Remoteness in a claim for damages – how far is too far?

Attorney General of the Virgin Islands v Global Water Associates Ltd (British Virgin Islands) [2020] UKPC 18 (13 July 2020) (Lord Hodge, Lord Wilson, Lord Lloyd-Jones, Lady Arden and Lord Sales).

A recent privy council decision has updated and clarified the law in relation to remoteness for damages in cases of breach of contract. In particular this decision may assist practitioners where two related contracts are entered into by the same parties.

The History of Remoteness

Hadley v Baxendale [1854] EWHC Exch J70 Courts of Exchequer is a renowned case on the issue of remoteness in which the court held:

1. The damages available for breach of contract include:

(i) Those which may fairly and reasonably be considered arising naturally from the breach of contract **or**

(ii) Such damages as may reasonably be supposed to have been in the contemplation of both the parties at the time the contract was made.

2. If any special circumstances exists which were actually communicated to the Defendant, the Claimant may recover any damages which would ordinarily follow from a breach of contract under the special circumstances communicated.

Victoria Laundry (Windsor) Ltd v Newman Industries Ltd [1949] 2 KB 528
In *Victoria* It was held that:

They could not reasonably argue they could not foresee that lost profits would result from the delay. It was unnecessary to prove NIL had specific knowledge of the specific contracts which had been lost. Damages would be awarded for losses which could reasonably have been expected to be lost.

Koufos v C Czarnikow Ltd ('The Heron II') [1969] 1 AC 350

Hadley was considered and it was further held:

Under the second limb in Hadley v Baxendale it was only necessary that the losses were in the reasonable contemplation of the parties as a possible result of the breach. There was no requirement as to the degree of probability of that loss arising. Since the defendant must have known that market prices fluctuate, the loss would have been in his contemplation as a possible result of the breach.

Burgundy Global Exploration Corp v Transocean Offshore International Ventures Ltd [2014] SGCA 24

On appeal, Burgundy submitted that Transocean's loss of profits claim fell within the arbitration agreement in the drilling contract. However, Transocean submitted that Burgundy was estopped from raising the damages issue because it had already been litigated and determined in the earlier stay proceedings.

The Singapore Court of Appeal upheld Burgundy's appeal and found that the proper cause of action by Transocean for recovery of the losses it claimed must be a claim in arbitration under the drilling contract.

This procedural history assists practitioners by clarifying the following:

Damages – It is well known that the purpose of damages for breach of contract is to put the party whose rights have been breached in the same position as if the party at fault had performed their obligations under the contract.

Reasonably foreseeable -The party whose rights have been breached is entitled to recover only such losses as were reasonably contemplated as liable to result from the breach when the contract was made. To be recoverable, the type of loss must have been reasonably contemplated as a serious possibility.

What was reasonably contemplated depends on the knowledge which the parties possessed at that time or indeed knowledge that the breaching party possessed prior to the breach.

Test of remoteness - The test to be applied is an objective one – is it likely that the defendant contemplated the breach and the consequences thereof prior to the breach?

This brings us to the recent Privy Council case in ***Attorney General of the Virgin Islands v Global Water Associates Ltd***

The Decision on Appeal:

Global Water Associates Ltd ("Global") entered into two contracts with the Government of the British Virgin Islands ("the Government"). First, to design and build a water reclamation plant (the "DBA"). Secondly, to manage, operate and maintain that plant for 12 years ("the MOMA contract").

The Government breached the DBA by failing to provide a site. As a result, the plant was not built. Global was not able to earn profits from the MOMA.

The company terminated the DBA and claimed damages for breach of contract. The Court of Appeal concluded that the company <u>was not entitled to damages for the profit</u> it would have earned under the MOMA <u>as those sums were too remote to be recoverable</u>, because the Government could have had the treatment plant built by a third party and run by the company. Therefore, the parties could not reasonably have foreseen that the breach of the DBA would result in the operation of the plant under the MOMA not taking place.

Global took the case to the Privy Council and helpfully at paragraph 19 of the Judgement, LJ Hodge sets out the respondent's argument:

19. The arbitrators, while accepting that "[p]erformance of the MOMA was manifestly conditional upon completion of the DBA" and that there was a "vital interconnection" between the two contracts (para 17), held that the claim for loss of profits on the operation of the MOMA was too remote. The arbitrators referred to the classic cases of Hadley v Baxendale (1854) 9 Exch 341 and Victoria Laundry (Windsor) Ltd v Newman Industries Ltd [1949] 2 KB 528 for the general principles on remoteness of damage in contract and also to a judgment of the Singapore Court of Appeal in Burgundy Global Exploration Corpn v Transocean Offshore International Ventures Ltd [2014] SGCA 24 , which the Board discusses below. They purported to apply the reasoning in the Burgundy case to the facts of this case, emphasising that the parties had chosen to enter into two separate contracts. They held that the natural and direct consequence of a breach by the Government of the DBA was that GWA would lose such monies (if any) as it was entitled to receive under the DBA. The arbitrators sought to distinguish the Victoria Laundry case on the basis that the claimant in that case was to be the owner of the boiler which it had contracted to purchase and which it would use to earn profits. By contrast, the Government were to own the Plant and GWA had no right, except under the MOMA, to operate the Plant. The arbitrators held (paras 42-44): "Breach of the DBA prevented the fulfilment of a condition precedent to the performance of a distinct and separate contract; it prevented the MOMA from commencing. But there was no promise in the DBA to satisfy the requirement for commencement of the MOMA. Without the MOMA commencing [GWA] did not have the opportunity or any right to make a profit. It could have these only under the MOMA. Damages for loss of profit from the MOMA would flow from breach of the MOMA. They did not flow from breach of the DBA.

It is, therefore, our conclusion that the loss of profits resulting from the failure to commence the MOMA, although the indirect consequence of the breach of the DBA, may not be recovered by way of an award of damages for breach of the DBA. They are too remote in law."

Following the history of the case law Lord Hodge succinctly summarised the authorities on remoteness as follows:

"31. First, in principle the purpose of damages for breach of contract is to put the party whose rights have been breached in the same position, so far as money can do so, as if his or her rights had been observed.

32. But secondly, the party in a breach of contract is entitled to recover only such part of the loss actually resulting as was, at the time the contract was made, reasonably contemplated as liable to result from the breach. To be recoverable, the type of loss must have been reasonably contemplated as a serious possibility, …

33. Thirdly, what was reasonably contemplated depends upon the knowledge which the parties possessed at that time or, in any event, which the party, who later commits the breach, then possessed.

34. Fourthly, the test to be applied is an objective one. One asks what the defendant must be taken to have had in his or her contemplation rather than only what he or she actually contemplated. In other words, one assumes that the defendant at the time the contract was made had thought about the consequences of its breach.

35. Fifthly, the criterion for deciding what the defendant must be taken to have had in his or her contemplation as the result of a breach of their contract is a factual one."

Applying the above principles to the facts of the case, it was clear to the court that the losses resulting from an inability to earn profits under the MOMA were within the reasonable contemplation of the parties to the DBA when they made that contract because:

- The contracts were entered into between the same parties on the same day and they related to the same plant on the same site, giving rise to special knowledge under the second limb of the rule in *Hadley v Baxendale*.
- The Government intended that the performance of each party's obligations under the DBA would lead to the commencement of the MOMA as cl.9 of the DBA envisaged the commencement of the "management, operation and maintenance phase" of the plant.
- The design build documents which were incorporated into the DBA were the same documents as were incorporated into the MOMA.
- There was no express term in the DBA which limited the Government's liability in damages to the company's loss of earnings under the DBA, and no finding that such a term was to be implied into the DBA.

The decision in *Burgundy Global Exploration Corp v Transocean Offshore International Ventures Ltd [2014] SGCA 24* could be distinguished because the failure to perform the DBA prevented the company from obtaining profit from its performance of the MOMA. The Court of Appeal's reasoning in relation to the possibility of a third party building the plant could not be accepted. It was clear that in both contracts the parties envisaged the completion of the DBA to lead seamlessly into the operation of the MOMA *(paras 36, 38, 42 of the Judgment).*

Practitioners involved in construction and engineering disputes may find this Judgment particularly useful since it applies existing principles to the context of engineering projects; where the construction and operation phases of an agreement are distinct even though they involve the same parties. Further, practitioners will note that the Privy Council identified the following facts in support of its decision (at *Paragraph 36* of the Judgment):

- The DBA and MOMA were between the same parties, related to the same plant and were executed on the same day (and both contracts incorporated many of the same underlying documents).
- The employer knew that the DBA would lead to commencement of the MOMA.
- The DBA did not exclude liability for loss of profit under the MOMA.

Finally, at *Paragraph 39* of the Judgment, the Privy Council stated that the mere existence of separate contracts for the construction and operation phases did not by itself support the view that the DBA contained an implicit limitation of liability for breach of contract.

Whilst every effort has been taken to ensure that the law in this article is correct, it is intended to give a general overview of the law for educational purposes. Readers are respectfully reminded that it is not intended to be a substitute for specific legal advice and should not be relied upon for this purpose. No liability is accepted for any error or omission contained herein.

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September 2020