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BRIEFING

BUNGE SA v NIDERA BV: GOLDEN VICTORY ALL-AROUND?

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- WHEN DETERMINING DAMAGES, SHOULD THE COMPENSATION PRINCIPLE ESTABLISHED IN *THE GOLDEN VICTORY* REQUIRE CONSIDERATION OF SUBSEQUENT EVENTS WHICH WOULD HAVE REDUCED LOSS?
- DOES THE GAFTA DEFAULT CLAUSE OPERATE AS A COMPREHENSIVE CODE FOR THE ASSESSMENT OF DAMAGES, SO AS TO EXCLUDE COMMON LAW PRINCIPLES?

The Golden Victory hardly seems an apt way to refer to a House of Lords decision that has suffered much academic criticism and judicial scrutiny. However, following the recent unanimous decision by the Supreme Court in *Bunge SA v Nidera BV* [2015] UKSC 43, which overturned a decision of the GAFTA (Grain and Feed Trade Association) Appeal Panel that was supported by both the Commercial Court and the Court of Appeal, the decision in *Golden Straight Corporation v Nippon Yusen Kubishika Kaisha (The Golden Victory)* [2007] 2 AC 535 has now been re-affirmed. The Supreme Court has also interpreted the GAFTA Default Clause, a clause widely used in commodities contracts which sets out a scheme for measuring damages, and the extent to which the clause excludes common law principles.

"PARTIES WANT TO KNOW WHERE THEY STAND AND TO ACT ACCORDINGLY. THIS IS PARTICULARLY IMPORTANT IN RELATION TO POTENTIAL DAMAGES."

The issues

When choosing governing law and jurisdiction commercial parties will look for certainty, finality and ease of resolution of disputes. Parties want to know where they stand and to act accordingly. This is particularly important in relation to potential damages.

However, the principle established in *The Golden Victory* has been criticised for reasons of lack of certainty. In that case a seven-year time charter had been brought to an end by the charterer's repudiation in the course of performance some four years before the contractual expiration date but only fourteen months before it would have been cancelled in any event under a war clause as a result of the outbreak of the Iraq war. At the time when the charterer's repudiation was accepted, war was far

from inevitable. It was found to be no more than a possibility. The question arose as to how damages should in this case be calculated.

The House of Lords in *The Golden Victory* held by a 3:2 majority that the overriding principle was the compensatory principle, namely that the injured party is, in so far as money can do, to be placed in the same position as if the contract had been performed. Consequently, irrespective of the date at which the loss is to be measured, it is necessary to take account of events known to have occurred by the date of assessment if their effect would have been to allow the contract to have been lawfully terminated before its contractual term, thereby reducing the loss that would have been suffered. It followed that damages were to be assessed on the assumption that the charter would have lasted for another 14 months only, rather than four years.

This decision has been heavily criticised. In particular, Professor Sir Guenter Treitel QC has said that the decision meant that the shipowner in that case could not have known where it stood when its right to damages accrued; the value of that right fluctuated in the light of later events for which it was not responsible and which, when the right accrued, were merely a possibility. In this respect certainty was subordinated to the compensatory principle. It was also unclear whether the decision in *The Golden Victory* would be applicable to cases involving a contract for a one-off sale rather than a contract for the sale of goods and services over a period of time.

"JUDICIAL CONCERN HAS OFTEN EMERGED WHERE UPHOLDING A DAMAGES CLAUSE WOULD CAUSE THE INJURED PARTY TO RECOVER A WINDFALL WHICH DOES NOT ACCORD WITH THE ACTUAL LOSS SUFFERED."

To overcome such problems and increase certainty of how damages will be assessed, parties may contractually agree either a fixed measure of loss (as in the case of a liquidated damages clause) or a mechanical formula for assessing loss (such as that provided for by the GAFTA Default Clause), to replace the more nuanced and fact sensitive approach of the common law. The GAFTA Default Clause is just one example of a number of standard form contracts which seek to produce an easily understood and readily applied formula that is relied upon by those in the relevant trade or profession for calculating damages. However, judicial concern has often emerged where upholding a damages clause would cause the injured party to recover a windfall which does not accord with the actual loss suffered.

Therefore, two issues arose before the Supreme Court in *Bunge SA v Nidera BV*. First, the scope of the compensation principle established in *The Golden Victory* and whether, ignoring the GAFTA Default Clause, this principle required the arbitrator to consider events subsequently known to have occurred which would have reduced or extinguished loss. Second, whether the GAFTA Default Clause operated as a comprehensive code for the assessment of damages so as to exclude common law principles including, in particular, the compensation principle identified in *The Golden Victory*.

Background facts

This case concerned a contract for the supply of 25,000 metric tonnes of Russian milling wheat crop. Under the contract the shipment period was August 2010, but there were provisions for narrowing that period by notice. In the event it was narrowed to 23-30 August 2010. The contract incorporated GAFTA Form 49, one of GAFTA's standard form contracts.

Clause 13 of GAFTA Form 49, known as the Prohibition Clause, was incorporated into the contract and gave rise to a right to cancel in the case of a prohibition of export. Clause 20 of GAFTA Form 49, known as the Default Clause, was also incorporated. This provided:

"20. DEFAULT - In default of fulfilment of contract by either party, the following provisions shall apply: …(c) The damages payable shall be based on, but not limited to the difference between the contract price and … the actual or estimated value of the goods on the date of default ..."

On 5 August 2010 Russia introduced a legislative embargo on exports of wheat from its territory, which was to run from 15 August to 31 December 2010. On 9 August 2010, the Seller notified the Buyer of the embargo and purported to declare the contract cancelled. The Buyer did not accept that the Seller was entitled to cancel the contract and treated the purported cancellation as a repudiation, which it accepted on 11 August 2010. The following day the Seller offered to reinstate the contract on the same terms, but the Buyer would not agree. Instead, it began arbitration proceedings under the GAFTA rules in support of a claim for damages of US$3,062,500.

The Proceedings

GAFTA's first tier tribunal held that the Seller had repudiated the contract. This was because the possibility existed at the date when the Seller cancelled the contract that the embargo might have been lifted in time to permit shipment. However, the first tier tribunal declined to award substantial damages as the fact that the embargo remained in place at the time of shipment meant that no loss had been suffered, as the contract would have been cancellable in any event.

An appeal was made to the GAFTA Appeal Panel. The Appeal Panel agreed that the Seller had repudiated the contract and awarded the Buyer US$3,062,500; representing the difference between the contract and the market price on 11 August 2010, the date the repudiation was accepted. In the Appeal Panel's view such an award was required by subsection (c) of the Default Clause. The Commercial Court, before Hamblen J, and the Court of Appeal agreed with the GAFTA Appeal Panel's decision.

"PROPER APPLICATION OF THE COMPENSATORY PRINCIPLE MADE IT RIGHT WHEN AWARDING DAMAGES TO TAKE INTO ACCOUNT FACTS KNOWN AT THE DATE OF ASSESSMENT."

Before the Supreme Court the Seller did not dispute that it had repudiated the contract. However, it contended that the GAFTA Default Clause did not exclude the compensation principle established in *The Golden Victory* and that the application of such principle to this case would mean that the Buyer had no right to recover damages where no loss had been suffered by it.

The Decision

Scope of *The Golden Victory*

The Supreme Court expressly supported the decision of the majority in *The Golden Victory* that proper application of the compensatory principle made it right when awarding damages to take into account facts known at the date of assessment. Therefore in this case it was relevant to take into account that if the contract had not been repudiated it would have been lawfully cancellable shortly thereafter. The Supreme Court also clarified that there is no distinction to be drawn in this regard between a one-off contract of sale, a contract of sale in instalments or a period contract.

In reaching this decision the Supreme Court started by considering that ordinarily upon repudiation of a contract for the sale of goods, where there is deemed to be an available market, damages are assessed by comparing the contract price with the price that would have been agreed under a notional substitute contract assumed to have been entered into in its place at the market rate but otherwise on the same terms. In relation to a repudiation that occurs before the time specified for performance (i.e. an anticipatory breach), the date at which the notional substitute contract is deemed to be entered into is normally the date that such repudiation is accepted.

"THE SO-CALLED DUTY TO MITIGATE IS NOT A DUTY IN THE SENSE THAT THE INNOCENT PARTY OWES AN OBLIGATION TO THE GUILTY PARTY, IT IS AN ASPECT OF THE PRINCIPLE OF CAUSATION THAT THE DEFAULTING PARTY WILL NOT BE HELD TO HAVE CAUSED LOSS WHICH THE INJURED PARTY COULD EASILY HAVE AVOIDED."

The Supreme Court explained that these principles arise out of both the compensatory principle and principles of mitigation whereby it is expected that the injured party should promptly go into the market and enter into a substitute contract. Although the so-called duty to mitigate is not a duty in the sense that the innocent party owes an obligation to the guilty party, it is an aspect of the principle of causation that the defaulting party will not be held to have caused loss which the injured party could easily have avoided.

Notwithstanding the above, the Supreme Court considered that, where the loss suffered by the injured party would have been reduced by supervening events even without the repudiation of the defaulting party, judges and arbitrators should take into account such contingencies when assessing damages. The Supreme Court clarified that the compensatory principle makes it axiomatic that any assessment of damages must reflect the nature of the bargain which the innocent party has lost as a result of the repudiation. However, there may still be scope for arguments to be made by parties as to how the loss of bargain in such cases is to be assessed. Lord Sumption and Lord Toulson both accepted that loss in this case could not be assessed by a simple comparison of the contract price with the market price in the notional substitute contract, but seemed to use different approaches to arrive at the same conclusion that the Buyer suffered no loss.

Lord Sumption's approach (with which Lord Neuberger, Lord Mance and Lord Clarke agreed) was that under common law, and as is also set out under Sections 50 and 51 of the Sales of Goods Act 1979, for the purpose of assessing loss it is necessary to value the price of the goods or services that would have been delivered rather than the value of the contract itself at the time that it was terminated. Lord Sumption held that the notional substitute contract, whenever it was made at whatever market rate, would have made no difference because it would have been subject to the same Prohibition Clause. Accordingly, the Buyer would have recovered no value from performance of the contract had it not been wrongfully terminated as it would have been cancelled shortly thereafter in any event.

On the other hand, Lord Toulson expressed the Buyer's loss arising out of the repudiation as loss of the chance of obtaining a benefit in the event that the export ban was lifted before the delivery period, only in which case would the notional substitute contract have been capable of lawful performance. Lord Toulson explained that assessment of the loss of a chance of obtaining a benefit would have to be made by arbitrators or the judges doing the best they can. However, he confirmed that he saw no virtue in attempting some kind of retrospective assessment of prospective risk when the answer was known (i.e. in this case it was known that the embargo was not lifted).

In respect of the need for the common law to provide commercial parties with certainty, finality and ease of settlement of disputes, Lord Sumption simply said "*commercial certainty is undoubtedly important…but it can rarely be thought to justify an award of substantial damages to someone who has not suffered any*".

"IN THE ABSENCE OF CLEAR WORDS, IT MAY BE ASSUMED THAT THE PARTIES WOULD NOT HAVE INTENDED THE DAMAGES CLAUSE TO OPERATE ARBITRARILY, FOR EXAMPLE BY PRODUCING A RESULT UNRELATED TO ANYTHING WHICH THE PARTIES CAN REASONABLY HAVE EXPECTED TO APPROXIMATE TRUE LOSS."

Interpretation of the GAFTA Default Clause

The Supreme Court held that damages clauses are not necessarily to be regarded as complete codes for the assessment of damages. It is a question of construction whether a clause is intended to deal with damages exhaustively. Further, in the absence of clear words, it may be assumed that the parties would not have intended the damages clause to operate arbitrarily, for example by producing a result unrelated to anything which the parties can reasonably have expected to approximate true loss.

In considering the GAFTA Default Clause, the Supreme Court considered that the clause could not be treated as a complete code for every aspect of the assessment of damages. In particular, it provided that damages payable "*shall be based on*" the difference between the contract price and the relevant market price or value and did not exclude other considerations which might be relevant to determine damages.

Accordingly, the Supreme Court stated that the Default Clause was concerned only with determining the market price or value of goods that either were actually purchased by way of mitigation or might have been purchased under a notional substitute contract where this was relevant to assessing damages. It:

- was not concerned with bases of assessment which did not depend on the terms of a notional substitute contract or on any determination of the market price. For example, expenses incurred by the Buyer in the course of performance which were not occasioned by the breach of contract but had been rendered futile by it and would normally be recoverable as an alternative to the prima facie measure;
- did not deal with any other aspect of mitigation other than the injured party's duty to mitigate by going into the market to buy or sell; and
- neither addressed nor excluded the consideration of supervening events which operated to reduce or extinguish the loss.

The Supreme Court therefore concluded that the Default Clause: (i) did not preclude the compensation principle established in *The Golden Victory* and allowed the Court to take into account supervening events which operate to reduce or extinguish the loss; and (ii) left open the possibility that damages may be affected by an offer from the defaulter which it would have been reasonable for the injured party to accept. The Supreme Court considered that the alternative would allow the clause to operate arbitrarily as a means of recovering substantial damages in circumstances where there has been no loss at all.

Conclusion

This is an important decision of the Supreme Court. Not only does it resolve the uncertainty which existed as to the future of the decision in *The Golden Victory*, but it also provides helpful guidance generally as to assessment of damages arising out of repudiation of a contract for the sale of goods.

It is now indisputable that when assessing damages arising from a repudiation which has occurred before the time specified for performance (i.e. an anticipatory breach

of contract) that a Court or Tribunal should take into account supervening events known at the date of assessment which would have caused the loss suffered to be reduced or extinguished regardless of the repudiation. However, it remains to be seen whether parties in dispute will seek to make anything of the different approaches adopted by Lord Sumption and Lord Toulson to assessing a party's loss of bargain in such case.

"THE SUPREME COURT'S FINDING THAT THE GAFTA DEFAULT CLAUSE WAS NOT SUFFICIENT TO EXCLUDE COMMON LAW PRINCIPLES IS LIKELY TO HAVE WIDE RANGING EFFECT..."

On the other hand, if parties to a contract wish to take control of how damages are to be assessed by including a damages clause in the contract, they may do so. However, the Supreme Court has highlighted that common law principles, including the compensatory principle established in *The Golden Victory* and principles of mitigation, will not be excluded from the assessment of damages unless very clear words are used to achieve this. As a result, careful thought will be required at the drafting stage to consider different common law principles that may be applied to assess damages in different factual scenarios and whether the parties wish to exclude such principles from applying. If so, clear words will be required to exclude such principles. In some cases this may lead to more complex damages clauses being required.

Further, the Supreme Court's finding that the GAFTA Default Clause was not sufficient to exclude common law principles is likely to have wide ranging effect given the vast number of commodities contracts which incorporate this clause.

FOR MORE INFORMATION

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