CALCULATING DAMAGES FOR A CONTRACT BREACH – CAUTION WHEN AN ASSOCIATED PARTY SUFFERS THE LOSS

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In *Palmali Shipping SA v Litasco SA*, the UK Commercial Court considered the calculation of owners' lost profit claim resulting from the charterer's alleged non-performance of a long-term contract of affreightment ("COA"), where the owners did not own their own fleet and instead chartered vessels from associated group companies.

> "This decision serves as a stark reminder that when claiming damages, claimants need to account for all benefits and losses as part of the compensatory rule of damages under English law."

BACKGROUND

Palmali Shipping (the "Owners") said they had entered into a long-term COA with Litasco (the "Charterers") giving them the exclusive right to carry 400,000-700,000mt of oil products per month in the Caspian Sea, the Black Sea and the Mediterranean Sea. The Owners claimed US$1.9bn of damages from the Charterers for breaching the exclusivity and minimum quantity obligations.

The Owners did not own their own fleet of ships. Instead they chartered in vessels from related group companies and unrelated third parties. However, their lost profit claim assumed they would have incurred no expenses chartering vessels up the line from related companies.

The Charterers disputed this part of the damages' calculation. The Owners managed the related owning companies' ships under management agreements providing that they held the COA revenues for the related companies' account and thereby earn a 2.5% management fee in return. The Charterers therefore argued that the Owners had only lost the management fee.

However, the Owners argued that the management agreements did not reflect the basis on which the vessels were actually operated in practice, as they would never be required to pay the hire or freight invoiced to them by the related companies and were effectively able to treat the entire amounts received from the Charterers as their own, so their calculation rightly ignored such expenses.

SUMMARY JUDGMENT APPLICATION

The Charterers applied for summary (immediate) judgment on this part of the calculation on the basis that the Owners had no real prospects of succeeding on it (i.e. the Owners' arguments regarding this part of their calculation were hopeless).

The Owners opposed the application on the basis of their existing arguments, alternatively on the basis that they could recover the related owning companies' losses by way of the transferred loss principle (which in certain limited situations allows contract party A to claim for contract party B's breach losses incurred due to a breach by third party C).

DECISION

As to the Owners' existing argument, the judge, Mr Justice Foxton, held that:

1. A lost profit calculation must take into account (i) expenses caused, and benefits lost, by a breach; as well as (ii) expenses saved, and benefits enjoyed, as a result of the breach;
2. In this regard, an unpaid liability constitutes a loss that must be taken into account by the calculation[1];
3. It was for the Owners to show, on this summary judgment application, they had an arguable case that they had no liability to the related owning companies for hire/freight up the line on the basis that, even though they were invoiced for it and the sums would appear in the inter-companies' accounts, the money would in practice never be paid;

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4. However, the evidence contradicted that. The Owners had accepted that with vessels chartered from related companies they would use the COA freight to pay the vessel's operating expenses and loan repayments; and
5. Therefore, the judge said, the Owners had no realistic prospect at trial of succeeding in their argument that these expenses should be ignored.

As to the Owners' argument that they were entitled to recover the owning companies' losses under the 'transferred loss' principle, the judge held that:

"The 'transferred loss' principle will only apply where the "known object" of the contract transaction is to benefit that third party, and, in practice, will have limited application."

1. The 'transferred loss' principle is restricted to those cases where the "*known object*" of the contract transaction is to benefit a third party, such that a contract breach would foreseeably cause a loss to that third party;
2. However, this was not the case here. There was no common intention or "*known object*" under the COA that it was to benefit the owning companies. How the Owners chose to source the performing vessels was a matter for them;
3. Furthermore, it was unclear which owning companies suffered losses (and what those losses were);
4. It was also difficult to identify what legal or economic connection the Owners needed to have with those owning companies to bring them within the 'transferred loss' class of third-party beneficiaries;

5. Finally, the owning companies did not need to recover their losses under the COA – they could simply sue the Owners under their contracts with them; and
6. Therefore, the 'transferred loss' principle could not apply here, and the Owners were not permitted to amend their claim to include it.

CONCLUSION

This decision serves as a stark reminder that when claiming damages, claimants need to account for all benefits and losses as part of the compensatory rule of damages under English law. In this regard, if a claimant sources their vessels or anything else under separate contracts that it has with third-party or associated companies, it needs to account for the expenses incurred under those contracts so that the sum of money it is claiming reflects its actual loss.

Furthermore, if the claimant contends that a third party has suffered loss because of the contract breach, that loss will need to be dealt with under the claimant's own contract with that third party. If the third party is entitled to claim the loss from the claimant, then the claimant may in turn be entitled to claim that loss from the contract breaker under the main contract, subject to questions of foreseeability and remoteness. The 'transferred loss' principle will only apply where the "*known object*" of the contract transaction is to benefit that third party, and, in practice, will have limited application.

[1] Applying *Total Liban SA v Vitol Energy SA [2001] QB 643*

KEY CONTACTS

HENRY STOCKLEY
SENIOR ASSOCIATE • ATHENS

T: +30 210 947 2672

hstockley@wfw.com