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The benefit of hindsight: the Supreme Court resets the course of the New Flamenco, and the law on mitigation of damages

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The much-anticipated judgment of the Supreme Court in *Globalia Business Travel SAU (formerly TravelPlan SAU) of Spain v Fulton Shipping Inc*[1] ("The New Flamenco") has been handed down, overruling the Court of Appeal and clarifying the rules on mitigation of damages.

The importance of causation

When faced with a repudiatory breach of contract, it is trite law that the innocent party must take steps to mitigate its loss. In this regard, the Supreme Court's judgment in *The New Flamenco*, handed down on 28 June and heard pursuant to section 69 of the Arbitration Act, is of great significance. It concerns the treatment of a substantial capital benefit realised by the owners of a vessel, the New Flamenco, following its sale after termination of a charterparty for repudiatory breach. The question before the Court was whether that benefit should inure to the charterers as a mitigating act reducing their liability for damages for breach of contract.

In short, the charterers committed a repudiatory breach of the charterparty by redelivering the New Flamenco in breach of the agreement. The owners accepted the charterers' breach as terminating the contract and sold the New Flamenco in October 2007 for a significantly greater sum than would otherwise have been possible had the charterparty run its full term (until November 2009). In fact, the gain was so great that the capital benefit of the sale far exceeded the two years of lost income under the repudiated charterparty. The essential question to be answered in the case was: had the owners mitigated their damages by making a propitious sale in 2007, meaning the charterers could rely upon this benefit to reduce the amount of damages they had caused to the owners?

In overruling the findings of both the (sole) arbitrator - from whose award the point of law was initially appealed - and the Court of Appeal, Lord Clarke (with agreement of the other Justices) held that:

- The capital benefit realised by selling the vessel following repudiation was *not* an act of mitigation "because it was incapable of mitigating the loss of the income stream"[2] which would have been provided under the charterparty;
- This was "not because the benefit must be of the same kind as the loss caused by the [charterer],"[3]

1 [2017] UKSC 43

2 *Ibid*, [34]

3 *Ibid*, [30]

- Rather, benefits, including shrewd realisations of capital investment, can only be brought into account in damages assessments where they "have been *caused* either by the breach or by a successful act of mitigation"[4].
- In this case, the early termination had, at best, prompted the sale of the vessel. In any event, it was not the legal cause of it.[5]

The New Flamenco

At a meeting in 2007, the owners and charterers of the New Flamenco came to an oral agreement to extend their charterparty for two years until 2 November 2009. The charterers later denied ever having made the agreement and maintained their right to redeliver the vessel in October 2007 in accordance with the terms of their previous agreement. After treating the charterers as in anticipatory repudiatory breach of the extended charterparty, the owners accepted the breach as terminating the contract. At this point, the owners chose to sell the New Flamenco for $23,765,000.

Arbitration was then commenced, and by the time of the hearing in May 2013 it had become clear that the value of the vessel in November 2009 (the intended end-date of the charterparty) was worth much less – $7,000,000 per the arbitrator's award. When making his award, the arbitrator faced two questions:

- Were the owners entitled to terminate the charterparty?
- If so, did they have to give credit to the charterers for the benefit of selling the vessel in October 2007?

Upon receiving the arbitrator's adverse finding, it was the second issue that was referred by the owners to the High Court on appeal as a point of law under section 69 of the Arbitration Act (the first issue was not challenged). This is a notable example of a case in which the parties had agreed not to oust the jurisdiction of the English courts to determine questions of law arising out of arbitral proceedings. Difficult questions of law frequently arise in arbitration; maintaining the flexibility to benefit from the jurisprudence of the English courts may well be a useful tool in avoiding potential injustice at the hands of a sole arbitrator, as the owners of the New Flamenco will now undoubtedly attest.

Justice Popplewell, sitting in the High Court, overturned the arbitrator holding that, in legal terms, the sale was not caused by the repudiation and could not therefore properly be considered as mitigation of the owner's lost income under the charterparty. Notably, His Honour commented that the owners would have been free to sell the vessel at any time, including while the charterparty was on foot, had they chosen to do so.[6]

Navigating uncertainty: the Supreme Court comes around

Justice Popplewell's first instance decision was then overturned by the Court of Appeal, thereby setting the stage for the Supreme Court.

Lord Clarke gave the unanimous judgment of the Court, confidently holding that the fall in the value of the New Flamenco was "irrelevant because the owners' interest in the capital value of the vessel had nothing to do with the interest injured by the charterers' repudiation of the charter party."[7] In other words, the owners' capital investment in the New Flamenco was not so closely connected to their income stream under the charterparty that the termination of the charterparty necessarily caused the owners to recoup their capital investment in mitigation.

4 *Ibid.* (Our emphasis)

5 *Ibid*, [33].

6 [2014] EWHC 1547 (Comm), [70].

7 [2017] UKSC 43, [29].

Thus, the court preferred Popplewell J's assessment that the act of mitigation must be actively *caused* by the wrongdoer's repudiation. The Court of Appeal's broader, more general approach of considering whether the act of mitigation "arises out of the consequences of the breach"[8] – taking its cue from Viscount Haldane LC's judgment in *British Westinghouse*[9] – appears to have been rejected, if only tacitly.

Certain matters remain unclear, however. Although Lord Clarke expressly avoided applying the "difference in kind" test whereby a successful mitigating financial benefit must be of the same type as the loss caused by the wrongdoer, it is not clear that a *sale* could ever be sufficiently causally connected to a repudiation that it could constitute successful mitigation for lost *income*.

The course ahead

One thing is clear: causation is key. It is always crucial that commercial entities turn their minds to how they might mitigate their losses when faced with the repudiation of a contract, but they may now rest a little easier should they decide to sell income-generating assets in such circumstances. Unless it can be said that the redelivery of an asset following a repudiatory breach had actually *caused* its owner to sell it (and it is difficult to envisage such a scenario), then the owner is free to dispose of his assets with no risk that his damages for loss of income will be reduced as a result.

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8 *Fulton Shipping Inc of Panama v Globalia Business Travel S.A.U. (Formerly Travelplan S.A.U.)* [2015] EWCA Civ 1299, [23].

9 See *British Westinghouse Electric and Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd* [1912] AC 673 at 689. See also the judgment of Goff J in *The Elena D'Amico* [1980] 1 Lloyds Rep 75 at pp.88-89.