CAUSATION AND DAMAGES IN CONTRACTUAL DISPUTES

LESSONS FROM A FORMULA ONE TEAM, AN INTERNATIONAL LAW FIRM AND A SHIPPING DISPUTE

When deciding whether to bring a claim against another party, it is important to consider both causation and damages. Causation is the process of proving that the other party caused your loss. Damages are the losses suffered.

At what first appears to be a straightforward exercise is actually riddled with technical legal principles. During 2010 there were a number of cases concerning causation and damages. Some of these cases applied new, and at times contested, principles of law whilst others continued the more established precedents.

It is now opportune to consider three of the reported cases of 2010 which deal with causation and contractual damages. The cases to be considered are:

1 *Supershield Ltd v Siemens Building Technologies FE Ltd* [2010] EWCA Civ 7

2 *Omak Maritime Ltd v Mamola Challenger Shipping Co.* [2010] EWHC 2026 (Comm)

3 *Giedo Van der Garde BV v Force India Formula One Team Ltd* [2010] EWHC 2373

CAUSATION

Causation is often considered before damages, so following this theme, *Supershield Ltd v Siemens Building Technologies FE Ltd* [2010] EWCA Civ 7 shall be discussed first.

SUPERSHIELD LTD V SIEMENS BUILDING TECHNOLOGIES FE LTD [2010]

In contractual disputes there must be a causal link between the breach of contract and the resulting damages. The party in breach must have caused the loss or contributed to it.

The leading case in this area is the ubiquitous *Hadley v Baxendale (1854) 9 Ex 34*. The case explained there are two tests to determine if there is a causal link. The first relates to direct losses that flow from the breach. The second relates to losses which may be in the reasonable contemplation of the parties at the time the contract is made. These are often referred to as

indirect, or consequential, losses. If a loss could not be foreseen, then the general rule is that it cannot be claimed.

Assumption of Responsibility

In 2008, the House of Lords threw doubt upon whether these criteria are still the guiding principles.

The case in question was *Transfield Shipping Inc v Mercator Shipping Inc ("The Achilleas") [2008] UKHL 48* which suggested that the courts should look at whether the defendant had assumed responsibility for the loss suffered. The courts would have to look at the full commercial background, often referred to as the factual matrix, to determine if this was so. Many questions have arisen from this case, two of which appear to have been answered by the *Supershield* case.

The Assumption of Responsibility Test in Supershield

Briefly, the facts of the *Supershield* case were that there was a chain of sub-contracts for the installation of a water tank sprinkler system at the London office of international law firm Slaughter and May. The system contained a valve, fitted by Supershield that failed, resulting in flooding. The flood was made worse as the drainage system was blocked. It was Supershield's claim that the drain blockage was an unfortunate and unlikely occurrence. As a result, the losses were too remote to be sustained.

In *Supershield*, Lord Justice Toulson discussed the law applicable to causation and the assumption of responsibility test. He concluded that, upon considering the cases of *The Achilleas*, and *South Australia Asset Management Corp v York Montague Ltd [1997] A.C. 191*, *Hadley v Baxendale* remains a standard rule. However, there are circumstances where

'on the proper analysis of the contract against its commercial background, the loss was within the scope of the [assumed] duty, it cannot be regarded as too remote, even if it would not have occurred in ordinary circumstances.'

Lord Justice Toulson further stated the probability of the water causing harm was low, given that the drainage in place was a preventative measure. However, there was a causal link. There was a contractual duty to prevent flooding. Responsibility had been assumed for it.

Therefore, even though the risk of flooding was remote, the fact responsibility had been assumed was enough.

Issues clarified by Supershield

First, the assumption of responsibility criteria also applies to contracts where the basis is the supply of services. *The Achilleas* is a shipping case and it was previously thought that the assumption of responsibility test would only apply in shipping litigation.

Second, the assumption of responsibility test may have an inclusionary effect. As discussed in *Supershield*, many considered that the principle could only be used to exclude claims where there was no assumption of responsibility. *Supershield* is clear in that the test will also apply to include claims where responsibility for a loss has been assumed.

DAMAGES

If a causal link can be found, the next process is to determine the level of damages. The general principle of contractual damages is to put the claimant in the position they would have enjoyed if the contract had been performed. Consequently, the claimant should not be put in a better position than they would have enjoyed had the contract been performed. This is from the much quoted dictum of Parke B in *Robinson v Harman (1848) 1 Exch 850*.

Historically there were two forms of damages; expectation loss and reliance loss. The expectation interest is the amount that would have been gained had the contract been performed. For instance, a claimant can seek to recover the profits which he expected to receive.

Alternatively, the reliance interest is the loss sustained in preparing for the contract, such as purchasing new machinery in readiness for the contract. In effect, the claimant is to be put in the position he enjoyed prior to the contract, much like the position in tort. A claimant cannot claim both the expectation and reliance interests. They are mutually exclusive.

The case of *Omak Maritime Ltd v Mamola Challenger Shipping Co. [2010] EWHC 2026 (Comm)* gave an interesting account of the law relating to the relationship between the two forms of damages.

***OMAK MARITIME LTD V MAMOLA CHALLENGER SHIPPING CO.* [2010]**

Omak Maritime involved the unusual situation where the defendant's breach resulted in the claimant being in a better financial position than if the contract had been performed. A brief

summary of the facts is a charterer of a ship breached a long term charterparty with the ship's owner. The ship owner then managed to trade the ship at a higher market rate than that of the original charterparty.

The charterer required the ship for a specific purpose. Consequently, the ship owner made a number of alterations to the vessel. The ship owner claimed the costs incurred in amending the vessel for the charterparty. However, the cost of these alterations was less than the extra profits obtained from entering into the subsequent contracts.

The claimant would have been in a better financial position than if the contract had been performed if he could claim the full amount of the costs incurred in preparing the vessel for the contract.

The claimant argued that the principle from *Robinson v Harman* only applied to claims based on the expectation interest. As this action was for wasted expenditure, thus on the reliance basis, the claimant argued they were entitled to the full amount of their expenditure, irrespective of their profits.

The judge discussed a number of fundamental cases in length. The conclusion was that reliance losses are a species of expectation loss.

As a result, the principle from *Robinson v Harman* applied to reliance losses. The claimant could not be put in a better position than if they had not entered into the contract. The claimant's were not awarded the damages claimed as, in reality, they had not suffered a loss.

In this case this was clearly the right outcome. Otherwise, the claimant would be able to obtain damages for a breach of a non-profitable contract. In essence, this would make the defendant the insurer of the claimant's enterprise. This would not be correct.

The third form of damages

In addition to the expectation and reliance interests, recent case law has established a third type of loss, known as restitutionary damages. Restitutionary damages apply if a defendant has been unjustly enriched by their actions. The claimant is awarded the gain the defendant has received.

The case of *Wrotham Park Estate Company Ltd v Parkside Homes Ltd [1974] 1 WLR 798* was the only case in this area for almost two decades. In *Wrotham Park*, a developer built homes in breach of a restrictive covenant. No planning permission was obtained. There was no loss on the

traditional basis as the land had not suffered a diminution in value. However, the developer had gained by being able to sell more houses. This unjust enrichment could be claimed.

It was not until *Attorney-General v Blake [2001]* that restitutionary damages were finally recognised as forming part of English law. In *Blake*, Lord Nicholls described *Wrotham Park* as a "solitary beacon, showing that in contract as well as tort damages are not always narrowly confined to recoupment of financial loss". After *Blake*, the Court of Appeal further developed this area of law in *Experience Hendrix v PPX Enterprises Inc [2003]*.

As well as restitutionary damages, it is also possible to bring a claim for restitution. As with restitutionary damages, this is an area of law that was only accepted quite recently. It was not until the landmark case of *Lipkin Gorman v Karpnale [1991]* that restitution was formally recognised as forming part of English law.

Restitution is the act of restoring something to its rightful owner, such as where the defendant has been enriched on account of his own wrongdoing. This is different to restitutionary damages, otherwise known as an account of profits, which aim to compensate the claimant against the defendant's wrongs.

GIEDO VAN DER GARDE BV V FORCE INDIA FORMULA ONE TEAM LTD [2010]

One claimant, Giedo Van der Garde, was a young Dutch racing driver with aspirations to become a Formula One driver. The other claimant was a Dutch company set up to manage the career of Mr Van der Garde. The defendant was an English company which runs the Force India Formula One Team, the successor of Spyker F1 Team Ltd ('Spyker').

In 2007, the claimants and Spyker entered into a Service Agreement which stated that Mr Van der Garde must be permitted to drive a Formula One racing car in testing and/or practising and/or racing for a minimum of 6,000 kilometres during the 2007 Grand Prix season. A Fee Agreement was also entered into whereby the claimants would pay the defendant $3 million. This fee was paid.

In breach of the Service Agreement, the defendant only permitted Mr Van der Garde to use a car for 2004 kilometres.

The claimants claimed four remedies: restitution, loss of value of the performance due, career damages and restitutionary damages.

1 Restitution

Restitution of sums paid under a contract is only possible where there has been a total failure of consideration.

The doctrine of failure of consideration refers to a situation whereby one party fails to perform their side of a bargain. If this occurs, the other party can claim the purchase price of the contract back under the principle of restitution. The party in default must return the monies; otherwise they would be unjustly enriched.

Yet, English law does not recognise a partial failure of consideration. Restitution can only apply where no performance under the contract has occurred.

A caveat to this is if the contract can be split into different, several parts, then there may be a total failure of consideration of part.

On the facts, the contract was not severable and could not be split into parts. As a result, the judge could not award restitution. It was recognised that the total failure of consideration doctrine can result in injustice. This is an area to watch in the coming years as a number of judges and academic writers have shared this view.

2 Loss of Value of the Performance Due

This was the claimants second argued remedy. Under contractual principles, the claimants were demanding a figure to compensate for the performance they expected to receive under the Service Agreement. This reflects the expectation interest.

To determine the level of damages, it was necessary to find the market value of the service not provided, less the market value of what was received.

On the facts, the sum was found to be US$1.865 million.

3 Career Damages

The third remedy, career damages, is one that is very difficult to put a quantitative value on. The claimants claimed losses arising from the future loss of opportunity of obtaining a salary from

Formula One testing and racing, plus the lost chance of receiving sponsorship and merchandising income.

Much expert evidence was debated as to whether Mr Van der Garde would likely have become a professional Formula One driver. It was found that Mr Van der Garde was deprived of a real and substantial chance of obtaining a financial benefit from the profession. He was awarded US$100,000.

4 Restitutionary Damages

This was an alternative claim to the first and second remedies discussed. The argument was the defendant would be unjustly enriched as performance had not been fulfilled yet payment had been made. The defendant should repay this unjust enrichment to compensate the claimant.

The question was what sum would have been agreed to by the claimants to release the defendant from its liabilities. This figure would represent the unjust enrichment obtained by the defendant from its breach.

On the evidence, the value for the release would have been US$1.865 million, exactly the same as the damages claimed on the expectation interest.

Conclusions

Supershield Ltd v Siemens Building Technologies FE Ltd appears to have further entrenched the principle contained in *The Achilleas*. Where there is an assumption of responsibility, even remote losses may be claimed. We await more case law on this point.

However, in light of the decision in *Supershield*, parties would be best advised to include a schedule in contracts setting out exactly what they assume responsibility for and what they do not assume responsibility for. This schedule would likely be useful evidence in a dispute involving an assumption of responsibility argument.

Omak Maritime Ltd v Mamola Challenger Shipping Co clearly resulted in the correct outcome. It would be perverse if the claimant was allowed a windfall. However, the way the judge reached the decision has been criticised. Professor Treitel, a leading academic in this area, viewed the law of damages as having two distinct arms; one being the expectation loss and the other the reliance

loss. He argued they are separate forms of damages and as a result, the principle in *Robinson v Harman* should not apply to reliance losses.

However, a number of cases from the United States, Australia and Canada pointed to the fact the expectation and reliance damages are both a form of expectation loss. This appears to be in contrast to countries where civil, otherwise known as Roman law, applies. Continental Europe and South Africa use civil law which differentiates between damnum emergens (reliance loss) and lucrum cessans (expectation loss). Civil law academics have argued these two forms of damages are entirely separate. This will be an interesting area to watch in the coming years due to the underlying academic debate.

Giedo der Garde BV v Force India Formula One Team Ltd shows the relationship between the varying forms of remedies available to claimants. It is particularly interesting to note that restitutionary damages would have been awarded and on the same figure as the more traditional expectation damages.

Many see no place for restitutionary damages in the law of damages. However, as can be seen, restitution is not always available, sometimes resulting in an unjust outcome. Restitutionary damages address this and are a welcome addition to the arsenal of claimants.

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