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## From *British Westinghouse* to *The New Flamenco*: Misunderstanding Mitigation

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## From *British Westinghouse* to the *New Flamenco*: Misunderstanding Mitigation

Victor Goldberg

The Supreme Court has taken an appeal of *Fulton Shipping Inc of Panama v Globalia Business Travel S.A.U. (The New Flamenco)*<sup>1</sup> which is scheduled for argument in late November. The claim was for damages following the anticipatory repudiation of a time charter. Ostensibly, the case concerns whether the claimant's subsequent sale of the vessel should be viewed as having mitigated the damages. This struck me as odd, so I read both the High Court and Court of Appeals decisions to see if they could shed some light. To explain the mitigation doctrine, both decisions harkened back to the classic statement, *British Westinghouse Electric & Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd (No.2)*.<sup>2</sup> So, I went back to that, thinking that might help. It did, but not in the way I had initially expected. It turns out that, properly understood, neither *British Westinghouse* nor *Fulton Shipping* involves mitigation at all.

That was a bit of a surprise. *British Westinghouse* was, after all, an oft-cited century-old precedent that appeared to be beyond controversy.<sup>3</sup> However, Andrew Dyson, in a nice piece of legal archeology, has provided new information that undermines the mitigation claim.<sup>4</sup> To be sure, Professor Dyson and I disagree on how to interpret this, as he still couches his analysis in mitigation language.

Mitigation is an element of contract damages, but its role should not be exaggerated. Take one example. If the seller were to breach a contract to purchase a fungible commodity in a competitive market, the damages would be the contract/market differential. This could be put in mitigation language—the buyer mitigated by buying from someone else; even if it hadn't, the buyer could have bought from someone else but chose not to, so we will treat him as if he had. Dyson (and his coauthor) put it this way: "Mitigation is often said to comprise three rules, but it is better expressed using just one: damages are assessed as if the claimant acted reasonably, [even] if in fact it did not act reasonably."<sup>5</sup>

An alternative way of framing the matter is to view the buyer's purchase from another seller as *evidence* of the market price. If it purchased an identical item on the same date, it would be extremely good evidence; the more imperfect the substitute and

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<sup>1</sup> [2014] EWHC 1547 (Comm).

<sup>2</sup> [1912] A.C. 673.

<sup>3</sup> Andrew Burrows, *Remedies for Torts and Breach of Contract* (3<sup>rd</sup> edn OUP, 2004) 122-3, 158; Harvey McGregor, *McGregor on Damages* (18<sup>th</sup> edn Sweet & Maxwell, 2009) [7.014]; Edwin Peel, *Treitel on the Law of Contract* (13<sup>th</sup> edn Sweet & Maxwell, 2011) [20.003]; H Beale, *Chitty on Contracts* (31<sup>st</sup> edn Sweet & Maxwell, London 2012) [26.014-26.086].

<sup>4</sup> Andrew Dyson, 'British Westinghouse revisited' [2012] LMCLQ 412.

<sup>5</sup> Andrew Dyson and Adam Kramer, 'There is no "breach date rule": mitigation, difference in value and date of assessment, assessment' (2014) 130 LQR 259, 263.

the longer the period of time between the breach date and the cover date, the poorer the evidence. But what if the buyer chose not to cover? Would this require an inquiry into the reasonableness of the refusal? Should the purchase be imputed? Would it make any difference if the buyer chose not to cover because (a) it was speculating that it might get a better price in the future, (b) it no longer wanted the commodity and was grateful that it had been spared, or (c) given the new higher price, it no longer found the purchase attractive? Should any of these preclude recovery? The mitigation language gets in the way. The problem arises in the case law when the courts ask if there is an “available market.”<sup>6</sup> It was, as we will see, a significant cause of the confusion in *The New Flamenco*.

In cases involving direct damages—the change in the value of the contract when one party breaches—the mitigation language is, at best, unhelpful. Consider an example at the opposite extreme of the fungible commodity sale of the previous two paragraphs: repudiation by a buyer in the third year of a twenty-year take-or-pay contract; is anything to be gained by asking what would constitute mitigation? Is the question even coherent?<sup>7</sup> *The New Flamenco* is a direct damages case and, as I will show in Section II, the attempt to stuff it into the mitigation box led the Court of Appeal astray. The claim in *British Westinghouse*, however, was not for direct damages, but rather for consequential damages. There, the notion that the extent of the damages can be controlled by the pre- or post-breach behavior of the claimant carries more weight. Nonetheless, given the facts, mitigation was almost completely irrelevant in *British Westinghouse*. I use the “almost” qualifier to isolate a possible mitigation story quite different from the one presented in the actual case.

### I. *British Westinghouse*

British Westinghouse (hereafter BW) provided eight steam turbines and alternators for the Chelsea power station for what are now the Circle and District lines. The total cost was £250,000 to be paid in installments. Although the turbines fell short of the promised specifications, Underground (hereafter UER) accepted them, reserving the right to sue for damages. Excess annual coal purchases to power the turbines were around £10,000. After Westinghouse failed to bring the machines up to specifications, UER replaced the turbines by those made by a competitor, Parsons. The new machines were installed roughly five years after the BW machines had begun performance. The cost of the Parsons machines was £78,186.<sup>8</sup> UER’s Chief Engineer estimated an annual saving of around £20,000 per year as a result of the reduced consumption of coal.<sup>9</sup>

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<sup>6</sup> See *R Pagnan & Fratelli v Corbisa Industrial Agropacuaria Ltd* [1970] 2 Lloyd’s Rep 14; *Koch Marine Inc v d’Amica Societa di Navigazione arl (The Elena d’Amico)* [1980] 1 Lloyd’s Rep 75; *Glory Wealth Shipping Pte Ltd v North China Shipping Ltd* [2010] EWHC 1692 (Comm); *Glory Wealth Shipping Pte Ltd v Korea Line Corp* [2011] EWHC 1819 (Comm).

<sup>7</sup> For analysis of how to ascertain damages for the repudiation of long-term contracts, see Victor Goldberg, *Reckoning Contract Damages: Valuation of the Contract as an Asset*, Part III.

<sup>8</sup> *British Westinghouse* [1912] AC 673, 675

<sup>9</sup> Dyson, (n 4) 416.

After the turbines had been replaced UER ceased payment and BW sued for the unpaid balance, £85,398. UER counterclaimed for over £40,000 for the additional costs (mainly for extra coal) it had already incurred. In addition, it argued that it would have suffered £237,728 of additional costs for the remaining life of the turbines. Alternatively, it argued that it had mitigated the damages by installing the Parsons turbines and so should be credited with the £78,226 it had spent to mitigate the damages (the £237,728) that would have occurred had it not replaced the turbines.

The arbitrator found that UER would have replaced the BW turbines with the Parsons machines even if the BW machines had been as specified:

I further find that the purchase of the Parsons machines was to the pecuniary advantage of the respondents, and that the superiority of the Parsons machines in efficiency and economy over those supplied by the claimants is so great that even if the claimants had delivered to the respondents machines in all respects complying with the conditions of the contract it would have been to the pecuniary advantage of the respondents at their own cost to have replaced the machines supplied by the claimants by Parsons machines.<sup>10</sup>

By purchasing the Parsons machines, the arbitrator held, the future damages from running the BW turbines for the remaining life of the turbines were avoided. The claim it would have had against BW was thereby mitigated. Who should bear responsibility for the £78,226? BW, said the arbitrator. He held that had UER not installed the Parsons machines, BW would have suffered much greater damages—the £237,728 of future coal costs. By installing the Parsons machines it had mitigated the damages to which it would have otherwise been entitled. The High Court and Court of Appeals concurred; however, the House of Lords reversed.

BW argued that “the arbitrator was entitled to draw the inference that the ‘commercial life’ of the claimant’s machines had expired at the date of the purchase by the respondents of the Parsons machines.”<sup>11</sup> “The life of the Westinghouse machines was from that time as much at an end as if they had been worn out in ordinary work. They were thenceforward valueless, and a prudent board would have at once consigned them to the scrap heap.”<sup>12</sup> UER argued that was irrelevant, because “the measure of the damages was fixed at the date of the breach; and at that date it could not be foreseen what would happen in the way of invention of a superior quality of machine.”<sup>13</sup>

UER continued: “No inference can be drawn that after the Parsons machines were invented the respondents would have bought them if the Westinghouse machines

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<sup>10</sup> *British Westinghouse Electric & Manufacturing Co Ltd v Underground Electric Railway Co of London Ltd* (No. 1) [1911] 1 KB 575, 584.

<sup>11</sup> *Ibid* 579.

<sup>12</sup> *Ibid* 580.

<sup>13</sup> *Ibid* 582.

supplied had been up to contract. Such contingencies are too remote to be entitled to consideration.”<sup>14</sup> At the Court of Appeal Lord Alverstone rejected BW’s argument:

You must first ascertain what would be the ordinary life of a properly constructed Westinghouse machine, that is to say the number of years during which a reasonable person would work it before finally consigning it to the scrap heap as worn out. And the measure of damages would be the loss which the purchaser would sustain from having to work a defective Westinghouse machine during all that period instead of one which was constructed in accordance with the contract. That it seems to me would prima facie be the measure of the damages, and the sum of money which would represent that loss we are told would be a very large sum indeed.

\* \* \*

It is clear that the railway company are entitled to recover the cost of the substituted machines on the ground that by their action they saved the claimants from a very much larger claim for damages than is in fact being made against them. . . . If the putting in the Parsons machines had increased the damages the cost ought not to be recovered. It is because the substitution was in relief of the claimants, and for that reason alone, that the cost is recoverable.<sup>15</sup>

In the House of Lords, the only opinion was given by Lord Chancellor Viscount Haldane. He reversed the decision, holding that UER should bear the costs of the Parsons machines. In the normal course of business, UER acted in such a way as to mitigate the damages.

The transaction was . . . but one in which the person whose contract was broken took a reasonable and prudent course quite naturally arising out of the circumstances in which he was placed by the breach. Apart from the breach of contract, the lapse of time had rendered the appellants’ machines obsolete, and men of business would be doing the only thing they could properly do in replacing them with new and up-to-date machines.<sup>16</sup>

He did not say what the result would have been had UER failed to install the Parsons turbines. Would it have been able to claim damages of over £200,000? Doubtful. The

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<sup>14</sup> Ibid.

<sup>15</sup> Ibid 583-4. In High Court. Hamilton J. rejected the contention that “the moment it is ascertained as a matter of business prudence that the inferior machines must be superseded, the cost of the substitution of other machines which is consequent on the breach of contract cannot be legally attributed to the breach, but must be attributed entirely to the progress of science.” (587) He further asserted that the court was bound by the arbitrator’s finding: “The finding that the purchase of the Parsons machines was a mitigation of the damages necessarily involved a finding as to the length of the normal life of a Westinghouse machine. That finding is a conclusion of fact, and even if the arbitrator in arriving at it made a mistake in his calculations, that is a matter with which we cannot interfere. The fact that the Parsons machine turns out to be so greatly superior to that for which it has been substituted that it would have been worth the respondents’ while in any event to effect that substitution is in my opinion a matter which is wholly irrelevant to the present inquiry.” 586-7

<sup>16</sup> *British Westinghouse* [1912] AC 673, 691.

court likely would have found that UER should have acted reasonably and damages would have been determined on that basis.<sup>17</sup>

Without explicitly saying so, Viscount Haldane adopted BW's position that the commercial value of the BW turbines, even if they had met the specifications, was zero when they were replaced by the Parsons turbines. None of the opinions indicated why this might be so. Andrew Dyson explained:

[O]ne must appreciate the rate at which steam turbine efficiency was advancing in the early 1900s. The pace of development may be likened to that of computer processors in the modern day. To think that London Underground could reasonably have continued working the defective Westinghouse turbines for twenty years, when the usual turnover of turbines due to obsolescence was in the region of five years, does not accord with common sense. Indeed, in 1913, just one year after the House of Lords' handed down its decision in *British Westinghouse*, London Underground decided to replace its turbines again, despite that the Parsons machines had met or even slightly improved upon their guaranteed efficiency.<sup>18</sup>

The physical life of the turbines (supposedly 20 years) was irrelevant. What mattered was the expected commercial life of about five years.<sup>19</sup>

The record on the timing of replacement is mixed. Dyson claims that "the defective state of the Westinghouse machines provided the initial trigger to replace them," relying both on the way UER pled its case and records of meetings of the board of directors.<sup>20</sup> On the other hand, Viscount Haldane characterized the arbitrator's opinion thusly: "it would yet have been to the pecuniary advantage of the respondents [UER] at their own cost to have replaced the machines supplied by the appellants by Parsons machines *so soon as the latter were to be obtained.*"<sup>21</sup>

Given the rapid pace of technological change, UER would have to decide when to replace the BW turbines. Suppose that if the BW turbines had met the specifications, they would have been replaced in five years. What would be the efficient replacement decision if the BW turbines fell short as in fact happened? If new turbines were installed a year earlier there would be some gains from incorporating the new technology earlier. These would be partially offset if the turbines installed in year four were not as good as the turbines that would have been installed in year five. The net effect would almost certainly be to replace earlier or, at worst, at the same time.<sup>22</sup>

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<sup>17</sup> Dyson (n 4) 421 makes this argument.

<sup>18</sup> Ibid 422-3..

<sup>19</sup> Many of us have old laptops and iPhones in closets, attics, and garages; they're physically fine, but they have been replaced by newer, better models.

<sup>20</sup> Dyson (n 4) 424.

<sup>21</sup> *British Westinghouse* [1912] AC 673, 684. (emphasis in original)

<sup>22</sup> If technical improvements were continuous the replacement date would be moved up; if it were "lumpy," it is more likely that there would be no change.

How would the damage rule impact the replacement decision? If UER would be fully compensated for the additional costs actually incurred, in each period it would be receiving the same benefit as it would have, had there been no breach. Consequently, its replacement decision would be the same as it would have been had BW not breached. It would purchase and install the Parsons machines at the same time it would have had there been no breach. Ironically, compensation for the additional costs would result in delayed installation. The breach did not cause a purchase of the Parsons turbines. The efficient response to the breach might have resulted in earlier installation than if there had been no breach, but the anticipated compensation for the additional costs would have reduced or eliminated the motive to accelerate the replacement.

If the arbitrator's findings are to be believed, the replacement was not premature—the Parsons turbines were installed when they would have been had the BW turbines functioned properly, at the end of the BW machines' expected commercial life. What if, for some reason, UER had jumped the gun and installed the Parsons machines earlier than it otherwise would have? That would have had the effect of both reducing the damages measured by the additional costs and moving the replacement date toward a more efficient outcome. The cost of accelerating the replacement date would have had two elements. One would be the time value of money—UER would incur the replacement costs earlier. The other would arise if the earlier replacement meant that the turbines would not be quite as good as ones available on the market at the later replacement date. It is plausible, though not inevitable, that this second component would be zero—there would not be enough time passed to alter the quality of the available machines.

If the benefits of accelerated replacement exceeded the costs, the acceleration would mitigate the damages. The mitigation would not be the cost of the Parsons machines, the £78,226, but the much smaller costs of acceleration. Ascertaining the interest cost would not be difficult; determining whether the quality had been affected, and by how much, would be much more problematic. If somehow it could be done and UER's compensation took it into account, UER would have had the proper incentive to replace the faulty machines in a timely fashion. Determining *ex post* what the optimal time for replacement should have been and whether UER's decision had been reasonable would be extraordinarily difficult. However, it shouldn't be necessary. Better to rely on BW's *ex ante* incentives. If BW perceived that it could not resolve the problems with its turbines, it could have offered to pay UER to adopt the new technology earlier, if that were the efficient resolution.<sup>23</sup> BW would, of course, still be liable for the excess costs that had been incurred.

The framing of the replacement decision by the arbitrator and the courts led to confusion over the "betterment" issue, as exemplified by Buckley L.J.'s dissenting opinion in the Court of Appeals. The new machines were obviously better, but he wanted to know if machines of equal quality were available. "If the arbitrator had found that they had no alternative to purchase such more powerful, more efficient, and more long-lived

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<sup>23</sup> This is just another manifestation of the Coase Theorem.

machines in order to mitigate the damages, the case would have been more easy. But I cannot find that he has found to that effect.”<sup>24</sup> He argued that the arbitrator should have asked “whether it was the only reasonable and prudent course which they could take to mitigate the damages, or whether, for instance, they could have bought Parsons machines of 5500 kilowatts and of efficiency and length of life no greater than that of the discarded machines.”<sup>25</sup> For him, mitigation ideally would entail replacement with machines that were only just as good as the properly functioning originals. Had he (and the others) not framed the matter in terms of mitigation, he would have recognized that it would make no sense to replace the machines with obsolete machines with a value of zero (or less) and that the expected commercial life of the original machines was only in the five-year range.

Had UER leased the BW turbines for five years, there would have been no issue of mitigation. At the end of the five years, the lease would have been up and the machines would be replaced by new ones. Damages would have been the additional costs incurred because the machines failed to meet the contract specifications and the replacement of the leased machines would have been irrelevant. In the actual case, UER bought machines with an expected life of about five years and when their effective commercial life had expired those machines were replaced. The damages, again, were the additional costs incurred. In either case, UER was going to replace the machines after about five years. In neither case does it make sense to refer to the anticipated replacement as mitigation.

## **II. *The New Flamenco***

The facts are straightforward. The charterer and owner of the *New Flamenco*, a small cruise ship, were negotiating an extension of the charter period and reached an oral agreement for a two-year extension. The charterer refused to sign and maintained that it could redeliver on the preexisting termination date. The owner disagreed, arguing that an agreement existed and the charterer had anticipatorily repudiated that agreement. On the liability question the arbitrator found in favor of the owner. The problem arose in assessing damages. The owner claimed that it would have earned €7,558,375 had the charter been performed for the two years. Shortly after the repudiation the *New Flamenco* was sold for \$23,765,000. Less than a year later Lehman Brothers imploded and the market for ships collapsed. The arbitrator found that by November 2009 (the end date for the contract extension) the ship’s market value had fallen to \$7,000,000. The question confronting the arbitrator, and the subsequent justices, was: How, if at all, should the fall in value of the ship be taken into account in determining damages? The damages would be the change in the value of the charter at the time of the repudiation. The market value of the *New Flamenco* when it was sold in 2007 could provide some information regarding that value; its value in 2009 could provide none.

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<sup>24</sup> *British Westinghouse Electric & Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd* [1912] 3 KB 128, 148.

<sup>25</sup> *Ibid.*



The charterer argued in effect that by breaching it did the owner a favor; by causing him to sell before the Crash, the owner saved over \$16 million. The arbitrator agreed. Because that saving was so much greater than the foregone earnings, he awarded nothing to the owner. In the High Court Popplewell rejected the arbitrator's conclusion;<sup>26</sup> he in turn was reversed by the Court of Appeal.<sup>27</sup> The case is now on appeal to the Supreme Court.

I note at the outset that the record is inconsistent regarding whether the owner could have sold the ship had the charter remained in force. The arbitrator, according to Popplewell, seems to have held that had the charter remained in force, the first day the owner could have sold the ship was November 2009.<sup>28</sup> Popplewell asserted that the ship could have been sold during the charter period: "Whilst the charter was on foot, the Owners might have sold the Vessel subject to charter, provided that they did so on terms which required the new owner to perform the charterparty so that they were not putting it out of their power to perform."<sup>29</sup> Longmore in the Court of Appeal concluded that the owner could have sold the ship, even if the charterer had not breached: "There was some difference between counsel on the question whether the Owners could in fact have sold the vessel for their own account during the currency of the charterparty. . . . The answer is that the Owners could in theory sell the vessel, always subject to the existing charterparty, but without the charterers' consent could not cease to provide the chartered services."<sup>30</sup>

The arbitrator concluded that it would not have been possible for the owner to find an alternative two-year charter and that the sale of the ship was caused by the breach. Therefore, "where the Owners acted in reasonable mitigation of damages caused by a breach of a time charterparty by selling the vessel, there was no reason why capital savings could not and should not be brought into account in considering the net loss suffered by the Owners."<sup>31</sup> There are five pieces to this argument: (a) mitigation, and in particular, *British Westinghouse*, is the proper framework for analysis; (b) an alternative two-year charter was not available; (c) selling the vessel was reasonable mitigation; (d) the breach caused the sale; and (e) the sale saved the Owner from incurring a capital loss.

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<sup>26</sup> *Fulton Shipping Inc of Panama v Globalia Business Travel SAU (formerly Travelplan S.A.U) of Spain* [2014] EWHC 1547 (Comm).

<sup>27</sup> *Fulton Shipping Inc of Panama v Globalia Business Travel SAU (formerly Travelplan SAU) of Spain* [2015] EWCA Civ 1299.

<sup>28</sup> *Fulton Shipping* [2014] EWHC 1547 (Comm) [10]. "the question whether such a sale would have been achievable during the currency of the charter was not apparently explored in the reference and the tribunal did not make any findings about it. It is at least arguable that it is implicit in the arbitrator's conclusion on the point in issue that he thought that the Vessel could not have been sold prior to November 2009 had the charter remained on foot." (¶ 70)

<sup>29</sup> *Ibid* 70. He continued: "They might, for example have entered into a back to back charter with the new owner so as to become disponent owners vis a vis the Charterers, or have arranged a novation to which the Charterers and the new owner were party. Alternatively they might have sold the Vessel on terms that she be delivered to the new owner following expiry of the charter period. Sale of the Vessel was a transaction which could, in principle, have occurred irrespective of the breach."

<sup>30</sup> *Fulton Shipping* [2015] EWCA Civ 1299 [35]. He then added: "To my mind that was somewhat of a side issue since the central questions must always be whether the actual sale was caused by the breach and was by way of mitigation." [35]

<sup>31</sup> *Ibid* [12], citing [73] of arbitrator's judgment.

Both the High Court and Court of Appeal accepted the first three propositions, but they disagreed on the others.

Regarding the availability of a substitute, both decisions took as a starting point *The Elena D'Amico*<sup>32</sup> which held that where there is an “available market” the damage measure would be the difference between the market rate and the charter rate. If there were an available market and the owner chose not to recharter, liability would still be based on the market rate. A failure to do so would not constitute a failure to mitigate since the losses would be the result of an independent decision not to recharter. The Court of Appeal accepted this: “An important question in this area of the law is whether there is an available market. . . . A decision to speculate on the market rather than buying in (or selling) at the date of the breach did not ‘arise’ from the contract but from the innocent party’s decision not to avail himself of the available market.”<sup>33</sup>

So far, so good. But what if, as the arbitrator concluded, there were not an “available market”? This is where the mitigation language gets in the way. All the parties accepted the “compensatory principle”—the purpose of the remedy is to compensate the owner. The question should be not how did the owner mitigate, but what did the owner lose. The owner’s loss was the change in the value of the contract at the time of the breach.<sup>34</sup> If an identical charter were available, that is, if there were an available market, that would provide the answer. If that substitute charter were not available, then ascertaining the change in the value of the asset (the charter) becomes more difficult. All the parties agreed that, given the state of the market, the owner’s response to the breach, selling the ship, was reasonable, and that the price it received was also reasonable.<sup>35</sup> They disagreed on what to make of this.

Popplewell argued that the sale mitigated the damages—the extra costs that it would have incurred from operating the ship. “The sale of the Vessel mitigated this loss because it reduced the continuing costs of operating or laying up the Vessel. To the extent that the benefits flowing from the sale comprised such cost savings, there is no difficulty in treating the causal nexus between breach and benefit as established through the mitigating step of selling the Vessel.”<sup>36</sup> The subsequent decline in the value of the ship, he held, was irrelevant. It was caused by the financial crisis, not by the breach. The decision to realize the capital value of the asset in 2007 was independent of the breach.<sup>37</sup> Longmore, for the Court of Appeals, on the other hand, argued that if the owner did trade the vessel

he may make additional losses or additional profits, but, in either event, they should be taken into account. He is not speculating on the market as he would be if there was an available market of which he chooses not to

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<sup>32</sup> *Koch Marine Inc v d'Amica Societa di Navigazione arl (The Elena d'Amico)* [1980] 1 Lloyd’s Rep 75.

<sup>33</sup> *Fulton Shipping* [2015] EWCA Civ 1299 [24].

<sup>34</sup> See Goldberg, *Reckoning Contract Damages: Valuation Of The Contract As An Asset*.

<sup>35</sup> *Fulton Shipping* [2015] EWCA Civ 1299 [11].

<sup>36</sup> *Fulton Shipping* [2014] EWHC 1547 (Comm) [68].

<sup>37</sup> *Ibid* [67-71].

avail himself; he is just bringing into account the consequences of his decision to mitigate his loss and those consequences will “arise”, generally speaking, from the consequences of the breach of contract.<sup>38</sup>

So, if the owner “speculated” when there was an available market (a perfect, or near perfect substitute charter), by not immediately accepting the new deal, that speculation risk was on him. Damages would be calculated as if he had taken the deal. But if only an imperfect substitute—in this case, sale of the vessel—were available, the owner would not be speculating. Implicitly, it would be the charterer who would be speculating, bearing the risk of subsequent capital gains or losses. The charterer’s counsel did, in fact, concede that if the value of the vessel had gone up, the damages would have been greater: “Mr Croall accepted that, if the sale market had risen substantially during that time, the Charterers would be liable for the Owners’ inability to take advantage of that rise in the market, if the sale had arisen from the consequences of the breach of contract and been undertaken by way of mitigating the loss caused by that breach.”<sup>39</sup> This was, of course, a costless concession.

Longmore concluded that the results for the available market did not hold if no such market were available:

[T]he prima facie measure of loss in hire contracts is the difference between the contractual hire and the cost of earning that hire (crew wages, cost of fuel etc). But it will not usually be reasonable for the shipowner to claim that prima facie measure if he is able to mitigate that loss by trading his vessel if opportunities to trade that vessel arise. If he does so trade the vessel, he may make additional losses or additional profits but, in either event, they should be taken into account.<sup>40</sup>

What did the owner lose when the charterer breached? Popplewell had it about right when he noted that the loss was the difference between the value of the vessel with and without the charter:

The Owners’ contractual rights under the charterparty were rights to an income stream, to which were attached the obligation to provide the Charterers with the use of the Vessel. So far as concerns the capital value of the Vessel, the only potentially beneficial change in the Owners’ position caused by loss of those contractual rights and concomitant obligations might be a difference in value between a vessel which is charter free and one which is subject to the unexpired period of the charter.<sup>41</sup>

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<sup>38</sup> *Fulton Shipping* [2015] EWCA Civ 1299 [25].

<sup>39</sup> *Ibid* [30].

<sup>40</sup> *Ibid* [25].

<sup>41</sup> *Fulton Shipping* [2014] EWHC 1547 (Comm) [72]. I say “about right” because he followed this up with “the relevant benefit . . . would be the difference in value between the Vessel being sold in October 2007 for immediate delivery, and the Vessel being sold in October 2007 for delivery at the expiry of the charter in November 2009.” As I show in the text, the 2009 date would be irrelevant.

The value of the vessel charter-free on the day of the breach was known—the sale price of \$23,750,000. Expert testimony might provide a plausible estimate of the value on that date with the charter in place. Why might the vessel have been worth more with the charter in place? There were potentially three sources of additional value. First, the charter price might have been favorable. Since it appears that no time elapsed between the formation of the contract and its repudiation, it is unlikely that this would matter. Nothing in the opinions suggested that there had been a deterioration in the charter market at that time. Second, without the charter the owner would have been responsible for operating costs. Recall that Popplewell treated the sale of the vessel as mitigation of those costs. Since the buyer would have to take those costs into account, the sale price should have reflected this. Third, without the charter there would be a period during which the vessel would have been idle and the owner would receive no revenue. The longer that period was expected to last, the greater the discount that the buyer would have required.

Conceptually, the purchase price could be broken down into two pieces—the first two years (the charter period) and the rest of the vessel’s expected life.<sup>42</sup> If the buyer expected to immediately replace the charter at the current market rate (perhaps because the new owner planned on using the vessel immediately itself) then the price would reflect that. That piece would have been valuable to the buyer and that value would have been captured in the sale price. The value of the vessel would have been about the same with and without the charter and damages would have been close to zero. At the other extreme, if the new owner had anticipated that the ship would remain idle for the full two years, it would have paid nothing for the first piece. If the arbitrator’s measure were correct, that would imply that the vessel with the charter in place would have been worth over \$30 million. The relevant question then becomes what would be the expected period of time the vessel would remain idle. Expectations regarding the idle period would be reflected in the discounted sale price. The actual sale price would be relevant if one could estimate the pre-breach market value of the vessel. The difference would be, as Popplewell noted, the measure of the owner’s damages.

To label the sale as mitigation misses the point. The sale did not affect the damages; it only made it easier to conceptualize them. The loss was the charter rate less the operating costs per day for the period that the vessel was expected to remain idle. The sale meant that the task of finding a new user was shifted to the new owner and the sale price reflected the expectations regarding how long the vessel would remain idle. The arbitrator found that had the vessel remained idle for the entire two years, the damages would have been €7,558,375.<sup>43</sup> Multiplying that number by the fraction of time that the vessel was expected to remain idle would provide a good approximation of the owner’s damages. What happened to the vessel after the owner sold the vessel—whether the shipping market changed, the ship sank, or it was resold—would be irrelevant.

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<sup>42</sup> The arbitrator expressly found that the useful life of a cruise vessel may vary between 40 and 50 years and that the vessel was 35 years old in 2007. *Fulton Shipping Inc of Panama v Globalia Business Travel SAU (formerly Travelplan SAU) of Spain* Application for Leave to Appeal Case No.: A3 / 2014 / 1863, 100.

<sup>43</sup> *Fulton Shipping* [2015] EWCA Civ 1299 [8].

The existence of an “available market” had nothing to do with determining damages. That would have provided the market price for determining the contract market differential. But, since there was no reason to believe that the market price had changed, damages on that score would have been zero. The owner’s loss depended not on the price change but on the expected cost of the ship remaining idle for some period of time. The “available market” concept would have been unhelpful in determining that.

### **III. Concluding Remarks**

Neither the purchase of the Parsons turbines nor the sale of the *New Flamenco* could sensibly be characterized as mitigating the damages suffered by the claimants. The former was simply the routine replacement of machines that would have been obsolescent had the contractual specifications been met; even if the claimant had accelerated the replacement, the mitigation offset would have been only a small fraction of the purchase price (and it would almost certainly have been a mistake to compensate for that). Once the nature of technical change in the turbine business and the distinction between the physical life and the economic life of the machines is recognized, the irrelevance of mitigation becomes clear.

At least in the context of *British Westinghouse* framing the case as involving mitigation did not do any direct harm—Viscount Haldane came to the right result. That has not been the case with *The New Flamenco*. The misapplication of the mitigation doctrine and the “available market” concept led the arbitrator and the Court of Appeal astray. The breach meant that the vessel would remain idle for at least some portion of the two years remaining on the charter. The damages would be for the expected period of idleness and that would be reflected in the *post-repudiation* change in value of the *New Flamenco*. The *post-recession* change in value, which the arbitrator and Court of Appeal focused on, had nothing to do with the loss the owner suffered at the time of the repudiation.