

The compensatory principle maintained – *The Glory Wealth*



Ewa Szteinduchert
Claims Director, Mediterranean &
Middle East
+44 20 7680 5657
ewa.szteinduchert@ctplc.com

With freight rates continuing to drop, the decision in *The Glory Wealth*¹ is a reminder as to the importance afforded to the compensatory damages principle established in *The Golden Victory*². The decisions of the English High Court in this matter have shown its common sense approach to resolving disputes regarding the quantum of damages arising out of a breach of contract, as well as the challenges it faces in ensuring that cash-strapped parties do not extend the compensatory principle beyond reasonable limits.

Background facts

Glory Wealth Shipping and Flame S.A. were parties to a contract of affreightment (COA) which provided for the carriage of six cargoes of coal, in bulk, in each of the years 2009, 2010 and 2011. Glory Wealth was the owner for the purposes of the COA but did not actually own the ships concerned, instead engaging in the business of chartering in and subchartering out. Disputes arose when Flame, the charterer, breached the COA by failing to nominate cargoes.

Glory Wealth commenced London arbitration proceedings on the basis of breach of contract by the charterer and sought damages. Glory Wealth claimed that the correct measure of loss was the difference between the COA freight rate it had been due and the (lower) market rate. This amounted to a sum in excess of \$5m.

First arbitration appeal

The arbitration tribunal found in favour of Glory Wealth, stating that Flame was in repudiatory breach of the COA and Glory Wealth was entitled to damages.

During the arbitration, Flame argued that, as a result of the market collapse and its deteriorating financial situation, Glory Wealth would not have been capable of performing the COA so as to earn the freight it was now claiming. As a result, Flame contended that

Glory Wealth should be forced to prove that it would have been able to perform the voyages had the repudiation not taken place before it was rightfully entitled to any damages.

The tribunal stated that it was not correct for the charterer, as the party in the wrong here, to require the owner, as the innocent party, to assume the burden of proving its loss after it had accepted the charterer's breach. Flame appealed to the High Court.

Glory Wealth argued that in assessing its loss as the innocent party, it had to be assumed that it would have performed its obligations if there had been no repudiatory breach and that having accepted the repudiation, it was released from any future performance of that contract. Flame submitted that this was illogical and that to be able to properly determine the actual loss suffered, the hypothetical situation had to be considered as to what would have happened 'but for' the breach.

The High Court considered that it should follow the compensatory principle as to the assessment of damages, as endorsed by the House of Lords in *The Golden Victory*³. This principle provides that damages are awarded to put the innocent party in the same position, but in no better position, than it would have been in had the contract been performed.

¹ [2016] EWHC 293

² [2007] 2 Lloyd's Rep 164; [2007] 2 AC 353

³ *The Golden Victory* [2007] 2 Lloyd's Rep 164; [2007] 2 AC 353

This meant that an assessment had to be made as to what would have happened had there been no repudiation, in order to establish the true value of rights that had been lost as a result of the breach. In other words, the innocent party has to prove its loss.

The court therefore held that the arbitration tribunal had erred and Glory Wealth was obliged to prove that, had there been no repudiation, it would have been able to perform its obligations under the COA. However, as the tribunal had found as a matter of fact that Glory Wealth would have been able to perform the COA, this requirement was fulfilled. There was no need to reconsider the assessment of \$5m in damages as claimed.

Second arbitration appeal

After losing in the High Court in 2013, Flame went back to the tribunal and Glory Wealth found itself in litigation once again. This time, the charterer argued that the freight due to Glory Wealth from Flame was being diverted to other companies and, therefore, the freights on future shipments would never have been received by Glory Wealth. The charterer further contended that this meant that the owner would never have suffered a loss as a result of the contract breach, as the funds would never have been received by it.

The tribunal's decision

Flame managed to persuade the arbitrators to find in its favour. The tribunal refused to award damages of \$5m to the owner on the basis that the freight payable under the COA would not have been paid to the owner anyway, but instead would have been directed to two other companies in a (separate) arrangement prescribed by the owner. As the owner would not have received those funds, the tribunal held that the owner had not suffered any true loss. In actual fact, Glory Wealth had become insolvent and was forced to redeliver early a number of long-

term time chartered ships, which led to substantial claims against it from other parties. In an attempt to protect its assets against Rule B attachments in New York, Glory Wealth had decided to divert these freight funds to two separate companies.

In coming to its decision, the tribunal applied the same compensatory principle as the court in the previous appeal, namely that an award of damages must place the innocent party in the same position it would have been in had the contract been performed. As the tribunal found that the two companies where the freight was being diverted were not agents of Glory Wealth, the freight could not have been held on the owner's behalf. Therefore, in this situation, although Flame's breach of the COA deprived Glory Wealth of the right to receive freight, it would not have received the freight in any event.

Glory Wealth appealed to the High Court.

The High Court

The High Court disagreed with the conclusion of the tribunal and stated that it had erred in law. The court held that the owner had a contractual right to receive freight due under the COA. The fact that the owner had decided that the freight would be subsequently paid on to other companies was only one limb to consider. The court held that there were two limbs to take into account:

1. the right of a party to receive freight into its bank account; and
2. the right to thereafter give it away.

It was immaterial that Glory Wealth had decided to give the freight away to other companies, or that this had been done in order to avoid attachments of those funds by other creditors. The repudiatory breach of the COA by Flame had deprived Glory Wealth of the right to earn freight.

The compensatory principle maintained: *The Glory Wealth* continued

The court also considered that it could not be correct that the charterer could escape having to pay damages where it openly breached a contract which caused a loss. The owner was therefore entitled to damages, this time of just over \$3m, based on the difference between the incoming freight that would have been earned under the COA and the freight that would have been payable down the charterparty line so as to perform the COA.

Summary

In holding that the owner had not suffered any loss, the tribunal had not taken into account the owner's right of ownership to the funds as well as the right to dispose of the funds due to it. There was no question that the funds were due to the owner under the COA; how the owner chose to dispose of the funds was a matter for the owner and did not, and should not, affect the conclusion that the owner had actually suffered a loss. Had the court agreed with the tribunal, this would have allowed the charterer to obtain a windfall for its own repudiatory breach of contract which would have been inequitable. In addition, the two companies to whom the freight was to be redirected

were not parties to the COA so they would not have been able to step into the shoes of the claimant in this arbitration to try to recover damages.

This decision highlights the complications that can often arise in determining the correct contractual level of damages, as well as the importance of the compensatory damages principle. No doubt the common sense approach of the courts will be called upon again in future to resolve what may be an increasing number of disputes regarding the quantum of damages recoverable after a breach of contract. This is especially significant where both parties to the contract may be struggling financially given the poor market conditions presently faced by the shipping community at large.



The Royal Courts of Justice