel had been sold when the charter was due to come to an end in November 2009, her value would have been USD 7,000,000, a fall in value of USD 16,765,000. It followed that the Charterers were entitled to a credit of USD 16,765,000 in respect of the benefit that accrued to the Owners by selling the Vessel when worth more in October 2007 than it was at the end of the charter period in November 2009. This was more than the Owners' loss of profit and would result in the Owners recovering no damages for the Charterers' repudiation.

The question in the appeals was whether that difference constituted a benefit which, on principles of mitigation and avoidance of loss, should be brought into account.

In the Commercial Court, Popplewell J disagreed with the arbitrator and held that it should not, because, *inter alia*: a) the Owners' decision to sell an asset acquired before the breach was not caused by the Charterers' breach and the arbitrator's conclusion that the sale was, in fact, in reasonable mitigation of the loss could not be conclusive when the sale was caused by the independent decision of the Owners to realise the capital value of the vessel; b) the facts that the benefit gained was of a different kind (capital as opposed to income) and that the sale was a transaction that Owners could enter in to at any time were indicative that the benefit was not 'legally caused' by the breach; c) if the benefits accruing from the sale were to be taken into account, so should the use of the proceeds, leading to an endless regression; and d) the Owners had taken the business risk of acquiring the Vessel in 2005 and selling it in 2007 and it would be contrary to public policy to allow the contract-breaking Charterers to appropriate the result of the Owners' business acumen.

In the Court of Appeal, the arbitrator's award was reinstated. Focusing on the decision of the House of Lords in British Westinghouse Electric and Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd [1912] A.C. 673, the CA held that if a claimant adopts by way of mitigation a measure which arises out of the consequences of the breach and is in the ordinary course of business, and such measure benefits the claimant, that benefit is normally to be brought into account.

The Court of Appeal considered that when there is no available market, an owner may decide to mitigate his loss by selling the vessel and it was not easy to see why the benefit should not be brought into account, nor was there any reason why the value of that benefit should not be

calculated by reference to the difference between the value of the vessel at the time of sale and its value at the time when the charter was due to expire.

In a short judgment, Lord Clarke, with whom the other four lords agreed, said he preferred Popplewell's reasoning, which led to the Court of Appeal's decision being overturned and Popplewell's order being restored.

The reason why the benefit could not be taken into account was not because the benefit must be of the same kind as the loss suffered by the claimant. Lord Clarke said the difference in kind is not the appropriate test because it 'is too vague and potentially too arbitrary a test'. The relevant test, he said, is causation. To be brought into account, the benefit must have been caused either by the breach or by a successful act of mitigation.

In this case, there was nothing about the premature termination which made it necessary for Owners to sell the Vessel. The decision to sell was a commercial decision made at the Owners' own risk. The termination was, at the most, the occasion for selling the Vessel, not the legal cause of it. It was for the same reasons that the sale was not an act of successful mitigation.

At paragraph 34 of the judgment, Lord Clarke said:
'If there had been an available market, the loss would have been the difference between the actual charterparty rate and the assumed substitute contract rate. Sale of the vessel would have been irrelevant. In the absence of an available market, the measure of the loss is the difference between the contract rate and what was or ought reasonably to have been earned from employment of the vessel under shorter charterparties, as for example on the spot market. The relevant mitigation in that context is the acquisition of an income stream alternative to income stream under the original charterparty. The sale of the vessel was not itself an act of mitigation because it was incapable of mitigating the loss of the income stream.'

Comments
In the Commercial Court, Popplewell J gave a detailed judgment which highlighted a number of applicable principles. Lord Clarke did not consider each of them, but to the extent that he did not disagree with anything that Popplewell J said, it is submitted that Popplewell J's analysis is likely to serve as guidance in the future in similar cases.

Whilst the Supreme Court clarified that the relevant test is that of causation, the last two sentences of paragraph 34 indicate that difference in kind was also particularly relevant and make it unclear as to when a benefit which is different in kind can ever be taken into account.

If you have any questions, please do not hesitate to speak to your usual Clyde & Co contact or Elizabeth Turnbull and Marcia Perucca, the authors of this update, and the solicitors acting for charterers in the "New Flamenco".

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