

CONTRACT LAW REVIEW

**SOME AREAS TO WATCH AND AN
INTERESTING CASE ON DAMAGES**

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Contract Law Review

Some areas to watch and an important decision on damages

1. There have not been many contract cases of general significance in the New Zealand courts in the last year but the good thing about contract law is that developments and decisions in other Commonwealth countries are relevant to the development of our law. This paper outlines some recent New Zealand decisions and areas and appeals to watch, then highlights a recent decision in the English Courts in a shipping dispute which is of general relevance in the assessment of damages for the breach of a long term contract.¹ An appeal to the House of Lords has just been heard in the case and the outcome of that appeal will be of general importance.

New Zealand cases

2. Last year I reviewed a number of cases which generally highlighted the objective approach which underpins many of the principles of the law of contract.² In two of the areas covered - the interpretation of contracts and the implication of a requirement to give a reasonable period of notice to terminate a long term contract containing no provision for termination – decisions are awaited from the Supreme Court which are likely to be of general importance.

Implied periods of notice

3. *Paper Reclaim Ltd v Aoteroa International Ltd*³ concerned a dispute between commercial parties which had operated in a commercial relationship for many years exporting waste paper. Aoteroa International claimed that Paper Reclaim had broken the agreement between them in various ways. The High Court found, rejecting PR's case that there was no long term commercial contract, that there was a long term joint venture agreement in the nature of an exclusive agency. It found

¹ *Golden Strait Corporation v Nippon Yusen Kubishka Kaisha (The Golden Victory)*
[2005] 2 Lloyds Rep 747

² For the outline of the matters covered in 2006 www.pauldavid.co.nz

³ [2006] 3 NZLR 188

that PR had wrongly repudiated the agreement and that AI had, ultimately, elected to accept the repudiation and cancel the contract. The question of the period of notice required to terminate the agreement was (possibly) relevant to the assessment of damages on the cancellation of the agreement.⁴ On one side, AI claimed that the agreement was not capable of termination and was of indefinite duration, while PR said that, if there was an agreement between it and AI, it could be determined at will or at most on 6 weeks' notice. The High Court held that a reasonable period of notice should be implied into the contract and that a reasonable period of notice was 8 years. The judge reached this decision on the basis that this was the period of time which would be required to allow AI to build up to be the business operation it had been under the cancelled agreement. The Court of Appeal held that the High Court had approached the question of the period of notice in the wrong way. The test was not the period of notice which was required to re-establish the business which was being terminated but rather the period of notice which was reasonably required to wind down the existing business and start on new business in a general sense. The Court of Appeal held that a reasonable period of notice was 1 year. The Court also saw 1 year as generally consistent with the notice periods fixed by the Courts in comparable circumstances. The Court applied the established approach that the period of notice fell to be determined by reference to the intention of reasonable commercial persons in the position of the parties to the contract at the time of the giving of the notice.⁵ Leave to appeal to the Supreme Court has been granted and the Supreme Court is likely to consider (among other things) the proper approach to the implication of a reasonable notice period.

The interpretation of contracts

4. Last year, I said that the debate over the approach to the interpretation of contracts seemed to have settled down somewhat and that the New Zealand courts were following the established approach to ascertaining the intention of the parties to the contract as exemplified by the judgments in the Court of Appeal in *Potter v Potter*⁶.

⁴ The question whether the period of notice to be implied was, in fact, relevant to the assessment of damages where the agreement was cancelled for repudiatory breach was not argued at this stage of the case.

⁵ See e.g. *Australian Blue Metal Ltd v Hughes* [1963] AC 74; *Anchor Butler Co Ltd v Tui Foods Ltd* [1997] 3 NZLR 107.

⁶ [2003] 3 NZLR 145; [2005] 2 NZLR 1(PC); [2004] UKPC 41.

In *Wholesale Distributors v Gibbons Holdings Limited*,⁷ where the Court of Appeal reversed the High Court (with Chambers J dissenting) on the construction of a covenant given by an assignee to a lessor, the Supreme Court granted leave and heard the appeal over a year ago. In the Court of Appeal the majority reached its construction of the covenant by applying an approach which focused heavily on what they saw as the purpose of the arrangements. It would seem that the Supreme Court is likely to make some observations in relation to the principles governing the interpretation of contracts on this appeal, and, in particular, in relation to the relevance (if any) to questions of construction of the parties' conduct after the contract has been entered into.⁸

5. Lord Nicholls, a Law Lord, has “stirred the pot a little” in the area of contractual interpretation in a lecture, which was subsequently published in the Law Quarterly Review under the title *My Kingdom for a Horse: The Meaning of Words*.⁹ In the lecture he expresses the view that pre-contract negotiations expressing the intention of the contracting parties should be admitted, where they assist in arriving at the meaning of the agreement between the parties, and, that conduct, subsequent to the contract, should also be admitted to assist in construing a contract. This all suggests that we do not appear to have seen the last of developments in this area. It seems inevitable that the very difficulty of the task of ascertaining meaning in any context means that the Courts will continue to consider how best to approach the question of interpreting the intentions of parties to an agreement.

6. I should also briefly mention the decision of the Court of Appeal in *Gulf Corporation Ltd v Gulf Harbour Investments Ltd*¹⁰ in which the Court of Appeal held, by a majority, that a letter which purported to accept an offer contained in an option, was not an acceptance of the offer because it did not comply with the terms of the offer. All the judges applied the principle in *Reporoa Stores Ltd v Treloar*¹¹ that there had to be strict compliance with the terms of the offer in the option for there to be a binding contract. McGrath J dissented on the outcome of the

⁷ For the Court of Appeal decision see, [2006] 2 NZLR 27

⁸ The position under English Law has been that subsequent conduct is irrelevant see, e.g. *Houlder Bros v Public Works Commissioner* [1908] 1 A.C page 276 at 285

⁹ (2005) LQR Vol 2 p577

¹⁰ [2006] 1 NZLR 21

¹¹ [1958] NZLR 177 (CA)

application of the test and found that, construed in the commercial context, the letter did amount to an unequivocal acceptance of the offer. Leave was granted to appeal to the Supreme Court but the appeal was subsequently abandoned.

***The Golden Victory* – A problem in assessing damages**

7. Damages issues lie at the centre of many contractual disputes in the commercial arena. This is to be expected in an area of the law which is concerned with the economic consequences of breaches of promises and where the aim of an award of damages is to give the innocent party the value of its contractual rights and put it back in the position it would have been in if the contract had not been broken.¹² An early assessment of the damages which can be recovered under the test for remoteness and the quantification of the recoverable damages is crucial to the prompt assessment and resolution of many disputes. Unfortunately, the applicable principles are often easier to state than to apply and difficult issues of fact and law can arise in establishing the types of loss which are recoverable and the quantification of those recoverable losses.

8. In *Golden Strait Corp v Nippon Yusen Kaisha (The Golden Victory)*¹³ the English Courts had to consider a simple factual situation which produced a novel point in relation to the assessment of damages. The decision illustrates the element of uncertainty in the application of the basic common law principles to the quantification of a head of recoverable loss. The case concerned the assessment of damages where one party to a long term contract repudiates the contract and the innocent party elects to cancel the contract and claim damages. The question before the English courts was: how does the court assess the damages which are to be paid to the innocent party where an event takes place after breach which would have made the contract rights valueless or reduced their value? Can the party in breach rely on such a contingency to reduce the damages payable, and if so, what kind of event is required?

¹² *Robinson v Harman* (1848) 1 Ex 850 at 855.

¹³ [2005] 2 Lloyd's Rep 747.

9. The *Golden Victory* was on a long term time charter for 7 years. The charter was executed in 1998 and the ship was delivered into service in 1999. The Charterers repudiated the charter by purporting to redeliver the ship early to the Owners and the repudiation was accepted by the Owners in December 2001. The Second Gulf War broke out in March 2003. Under the charter the earliest date for redelivery was December 2005. The arbitrator found that under the provisions of the charter the outbreak of the Gulf War would have entitled the Charterers to cancel, if the charter had been still running.
10. The Owners claimed damages for breach of the charter calculated by reference to the difference between what would have been earned if the charter had run its course and what would have been earned from a substitute charter entered into at the time of the acceptance of the repudiatory breach. This kind of damages claim is common in such situations and the type of loss is clearly recoverable on established foreseeability principles. The approach to the calculation of damages relied on by the Owners is also well established. Disputes more often concern whether the Owners have taken adequate steps to mitigate their losses.
11. On the facts which arose in *The Golden Victory*, the Charterers claimed that they were not liable to the Owners for the period after December 2003 because they would have been able to cancel the charter at that time had it continued.
12. The basic principles of assessment of damages are well established and the aim of an award of damages is to put the innocent party in the position it would have been in had the contract been performed. The usual approach is for damages to be assessed at the time of breach, although this is not an inflexible rule and, in addition, there are situations where the valuation of the contract rights lost can involve assessing the effect of events which may have taken place if the contract had been performed, in order to arrive at the proper value of the contract rights lost by the innocent party.¹⁴
13. In *The Golden Victory* the arbitrator found as a fact that the outbreak of the War was an event which a reasonably informed person would have considered as

¹⁴ See *McGregor on Damages* 17th Ed 8-060 and following paras

“merely a possibility” at the time of the breach. The problem was, of course, presented by the fact that this mere possibility had occurred by the time of the hearing. Was it relevant to the assessment of damages?

14. The arbitrator considered that he was bound by earlier authority to hold that this kind of subsequent event which had happened after breach was relevant and should be considered in calculating the damages to which the Owners were entitled to compensate them for their loss of bargain. He accordingly found that the damages should be reduced to reflect the reality that the charter could have been validly cancelled in 2 years by the party in breach. On appeal, Langley J, in the High Court, and the Court of Appeal agreed with this approach because, essentially, it reached a fair result and that it would be wrong for the Owners to receive a windfall. The Courts rejected the Owners’ argument that the subsequent event was irrelevant to the calculation of the damages. The case has recently been heard on appeal to the House of Lords and a judgment is awaited. The decision seems to have been greeted with approval in both commercial circles and by academic commentators. While it does not follow the date of breach rule for assessing damages it has been seen as representing a just assessment of damages on the facts. The arguments for the Owners, which are based on the certainty which is derived from having a rule which establishes the loss at the time of breach, have not found favour.

15. Some support for the approach taken by the Courts might be said to be available in *obiter dicta* in a case called *The Mihilis Angelos*¹⁵ which concerned an alleged anticipatory breach of contract. A party which had chartered a ship to carry a cargo cancelled the charter under a cancelling clause before the ship had reached the port of loading because it considered that the ship would not arrive on time under the charter. The Owners claimed that the Charterers were in anticipatory breach by cancelling when they did. The English Court of Appeal held that the Charterers were not in anticipatory breach and were able to cancel under the cancelling clause. They further held that, even the Charterers had been in breach, the Charterers would certainly have been able to cancel the charter if they had waited until the date on which the ship was supposed to arrive because it would **certainly** not have arrived on time. The result of this future event (which the arbitrators had found would

¹⁵ [1971] 1 QB 164

certainly have occurred after the alleged anticipatory breach) was that any damages awarded to the Owners would have been reduced to a nominal award. It should be emphasised that this was a case concerning anticipatory breach where the event which was found to be relevant for the assessment of damages was considered to be a certainty or pre-destined on the facts, whereas in *The Golden Victory*, the event was only a mere possibility at the time of breach.

16. Notwithstanding the warm welcome the decision has received for its “fair” outcome, it is difficult to reconcile with the general principles applicable to the assessment of damages. It might appear to favour the interests of the party in breach in allowing an event which was only a possibility at the time of breach to reduce damages. The decision does have the great attraction of appearing to produce a fair result in the particular situation which confronted the arbitrator. However, as the Owners will, no doubt, have submitted to the House of Lords the fairness comes at the price of certainty and the decision may give rise to some considerable practical consequences. The assessment of damages at date of breach has the merit of allowing commercial parties to know where they stand. With the possibility that later events may reduce damages, will settlements become rarer and litigation be delayed while the party in breach waits for something to “turn up” (as Mr Micawber would have said) which reduces the damages claim? Will long term contracts be drafted with an ever widening range of clauses which might give a party the option of cancelling in the future?
17. The real problem with assessment in a situation where a long term contract is cancelled for breach may lie in adopting an approach to assessment at the time of breach which assumes that the contract will continue to produce the income stipulated in it for its duration. An assessment rule using the date of breach might be more acceptable if the assessment gave a reduced value for the lost contractual rights to reflect the contingent nature of the returns under the contract generally. As things stand, *The Golden Victory* may be a hard case which makes bad law and it will be interesting to see what the House of Lords finds on the appeal. The judgments in the House seem likely to provide interesting observations on the principles for the assessment of damages in similar situations.

18. In New Zealand law a case like *The Golden Victory* would be considered under the Contractual Remedies Act 1979. The decision by the Charterers to redeliver the vessel early would be a breach entitling the Owners to cancel the charter. The CRA leaves the innocent party the right to claim damages and the assessment of the damages would be guided by common law principles. The kind of issue which arose in *The Golden Victory* could well arise under any long term contract where a party in breach seeks to reduce or eliminate a damages award by reference to an event occurring after the breach, which it claims would have entitled it to terminate the contract or would have brought the contract to an end. As a result, the judgments of the House of Lords should be read with interest by all.

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