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Form and substance in contract damages

DAVID MCLAUCHLAN*

Victoria University of Wellington

Abstract

This article discusses the role of form and substance in the modern law of contract both generally and with specific reference to the law of damages for breach of contract and, in particular, the decisions of the UK Supreme Court in Swynson Ltd v Lowick Rose LLP *[2017] UKSC 32 and* Fulton Shipping Inc of Panama v Globalia Business Travel SAU (The New Flamenco) *[2017] UKSC 43. Although it was probably true to say when Atiyah and Summers wrote in* Form and Substance in Anglo-American Law *over 30 years ago that 'the English law of contractual damages continues to be treated by judges and writers as governed by highly formal rules', it would be wrong to describe the reasoning employed by judges in modern times when explaining, refining and applying these rules as highly formal. Particularly in appellate decisions, judicial reasoning is usually an amalgam of what the authors would describe as formal and substantive considerations. Indeed, the formal reason for supporting a decision may be preferred precisely because it provides the just or most convenient solution to the dispute, as in* Swynson v Lowick Rose. *In that case the Supreme Court overturned the decision of the majority of the Court of Appeal that denial of the damages claimed 'would be a triumph of form over substance', preferring the view of the dissenting judge who said that 'the form here is the substance'. And, while the decision in* The New Flamenco *appears at first sight to rest on formal, arguably formalistic, reasoning, a closer reading reveals that substantive considerations influenced the outcome of the appeal.*

Keywords: contract; damages; mitigation; avoided loss; causation; form and substance.

1 Introduction

In the period 21–24 November 2016 the UK Supreme Court heard together two important cases involving the assessment of damages for breach of contract, namely, *Swynson Ltd v Lowick Rose LLP* (*Swynson*)[1] and *Fulton Shipping Inc of Panama v Globalia Business Travel SAU* (*The New Flamenco*).[2] Although the facts of the cases were very different, they did raise a broadly similar issue as to whether the 'loss' in respect of which damages were claimed had been avoided: in *Swynson* by the post-breach conduct of a third party and in *The New Flamenco* by the post-breach conduct of the claimants themselves. In both cases the

* Professor of Law, Victoria University of Wellington; Professorial Fellow, University of Melbourne; Honorary Professor, University of Queensland. Thanks to Andrew Summers for his helpful comments on an earlier version of this article. Of course, the usual caveat applies.

1 [2017] UKSC 32, [2018] AC 313.

2 [2017] UKSC 43, [2017] 1 WLR 2581.

decisions of the Court of Appeal, in which Longmore LJ had delivered the leading judgments, were unanimously reversed by the Supreme Court. In *Swynson* the Court of Appeal had upheld the trial judge's award in favour of the claimants, whereas in *The New Flamenco* it had overturned the trial judge's award. Thus, the outcome of the litigation was that in *Swynson* the conduct of the third party was found to have extinguished the loss, but in *The New Flamenco* it was found that the conduct of the claimants had not done so.

A curious feature of the cases is that, although they were heard together, the decision in *The New Flamenco* was handed down nearly three months after that in *Swynson*.[3] This seems surprising at first sight because the latter raised a wider, and on the surface more difficult, range of issues. Thus, the claimants sought to uphold the award on a number of alternative bases, including the principle of 'transferred loss', unjust enrichment and equitable subrogation, and three full judgments making much the same points and running to a total of 121 paragraphs were delivered. By contrast, in *The New Flamenco* there was essentially one issue only and the case was resolved by a single judgment delivered by Lord Clarke which, after reciting the facts and the lower courts' reasoning, comprised a mere seven paragraphs of original analysis. It might therefore have been expected that the decisions would be handed down at least contemporaneously. It is, of course, dangerous to speculate on the reasons why this did not occur. One simple explanation is that in *Swynson* their Lordships regarded the correct outcome as relatively straightforward and that three of them preferred to write their own judgments, whereas in *The New Flamenco* the issue was initially seen as more difficult and requiring further deliberation, although eventually a consensus was reached which it was thought did not need a lengthy explanation or analysis of the authorities. Another explanation is that the judges in *The New Flamenco* were in fact deeply divided, not necessarily as to whether to allow the appeal but rather as to the grounds for doing so, and that, for one reason or another, when it was felt that delivery of judgment could be delayed no longer, it was decided that the case could be disposed of satisfactorily in a single and 'economically' reasoned judgment which Lord Clarke agreed to prepare. Having watched the whole of the argument online, I am inclined to think that the latter explanation may not be too wide of the mark, but naturally we will never know.

The main purpose of this article is to discuss the two decisions against the background of the renewed interest recently in the relationship between form and substance in the law of obligations, an interest sparked in large part by the rise in the number of cases in which the common law courts have exhibited impatience with perceived 'formalistic' or 'legalistic' distinctions that are not in accordance with 'economic reality' or otherwise ignore the 'substance' of the matter. This topic was the theme of the important Obligations IX conference held in Melbourne in July 2018. Included among the issues discussed were: to what extent do the Commonwealth courts now place more emphasis in their reasoning on the substantive considerations that underlie the rules and doctrines of private law and hence lead them to exhibit a greater preparedness to change or qualify those rules and doctrines where that is thought to be justified; what precisely is the nature of the distinction between formal and substantive reasoning; and does it provide worthwhile insights into the manner in which modern, especially appellate, courts resolve private law disputes? My modest contribution to the discussions, of which this article is a revised version, was to suggest that, although the two cases I have highlighted contain elements of formal reasoning, they do tend to support my view that searching for distinctions between formal and substantive reasoning in the authorities that make up the

3 The judgment in *Swynson* was handed down on 11 April 2017. The judgment in *The New Flamenco* was handed down on 28 June 2017.

modern law of contract, while an interesting endeavour, provides limited insights into the judicial decision-making process nowadays. The conference programme succinctly described formal reasoning as 'the application of rules without reference to the justifications that underlie them' and substantive reasoning as reasoning that makes 'direct reference to considerations of purpose, justice or convenience', but it is almost a truism to say that very often the two types of reasoning merge into one another. Indeed, Atiyah and Summers in their monumental yet now rather dated work on the subject, which includes many complex refinements of what constitutes formal and substantive reasoning in the first place, concede that '[a] formal reason usually incorporates or reflects substantive reasoning. Thus it is an admixture of certain formal attributes on the one hand, and substantive reasoning on the other.'[4] Consequently, a formal reason that is inappropriate because, for example, it ignores substantive considerations is regarded as *formalistic* and hence a bad reason.[5]

Although it was probably true to say when Atiyah and Summers wrote over 30 years ago that 'the English law of contractual damages continues to be treated by judges and writers as governed by highly formal rules',[6] such as the rules relating to remoteness of damage and mitigation, it would be wrong to describe the reasoning employed by judges in modern times when explaining, refining and applying these rules as 'highly formal'. Particularly in appellate decisions, judicial reasoning is usually an amalgam of what the authors would describe as formal and substantive considerations.[7] Indeed, the formal reason for supporting a decision may be preferred precisely because it provides the just or most convenient solution to the dispute. As we shall see, the latter point is illustrated by the decision in *Swynson*. The Supreme Court overturned the decision of the majority of the Court of Appeal that denial of the damages claimed 'would be a triumph of form over substance'.[8] Their Lordships preferred the view of the dissenting judge who said that 'the form here *is* the substance'.[9] Furthermore, as we shall also see, although categorisation of the judgment in *The New Flamenco* is more problematic because the main reasons for allowing the appeal seem at first sight to be highly formal and, in one important respect, unsatisfactorily formalistic, a closer reading reveals that the outcome of the appeal was influenced by substantive considerations.

However, before discussing the cases, it may be helpful to provide some wider context by considering the role of form and substance in the modern law of contract as a whole.

2 Form and substance in the modern law of contract

In his 1986 essay 'Form and Substance in Contract Law', Professor Atiyah argued that:[10]

> . . . everyone must be aware of the fact that the power of formal reasons in contract law and, indeed, perhaps in all of the law, has been declining in recent years. More and more often the courts seem willing to unpick the transaction, to

4 P S Atiyah and Robert S Summers, *Form and Substance in Anglo-American Law* (Clarendon Press 1987) 2.

5 Ibid 29 ('formalistic reasoning involves a failure to take substantive considerations into account *when they ought to be taken into account*').

6 Ibid 84.

7 See, eg, *Ruxley Electronics and Construction Ltd v Forsyth* [1996] 1 AC 344 (HL); *Farley v Skinner* [2001] UKHL 49, [2002] 2 AC 732; *Golden Strait Corpn v Nippon Yusen Kubishika Kaisha (The Golden Victory)* [2007] UKHL 12, [2007] 2 AC 35; *Transfield Shipping Inc v Mercator Shipping Inc (The Achilleas)* [2008] UKHL 48, [2009] 1 AC 61; *Bunge SA v Nidera BV* [2015] UKSC 43, [2015] 2 Lloyd's Rep 469; *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67, [2016] AC 1172; *One Step (Support) Ltd v Morris-Garner* [2018] UKSC 20, [2018] 2 WLR 1353.

8 [2015] EWCA Civ 629, [2016] 1 WLR 1045 [16] (Longmore LJ).

9 Ibid [36] (Davis LJ).

10 Essay 6 in P S Atiyah, *Essays on Contract* (Oxford University Press 1986) 116.

> open it up, as it were, and go behind the formal reasons, and look at the substantive reasons for the creation or negativing of obligations. In some instances, these developments in the law might seem to amount to a mere narrowing of the limits within which formal reasons are treated as conclusive. But in other cases it is hard to avoid the conclusion that the formal reasons themselves have been jettisoned, and the issues treated as though they were completely at large. The virtual disappearance in modern English law of the parol evidence rule seems one clear example of the emasculation of a formal reason in contract cases.

Some 10 years later, Lord Steyn, writing extra-judicially, expressed a similar view. In opening his argument that the fundamental purpose of the law of contract is to give effect to the reasonable expectations of contracting parties, he said that '[t]he modern view is that the reason for a rule is important' and that '[t]he rule ought to apply where reason requires it, and no further'.[11] Thus, it is an important and legitimate part of the judicial function, particularly in appellate courts, to identify the purpose of legal rules and re-examine whether, as usually formulated, they fulfil their purpose, taking into account that 'simple fairness ought to be the basis of every legal rule and, in a common law case, that the presumption in favour of the fair solution is powerful'.[12]

The above observations echo a remark, not cited by either author (or indeed Atiyah and Summers), by Lord Wilberforce in the 1980 case of *National Carriers Ltd v Panalpina (Northern) Ltd* (*Panalpina*). His Lordship said:[13]

> I think that the movement of the law of contract is away from a rigid theory of autonomy towards the discovery — or I do not hesitate to say imposition — by the courts of just solutions, which can be ascribed to reasonable men in the position of the parties.

Many examples of the movement his Lordship described can be found scattered throughout the case law during the nearly 40 years since he wrote.[14] We have witnessed the abandonment or modification of several of the formal doctrines of the law of contract established during the nineteenth century and the first half of the twentieth

11 Johan Steyn, 'Contract Law: Fulfilling the Reasonable Expectations of Honest Men' (1997) 113 Law Quarterly Review 433, 433.

12 Ibid.

13 [1981] AC 675, 696.

14 Of course, there is nothing entirely novel in the idea that the law of contract seeks to find just solutions that can be ascribed to reasonable people in the position of the parties, for it is trite learning that one of the major purposes of the law of contract is to protect the reasonable expectations of the parties. As Professor Corbin observed at the outset of his treatise (A L Corbin, *Corbin on Contracts* vol 1 (rev edn, West Publishing Co 1960) §1, p 2)): 'That portion of the field of law that is classified and described as the law of contracts attempts the realisation of reasonable expectations that have been induced by the making of a promise. Doubtless, this is not the only purpose by which men have been motivated in creating the law of contracts; but it is believed to be the main underlying purpose, and it is believed that an understanding of many of the existing rules and a determination of their effectiveness require a lively consciousness of this underlying purpose.' Nevertheless, this purpose has had an even more pervasive influence in the evolution of the modern law of contract. It is reflected, for example, in the cases that have imposed duties of good faith in the performance of contracts (see *Yam Seng Pte v International Trade Corp Ltd* [2013] EWHC 111 (QB), [2013] 1 Lloyd's Rep 526) and, strikingly, in others where the courts have reviewed the exercise of contractual discretions and decision-making powers essentially on administrative law grounds of review, in particular, the *Wednesbury* rationality test, so that the contractual decision-maker is required to exercise its power honestly and genuinely in conformity with the nature and purpose of the contract, and must exclude considerations that are irrelevant in the light of that purpose, the terms of the contract and the context. See *Braganza v BP Shipping Ltd* [2015] UKSC 17, [2015] 1 WLR 1661 and *Waaler v Hounslow London Borough Council* [2017] EWCA Civ 45, [2017] 1 WLR 2817.

century. Let us take the relatively small area that is the main subject of this article, the law of damages. Here we have seen the refinement, much discussed in the academic literature, of the law relating to remoteness of damage. Atiyah and Summers argued that '[e]ven with respect to problems which are inherently difficult to force into a framework of formal rules—such as the foreseeability principle of *Hadley v Baxendale*—English courts still try to formulate the law in terms of specific formal rules, and most English judges try (if, as some may think, rather futilely) to apply these rules formally',[15] citing in support the judgments of the House of Lords in *Koufos v C Czarnikow Ltd* (*The Heron II*).[16] However, that formal approach has since been rejected by a majority of their Lordships who, in *Transfield Shipping Inc v Mercator Shipping Inc* (*The Achilleas*),[17] endorsed an agreement-centred approach to remoteness under which a loss may be considered too remote, even if it was of the type or kind that would have been within the reasonable contemplation of the parties as a not unlikely result of the breach. Although, as Lord Hoffmann conceded, satisfying the latter requirement will usually suffice, it will not always do so. Defendants will escape liability for foreseeable loss if it cannot reasonably be inferred that they accepted responsibility for that loss.[18]

Other developments have included the rejection of the rule that damages cannot be recovered for late payment of a debt,[19] substantial modification of the rule that damages are not available for mental distress caused by a breach of contract,[20] and, perhaps most importantly, the recalibration of the law relating to liquidated damages clauses and penalties,[21] albeit that a revised (and problematic)[22] version of the 'somewhat formal' distinction[23] between primary and secondary obligations has been retained. In the latter context there has been, for example, renewed emphasis on the proposition that 'the classification of terms for the purpose of the penalty rule depends on the substance of the term and not on its form'[24] and acceptance of the argument that the 'anomalies in the operation of the law as it has traditionally been understood' do not justify abolition of the rule because many of them can be overcome 'by a realistic appraisal of the substance of contractual provisions operating upon breach' and 'by taking a more principled approach to the interests that may properly be protected by the terms of the parties' agreement'.[25]

15 Atiyah and Summers (n 4) 84.

16 [1969] 1 AC 350.

17 [2008] UKHL 48, [2009] 1 AC 61.

18 See further D McLauchlan, 'Remoteness Re-invented?' (2009) 9 Oxford University Commonwealth Law Journal 109.

19 *Sempra Metals Ltd v Inland Revenue Commissioners* [2007] UKHL 34, [2008] AC 561; *Hungerfords v Walker* (1989) HCA 8, (1989) 179 CLR 125.

20 See, eg, *Farley v Skinner* [2001] UKHL 49, [2002] 2 AC 732.

21 *Cavendish* (n 7); *Paciocco v Australia and New Zealand Banking Group Ltd* [2016] HCA 28, (2016) 333 ALR 569; *Wilaci Pty Ltd v Torchlight Fund No 1 LP* [2017] NZCA 152, [2017] NZCCLR 9.

22 See A Summers, 'Unresolved Issues in the Law on Penalties' [2017] Lloyd's Maritime and Commercial Law Quarterly 95, 101–06.

23 *Cavendish* (n 7) [43] (Lord Neuberger and Lord Sumption).

24 Ibid [15] (Lord Neuberger and Lord Sumption).

25 Ibid [39] (Lord Neuberger and Lord Sumption). Interestingly, Lord Hodge, writing extra-judicially, has observed that '[t]he future health of the rule may depend on the court's concentration on substance rather than form and its astuteness to recognise disguised penalties': see Patrick Hodge, 'Revisiting Old Law: Judicial Development of the Law of Contract' in A J Steven, R G Anderson and J MacLeod (eds), *Nothing So Practical as a Good Theory* (Avizandum 2017) 63, 73. However, cf A Summers (n 22) (highlighting, inter alia, uncertainties as to how the 'substance over form' test is to be applied).

However, it would be wrong to suggest that in *Panalpina* Lord Wilberforce was foreshadowing an overarching concern to do justice in the individual case and a wholesale rejection of well-established rules or principles that stand in the way of achieving that. It is true that his Lordship refused to allow technical difficulties in satisfying the formal rules relating to the requirements of offer, acceptance and consideration to stand in the way of enforcing commercial transactions that were clearly intended to be legally binding,[26] but at the same time he believed in the values of freedom and sanctity of contract. In his view, there should be a reluctance to allow excuses for non-performance, particularly in arms-length commercial transactions. Thus, contractual allocations of risk should ordinarily be upheld and parties should not be allowed to escape from contractual obligations merely on the ground of inequality of bargaining power or inadequacy of consideration. Indeed, not long before his judgment in *Panalpina*, his Lordship joined with the other Law Lords in *Photo Production Ltd v Securicor Transport Ltd* in rejecting the doctrine of fundamental breach, and in the course of his speech he said:[27]

> It is significant that Parliament refrained from legislating over the whole field of contract [in the Unfair Contract Terms Act 1977]. After this Act, in commercial matters generally, when the parties are not of unequal bargaining power, and when risks are normally borne by insurance, not only is the case for judicial intervention undemonstrated, but there is everything to be said, and this seems to have been Parliament's intention, for leaving the parties free to apportion the risks as they think fit and for respecting their decisions.

Seven years previously his Lordship had delivered a vigorous dissent in *L Schuler AG v Wickman Machine Tool Sales Ltd*.[28] Unlike the majority, Lord Wilberforce was convinced that the designation of a term in a distributorship agreement as a 'condition' plainly indicated the parties' intention that the contract could be terminated for any breach of the term, however minor. Having reached this conclusion, his Lordship said that:[29]

> . . . to call the clause arbitrary, capricious or fantastic, or to introduce as a test of its validity the ubiquitous reasonable man (I do not know whether he is English or German) is to assume, contrary to the evidence, that both parties to this contract adopted a standard of easygoing tolerance rather than one of aggressive, insistent punctuality and efficiency. This is not an assumption I am prepared to make, nor do I think myself entitled to impose the former standard upon the parties if their words indicate, as they plainly do, the latter.

Although some contract theorists might suggest otherwise, there is no necessary inconsistency between the above statements and Lord Wilberforce's observation in *Panalpina*. It was no doubt his Lordship's view that *ordinarily* the just solution to disputes between commercial parties involves upholding sanctity of contract. The basic task of the court is to seek and give effect to the intention of the parties. Thus, in arms-length commercial transactions justice means holding parties to mutually agreed risk allocations. Justice also means not allowing conceptual or technical problems to defeat the clear intentions of the parties or their legitimate commercial expectations.

The above discussion is intended to provide some context, and support, for my earlier contention that only limited insights are to be gained from seeking an explanation or assessment of modern contract law in terms of whether judicial reasoning tends to be formal or substantive. The picture is much more complicated than that: it varies not only

26 *New Zealand Shipping Co Ltd v A M Satterthwaite & Co Ltd* [1974] 1 NZLR 505 (PC) 510.

27 [1980] AC 827, 843.

28 [1974] AC 235.

29 Ibid 263.

from jurisdiction to jurisdiction, from court to court, from judge to judge, but also within the various branches of the subject. One must also be mindful of the different senses in which the term 'substance over form' is used. In its narrowest sense the term means that the label the parties attach to their agreement is not determinative of its legal categorisation. Thus, an agreement to engage a person as an 'independent contractor' will be classified as a contract of employment if that is its true nature in the light of the rights and duties agreed to. Here, and elsewhere in our commercial law, 'substance' means 'legal substance' so that, in regulating commercial transactions, the courts have historically proceeded on the basis that 'there is no such thing . . . as looking at the substance, apart from looking at the language which the parties have used. It is only by a study of the whole of the language that the substance can be ascertained.'[30] More commonly nowadays, however, the term 'substance over form' is used in the sense that legal forms, rules or technicalities (so-called 'doctrinalism') should not, particularly in the adjudication of private law disputes, be allowed to prevail over 'economic realities' or get in the way of giving effect to the 'merits', the 'justice of the case', or the 'reasonable expectations' of the parties. Indeed, one finds an increasing number of modern cases in which the decision is justified on the basis that any other result would represent 'a triumph of form over substance' in one or other of the latter senses.[31] In my view, this so-called justification is in danger of becoming a ritual incantation in substitution for precise legal analysis and development of the law by reference to exegesis of established precedents or principles.

However, it is more important for the purpose of the theme of this paper to note that there are many aspects of the law of contract where formal and substantive considerations hold sway in varying degrees. In other words, as mentioned earlier, the law is an amalgam, often complex, of both such considerations. Take, for example, the important body of law governing contract interpretation. The 'highly formal'[32] plain meaning rule has been displaced in most common law jurisdictions by the 'less formal and more substantive'[33] contextual approach championed by Lord Hoffmann,[34] but that rule and its close relative, the parol evidence rule, have strongly influenced the survival of another rule that excludes evidence of prior negotiations as an aid to interpretation. Substantive considerations have also been at work. Thus, in *Chartbrook Ltd v Persimmon Homes Ltd*[35] Lord Hoffmann (with whom the other members of the House agreed) held,

30 *McEntire v Crossley Brothers Ltd* [1895] AC 457 (HL) 463 (Lord Herschell). In that case the fact that a conditional sale agreement had the same practical effect as a chattel mortgage provided no basis for treating it as an 'assurance' by the debtor within the meaning of the bills of sale legislation. Similarly, although the absolute assignment of book debts or block discounting of hire purchase agreements have the effect of providing finance to the seller and 'security' for the buyer, their legal substance is ordinarily that of sale: see, eg, *Re George Inglefield Ltd* [1933] Ch 1 (CA); *Chow Yoong Hong v Choong Fah Rubber Manufactory* [1962] AC 209 (PC); and *Lloyds & Scottish Finance Ltd v Cyril Lord Carpets Sales Ltd* (HL, 29 March 1979) reported in [1992] BCLC 609. In the latter case Lord Wilberforce said (at 615–16): 'Commercially, and in its economic result, [block discounting] may not differ from lending money at interest . . . Legally, however, there is no doubt that discounting is not treated as the lending of money and that the asset discounted is not considered as the subject of a charge.'

31 See text following n 76 below.

32 The term used by Atiyah and Summers (n 4) 15, to describe an interpretative method that 'merely focuses on literal meanings of words'.

33 Atiyah and Summers (n 4) 14.

34 *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 (HL); *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749 (HL); and *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38, [2009] AC 1101. See now *Wood v Capita Insurance Services Ltd* [2017] UKSC 24, [2017] AC 1173.

35 *Chartbrook* (n 34).

after discussing the advantages and disadvantages of the exclusionary rule, that the case for departing from it had not been made out by its critics. He was unconvinced that the often-raised pragmatic objections to doing so – for example, increased uncertainty and cost, potential prejudice to third parties – were outweighed by the advantages. At the same time, however, his Lordship endorsed the two legitimate safety devices of rectification and estoppel by convention which would prevent the rule causing injustice in cases where the evidence established that the parties had reached an agreement or common understanding as to the meaning of the words in question during their negotiations.[36] Therefore, it would be difficult to describe the modern law of contract interpretation as employing formal as opposed to substantive reasoning, or vice versa.[37]

Let us now consider whether the two recent decisions of the UK Supreme Court concerning the assessment of damages for breach of contract provide support for, or require modification of, the arguments in this and the previous part of this article.

3 The *Swynson* case

3.1 The facts

The essential facts for present purposes were as follows. In 2006 Swynson, a company controlled and owned by a Mr Hunt, lent £15m to EMSL to enable a management buyout of an American company, Evo. The loan was made in reliance on a negligently prepared due diligence report by the accountancy firm of Hurst Morrison Thomson (HMT) which subsequently changed its name to Lowick Rose LLP. The report failed to disclose some serious problems concerning Evo's finances, most importantly the insufficiency of its working capital. If the true position had been reported, the transaction would not have gone ahead. In 2007 Evo began to suffer cashflow problems that necessitated a further loan by Swynson to EMSL of £1.75m. However, the company's finances continued to deteriorate and in June 2008 Mr Hunt agreed to make another loan to EMSL through Swynson of £3m. As part of this transaction Mr Hunt obtained an 85 per cent shareholding in EMSL. Nevertheless, despite these cash injections Evo's performance did not improve. In December 2008 Mr Hunt made a fateful decision to refinance the 2006 and 2007 loans. He personally lent over £18m to EMSL on the condition that it be used to repay the latter loans. The loans were duly repaid, and as a result only the June 2008 loan was left owing to Swynson. There were two main reasons for this transaction. First, under UK law once Mr Hunt acquired control of both Swynson and EMSL Swynson

36 In fact, from time to time at least three other mechanisms have been used to give effect to a meaning that was commonly understood or agreed in the course of the parties' negotiations. These are, in brief: first, the 'private dictionary' principle (see, eg, *Partenreederei MS Karen Oltmann v Scarsdale Shipping Co Ltd (The Karen Oltmann)* [1976] 2 Lloyd's Rep 708 (QBD)); second, the 'objective background facts' exception (see, eg, the often endorsed decision in *Macdonald v Longbottom* (1859) 1 E & E 977, 120 ER 1177, where evidence was admitted of a pre-contract conversation showing that a contract for the sale of 'your wool' was intended to include both wool produced on the seller's farm and wool that the seller had bought in from other farms); and, third, Mason J's 'united in rejecting' principle in *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 (HCA) 352–53 which, despite being tentatively expressed, has since been widely followed in Australia.

37 Much the same might be said about the law relating to formation and variation of contracts. This is exemplified by the decision of the UK Supreme Court in *Rock Advertising Ltd v MWB Business Exchange Centres Ltd* [2018] UKSC 24, [2019] AC 119. In that case the court buttressed its formal reasons for upholding a 'No Oral Modification' clause with substantive considerations of commercial convenience. Thus, it was said (at [27]) that such clauses serve the legitimate commercial purposes of preventing fabrication of informal variations as a defence to summary judgment applications, avoiding disputes as to the making and terms of such variations, and enabling corporations to more easily police their internal rules concerning authority of employees to bind them.

became liable to pay tax on interest payable by EMSL even though payments were not being made. Secondly, Mr Hunt decided that it was contrary to Swynson's best interests for the impaired loans to remain on its books. No consideration was given to the possibility that the refinancing might jeopardise a future damages claim against HMT.

Despite Mr Hunt's best efforts Evo's fortunes did not improve and eventually the company was wound up. Neither the June 2008 loan nor the refinancing of the earlier loans were repaid, and in 2012 Swynson and Mr Hunt issued proceedings against HMT claiming damages of over £16m (representing the amount of the loans less the sums received from various realisations). HMT did not dispute that it was liable for the amount of the 2008 loan but contended that no damages were recoverable by Swynson in respect of the earlier loans because they had been repaid by EMSL, and accordingly there was no loss suffered. As succinctly explained by Lord Sumption in the Supreme Court, Swynson and Mr Hunt made four arguments in response:[38]

> . . . (i) that the December 2008 refinancing was res inter alios acta and did not affect the amount of Swynson's recoverable loss; (ii) that if the loss was not recoverable by Swynson it was recoverable by Mr Hunt, on the footing that HMT owed him a duty of care; (iii) that Swynson was entitled to recover on the principle of transferred loss; and (iv) that HMT having been unjustly enriched by Mr Hunt's provision of funds to EMSL to repay Swynson, Mr Hunt was subrogated to Swynson's claims against them.

The second argument was rejected by the trial judge and not appealed. The third and fourth arguments found little support in the lower courts[39] and were convincingly rejected in the Supreme Court.[40] A discussion of them is beyond the scope of this article and, in any event, the critical issue in the case in my view concerned the first argument.

3.2 The trial judge's decision

Mrs Justice Rose held that Mr Hunt's refinancing did not affect Swynson's damages claim. It was 'not an act of mitigation which operates to extinguish the loss that Swynson has suffered on the 2006 and 2007 loans for the benefit of HMT'.[41] Applying the principles of mitigation laid down by Viscount Haldane in the *British Westinghouse* case,[42] the judge ruled that the refinancing was 'mere good fortune' and 'not something that Swynson brought about in the ordinary course of business in order to mitigate the consequences of HMT's negligence'.[43] The problem with this reasoning, as later pointed out in the Supreme Court, is that the case raised an issue of avoided loss, not mitigation.[44] In other words, the question was whether the actions of a *third party* had the legal effect of avoiding or reducing the loss claimed, not whether steps taken by the *claimant* in response to the defendant's breach had that effect.

38 *Swynson* UKSC (n 1) [8].

39 Only Sales LJ in the Court of Appeal thought that Mr Hunt had a claim in unjust enrichment if Swynson's damages claim failed. If required, he would have held (*Swynson* EWCA (n 8) [57]) that 'Mr Hunt had made out a good claim in unjust enrichment such that he would have been entitled to be subrogated in equity to Swynson's damages claim against HMT.'

40 But see Peter Watts, 'Lucky Escapes' (2017) 133 Law Quarterly Review 542.

41 [2014] EWHC 2085 (Ch) [54].

42 *British Westinghouse Electric and Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd* [1912] AC 673 (HL).

43 *Swynson* EWHC (n 41) [54].

44 See, eg, *Swynson* UKSC (n 1) [97] (Lord Mance).

3.3 The Court of Appeal

Rose J's decision was upheld by majority in the Court of Appeal (Longmore and Sales LJJ, Davis LJ dissenting). Longmore LJ recognised that the case was strictly one of avoided loss, not mitigation, but nevertheless held that the *British Westinghouse* principles governed both situations. In his Lordship's view, the refinancing arose out of the consequences of HMT's breach 'but in no way did it arise in the ordinary course of business'.[45] He did accept that, ordinarily, where a loan induced by negligent advice is repaid, the repayment must be brought into account if the adviser is sued by the lender, but said that there was 'no inflexible rule to that effect'.[46] He went on to posit the situation where Mr Hunt had made a gift to Swynson of the amount outstanding under the loans to enable the latter to balance its books. There would be no question of that benefit having to be brought into account and a different result should not occur 'merely because the payment [was] made through EMSL'.[47] To hold otherwise 'would be a triumph of form over substance'.[48] Moreover, this did not involve piercing the corporate veil. Rather it was 'merely to disregard technicalities'[49] and to give effect to 'the realities of the case'.[50]

Sales LJ expressed his agreement with Longmore LJ in equally forceful terms. In his view, the principles that determine whether a payment received from a third party after breach is to be treated as 'collateral' or *res inter alios acta* 'are intended to reflect practical reality and basic justice as between the three persons involved: the person who has suffered the loss, the person who is in law responsible for causing the loss and the third party who has made a payment which reduces that loss'.[51] Therefore a court must 'focus on the substance of the matter, as against the technical form which may have been adopted by the third party in choosing how to benefit the person who has suffered the loss'.[52] Acceptance of the approach of the dissenting judge, Davis LJ, 'would place a huge premium on the particular form chosen for a transaction intended to benefit that person, which seems to me remote from the practical reality and justice of the matter'.[53] The fact that Mr Hunt chose for tax reasons to advance funds to EMSL to enable repayment of the loans, rather than directly to Swynson to improve its financial position, was 'not something which affects the substantive position or the just result' as between Swynson, HMT and Mr Hunt.[54] The situation was analogous to the case of benevolent payments where, as explained by Lord Reid in *Parry v Cleaver*,[55] considerations of 'justice, reasonableness and public policy' dictate that the benefit need not be brought into account. Thus, Sales LJ concluded:[56]

> Like benevolent contributors, Mr Hunt certainly did not intend that HMT should benefit from the funding which he was driven to provide to Swynson via EMSL. Nor did he simply pay EMSL money as a general contribution to its fund of assets: the terms of his loan to EMSL were such that it had to pay the money on

45 *Swynson* EWCA (n 8) [17].
46 Ibid [16].
47 Ibid.
48 Ibid.
49 Ibid.
50 Ibid [18].
51 Ibid [53].
52 Ibid [54].
53 Ibid.
54 Ibid.
55 [1970] AC 1, 13 15.
56 *Swynson* EWCA (n 8) [56].

> to Swynson. EMSL had no funds apart from what it received from Mr Hunt with which it could have repaid the 2006 and 2007 loans. In the circumstances, I consider it would be contrary 'to the ordinary man's sense of justice, and therefore contrary to public policy' (to use Lord Reid's language) that the funding Mr Hunt was driven to provide to help Swynson in the difficult position in which it found itself as a result of HMT's negligence should be treated as inuring to the benefit of HMT rather than Swynson alone.

Davis LJ, however, had no doubt that, since the 2006 and 2007 loans were repaid in full, Swynson had suffered no loss in respect of them. The fact that Mr Hunt did not appreciate the effect that his refinancing would have on Swynson's claim against HMT was 'neither here nor there'.[57] His Lordship made, inter alia, the following points in support of this conclusion. First, the majority's reliance on the *British Westinghouse* principles was misplaced because the case was not about whether Swynson had mitigated its loss but whether Mr Hunt's actions had the effect that no loss had been suffered. It was therefore immaterial whether the refinancing was 'in the ordinary course of business'. Secondly, there was no basis for treating the loan repayments as 'res inter alios acta or some kind of collateral transaction' because they had been brought about by the very party, EMSL, which was in default.[58] Thirdly, a ruling in favour of HMT did not 'give rise to a triumph of form over substance' or fail to have regard to 'the realities of the case'.[59] His Lordship said:[60]

> One cannot simply disregard the actual form which the transactions took, with a view to achieving what perhaps may appear (to some) to be a 'just' result. In fact, as I see it, the form here *is* the substance. The commercial form which the 2008 arrangements took—and designedly took—was that Mr Hunt (not, I note incidentally, acting 'benevolently' but through hard-headed commercial considerations) made the loan to EMSL. EMSL then, as required by clause 3.2 of the Loan Agreement of 31 December 2008, used most of that money to discharge its obligations to repay Swynson. It does not seem to me to be legitimate in such circumstances to say that, in effect, it was 'all Mr Hunt'. This is not a mere technicality. One cannot ignore the corporate structures involved. On the contrary, they must be respected. I am not able to agree with Longmore LJ that the contrary approach is 'merely to disregard technicalities'.

Fourthly, the fact that the repayment by EMSL was due to the 'mere good fortune' of Mr Hunt's intervention provided no support for Rose J's decision. Any refinancing by a borrower where the loan was negligently induced is likely to be 'adventitious' from the defendant's perspective.[61]

3.4 The Supreme Court

As foreshadowed, the Supreme Court was unanimous in allowing HMT's appeal. Judgments were delivered by Lord Sumption,[62] Lord Mance and Lord Neuberger.[63] The outcome was inevitable once it became apparent that the judges would insist on adhering to the separate

57 Ibid [32].

58 Ibid [34].

59 Ibid [35].

60 Ibid [36].

61 Ibid [42]. In fact, Rose J was referring (*Swynson* EWHC (n 41) [54]) to Swynson's, not HMT's, good fortune. This was part of her explanation of why the refinancing was not an action in the ordinary course of Swynson's business and hence did not mitigate the loss.

62 With whom Lord Neuberger, Lord Clarke and Lord Hodge agreed.

63 With whom Lord Clarke agreed.

legal personalities of Swynson and Mr Hunt. Indeed, one only had to read the first paragraph of Lord Sumption's lead judgment to know the result. His Lordship said:[64]

> The distinct legal personality of companies has been a fundamental feature of English commercial law for a century and a half, but that has never stopped businessmen from treating their companies as indistinguishable from themselves. Mr Michael Hunt is not the first businessman to make that mistake, and doubtless he will not be the last.

In rejecting the conclusion of the lower courts that the repayment of the 2006 and 2007 loans need not be brought into account, the following main points were made. First, this was a case of avoided loss, not mitigation, and therefore, in the words of Lord Neuberger, the reasoning in the *British Westinghouse* case was 'simply not in point'.[65] Secondly, the repayment of the loans 'discharged the very liability whose existence represented Swynson's loss' and therefore 'could not possibly be regarded as collateral'.[66] The fact that EMSL borrowed the money from Mr Hunt 'was no more relevant than it would have been if it had been borrowed from a bank or obtained from some other unconnected third party', particularly since HMT did not owe a duty of care to Mr Hunt.[67] The repayment could not be treated as discharging the loans 'as between Swynson and EMSL, but not as between Swynson and HMT'.[68] Thirdly, Lord Reid's reasoning in *Parry v Cleaver* did not support Swynson's argument. The ruling there that the question whether the likes of charitable payments, pensions and insurance proceeds are to be brought into account depends on 'justice, reasonableness and public policy' was not to be 'treated by judges as a green light for doing whatever seems fair on the facts of the particular case'.[69] Such benefits were truly collateral in nature because they 'are effectively paid out of [the claimant's] own pocket' (as in the case of insurance) or 'the result of benevolence (whether from the government, a charity, or family and friends)'.[70] They did not resemble the benefit in the present case 'where it is suggested that the court can ignore what is, in its intrinsic nature, a repayment of the loan under and by virtue of which the loss has been incurred'.[71] Fourthly, the fact that the position would have been different if Mr Hunt had given the amount of the loans to Swynson did not mean, as the Court of Appeal majority said, that a ruling in favour of HMT would represent a triumph of form over substance. Such a gratuitous payment was different in nature from what occurred in the present case because 'Mr Hunt's loan to EMSL was intended to and did lead to actual payment off of the first two loans which Swynson had made to EMSL'.[72] The same point was put even more strongly by Lord Neuberger who concluded his discussion of the issue by observing:[73]

64 *Swynson* UKSC (n 1) [1]. See also Lord Mance at [46].

65 Ibid [97]. See also Lord Sumption (at [13]) and Lord Mance (at [46]).

66 Ibid [13] (Lord Sumption).

67 Ibid [12] (Lord Sumption).

68 Ibid.

69 Ibid [98] (Lord Neuberger). See also Lord Sumption (at [11]): 'Justice, reasonableness and public policy are . . . the basis on which the law has arrived at the relevant principles. They are not a licence for discarding those principles and deciding each case on what may be regarded as its broader commercial merits.'

70 Ibid [98] (Lord Neuberger).

71 Ibid [47] (Lord Mance).

72 Ibid [48] (Lord Mance). See also his Lordship's statement (at [49]) that 'there is all the difference between a benevolent act which benefits a claimant (here Swynson) collaterally in an amount equivalent to a loss which it has incurred and satisfaction of the claimant Swynson's loss, by Mr Hunt's funding of EMSL to repay Swynson'.

73 Ibid [100].

> It is true that the money provided in the form of the new loan to EMSL could have been made available to Swynson (or even possibly to EMSL) by Mr Hunt in a way which would not have resulted in Swynson's loss being avoided, but that cannot possibly justify the conclusion that it must therefore be treated as if it had that effect. The fact that a transaction could have been differently arranged does not mean that it must have the same consequences as if it had been differently arranged. As a matter of logic, such a proposition would lead to an impossible situation, and as a matter of experience, it is by no means unusual to encounter cases where a transaction could be structured in two (or more) different ways, each of which would have different consequences—both in law and in commercial reality.

3.5 Form over substance?

It might be considered that the judgments of the Supreme Court in Swynson provide an example of highly formal reasoning: Mr Hunt and Swynson were separate legal persons; the repayment of the 2006 and 2007 loans discharged EMSL's liability to Swynson; and therefore the latter could not be said to have suffered a loss as a result of having been induced by HMT's negligence to make those loans. On the other hand, it cannot be said that the judgments are *formalistic* in the sense that the judges applied rules without reference to their underlying justifications and disregarded considerations of justice or convenience. Their Lordships probably had some sympathy for Mr Hunt's position,[74] but it seems that they had no qualms about denying his company's claim. In particular, there were no good reasons for treating the refinancing as analogous to benevolent payments where the courts have held that considerations of justice and public policy require the benefit to be ignored when applying the compensatory principle. The law was simply too clear. Fundamental legal principles dictated a conclusion that no loss had been suffered. The notion that this represented a triumph of form over substance was rejected.[75] If pressed on this matter, the likely response would have been that this was a hard case that should not be allowed to make bad law. If pressed further they might have pointed to the fact that historically the common law courts have shown no propensity to classify or regulate commercial transactions according to their economic substance or function. What matters is their *legal substance* which can only be derived from construing the agreed terms as a whole.[76]

Nevertheless, the question can fairly be asked whether the law was so clear that Swynson's case was hopeless. Obviously, the trial judge and two experienced Court of Appeal judges thought not. And I have more than anecdotal evidence that many other common law judges would agree with them. In 2016, one month before judgment in *Swynson* was delivered, I addressed a session of the Australasian Appellate Judges Conference in which my co-presenter, a senior judge, strongly defended the Court of Appeal's decision and said that he would be surprised if the Supreme Court reversed it. To my knowledge, only one attendee disagreed with that view. Furthermore, the desire of the Court of Appeal majority to reach what they perceived to be the just result despite the technical obstacles was not without precedent in the recent case law. There have been several modern cases in which the courts have allowed claims or denied defences on the basis that to hold otherwise would represent a triumph of form over substance. One

74 See ibid [90] (Lord Mance).

75 Expressly by Lord Mance (at [48]) and implicitly by the other judges.

76 See text at n 30 above.

notable example, albeit itself contentious, is *Shell UK Ltd v Total UK Ltd*[77] where the Court of Appeal held that a duty of care was owed to a beneficial owner of property by a defendant whose negligent actions damaged the property because 'it would be a triumph of form over substance to deny a remedy to the beneficial owner . . . when the legal owner is a bare trustee for that beneficial owner'. [78] Another example, also contentious, is *Menelaou v Bank of Cyprus plc*[79] where the Supreme Court rejected the defence to the bank's unjust enrichment claim because, inter alia, it 'represent[ed] a triumph of form over substance, or, to use the words of Lord Steyn in *Banque Financière* [1999] 1 AC 221, 227C, "pure formalism"'.[80] How many of us would have confidently predicted that the Supreme Court would disavow such an approach in *Swynson*?

4 *The New Flamenco*

4.1 The facts

Unlike *Swynson*, *The New Flamenco* did raise an issue of mitigation in the strict sense because the broad question was whether an alleged benefit accruing to the claimants that arose from steps taken by them after the defendants' breach of contract must be taken into account in the assessment of damages. The basic facts were relatively straightforward. The defendant charterers repudiated the time charter of a small cruise ship owned by the claimants when the charter still had two years to run. The owners accepted the repudiation and, since there was no possibility of arranging a substitute two-year time charter in the market, they decided to sell the ship. The price obtained was $US23.765m. The owners subsequently sued to recover the net loss of profits they would have earned (some €7.5m) if the charter had not been repudiated. However, since the value of the ship when the charter was due to end would have been a mere $7m as a result of a fall in the charter market, the charterers argued that the difference of $16.765m between this sum and the actual sale price must be brought into account. Accordingly, no damages should be awarded because the sum exceeded the lost profits claimed. The arbitrator agreed, ruling that the 'benefit' should be brought into account since the sale was caused by the breach and was a reasonable step taken to mitigate the damage. On appeal to the High Court,[81] Popplewell J disagreed, but, after being reversed by the Court of Appeal,[82] his Lordship's decision was reinstated and his reasoning endorsed by the Supreme Court.

77 [2010] EWCA 180, [2011] QB 86.

78 Ibid [143] (Waller LJ).

79 [2015] UKSC 66, [2016] AC 176.

80 Ibid [99] (Lord Neuberger). See also *Andrews v Australia and New Zealand Banking Group Ltd* [2012] HCA 30, (2012) 247 CLR 205, [13] (to hold that the doctrine of penalties is confined to obligations triggered by a breach of contract 'would elevate form over substance', but cf *Cavendish* (n 7) [42]); *Homburg Houtimport BV v Agrosin Private Ltd (The Starsin)* [2003] UKHL 12, [2004] 1 AC 715, [34]; *Breakspear v Ackland* [2008] EWHC 220 (Ch), [2009] Ch 32, [124]; *Standard Life Assurance Ltd v Oak Dedicated Ltd* [2008] EWHC 222 (Comm), [2008] 1 CLC 59, [92]; *Mauritius Commercial Bank Ltd v Hestia Holdings Ltd* [2013] EWHC 1328 (Comm), [2013] 2 Lloyd's Rep 121, [19]; *Novoship (UK) Ltd v Mikhaylyuk* [2014] EWCA Civ 908, [2015] QB 499, [92]; and *Super-Max Offshore Holdings v Malhotra* [2017] EWHC 3246 (Comm), [59] and [134].

81 [2014] EWHC 1547 (Comm), [2014] 2 Lloyd's Rep 230.

82 [2015] EWCA Civ 1299, [2016] 1 Lloyd's Rep 383 (Longmore, Christopher Clarke and Sales LJJ).

4.2 The judgment of Popplewell J

The main reason for Popplewell J's decision[83] was that the difference between the price obtained from selling the ship after the repudiation and the value of the ship had the charter been performed 'was not a benefit which was legally caused by the breach'.[84] It was not sufficient that the breach caused a reasonable mitigating step and that the mitigating step resulted in a benefit. There had to be 'a direct causative connection between breach and benefit',[85] and in this case the decision to sell was triggered by the breach but it was 'legally independent'[86] therefrom because the owners had a choice whether or not to realise the capital value of the ship at any time, including during the remaining period of the charter.[87] Whether they did so was a matter for their own 'commercial judgment and involved a commercial risk taken for their own account'.[88] Furthermore, it made no difference that the arbitrator had found that the sale was a reasonable step to take in mitigation of loss. The loss that was mitigated was the loss of net profits from the charter, and the sale achieved this by removing the costs involved in operating or laying up the ship.

His Lordship also held that the same result was 'dictated by the policy grounds' that informed the cases in which it had been held that some post-breach benefits, such as donations from third parties and the proceeds of insurance and pension schemes paid for or contributed to by the claimant, should be ignored.[89] Thus, when the owners first acquired the ship they undertook 'the risk of fluctuations in its capital value' and '[t]o allow the charterers to take the benefit of their decision to sell at what turned out to be an opportune moment in market conditions would be to allow the charterers to appropriate the fruits of the owners' investment in the vessel in a way which would be unfair and unjust'.[90]

4.3 The Court of Appeal[91]

The Court of Appeal's unanimous reversal of Popplewell J's decision turned on the fact that there was no available market for a substitute charter at the time of the repudiation. If a substitute charter had been available, the correct measure of damages would have been the difference between the contract and substitute market rates of hire regardless of the fact that the owners did not actually go into the market. In such a situation subsequent

83 For a fuller account of the judge's reasoning, see D McLauchlan, 'Mitigated Loss or Collateral Benefit?' [2016] Lloyd's Maritime and Commercial Law Quarterly 459, 459–60.

84 *New Flamenco* EWHC (n 81) [65].

85 Ibid [64].

86 Ibid [66].

87 Thus, his Lordship said (at [70]): '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. They might, for example have entered into a back-to-back charter with the new owner so as to become disponent owners vis-à-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 . . . But even if it be assumed that the existence of the charter would in practice have formed an impediment to sale before its expiry, a sale was nevertheless a transaction *of a kind* which the owners could have undertaken for their own account irrespective of the breach . . .'

88 Ibid [66].

89 Ibid [73].

90 Ibid.

91 For a fuller account of the court's reasoning, see McLauchlan (n 83) 461–63.

gains or losses resulting from the choice not to seek substitute hire are for the claimant's own account.[92] Thus, where a gain is made, it will be the result of an independent decision not arising out of the breach, and therefore it will be ignored in the assessment of damages. However, since there was no available market, the *British Westinghouse* principles applied and therefore the question was whether the alleged mitigating act arose out of the consequences of the breach and in the ordinary course of business. If the owners had taken advantage of opportunities to trade the vessel, say, by spot charter, the profits earned or losses suffered through such trading would be deducted from or added to, as the case may be, the usual measure of damages where a charterer repudiates,[93] and there was no reason why the position should be different if they decided to sell the ship and obtained a price much higher than the value it would have had if the charter to the defendant had remained on foot. They 'had made a considerable profit from the action they took by way of mitigating what would otherwise have been an undoubted loss' and '[t]hat profit arose from the consequences of the breach and should therefore be brought into account'.[94] Furthermore, their Lordships disagreed with Popplewell J that considerations of fairness and justice required the contrary conclusion. Ignoring the benefit derived from the sale would be inconsistent with the reiterations of the 'fundamental' compensatory principle[95] in *The Golden Victory*[96] and *Bunge SA v Nidera BV*:[97] in other words, it would put the owners in a better financial position than if the contract had been performed. Their Lordships also gave short shrift to Popplewell J's argument that the owners' action was legally independent of the breach because they could have sold the vessel at any time, even during the term of the charter. This was regarded as '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'.[98]

4.4 The Supreme Court

In a judgment delivered by Lord Clarke[99] the Supreme Court held that the owners were not required to bring into account the benefit derived from the sale because that benefit was not caused by the breach nor the result of 'an act of successful mitigation'.[100] The fall in the value of the ship 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',[101] namely, the loss of income from the remaining two years of the charter. The charterers' repudiation was not the legal cause of the sale because the ship could have been sold at any time, even while the charter remained on foot. Indeed, there was 'no reason to assume' that a sale would have 'followed from the lawful redelivery at the end of the charterparty term, any more than it followed from the premature termination'.[102] Accordingly, when the owners did decide to sell they were 'making a commercial decision at their own risk about the disposal of an interest in the vessel which was no part of the

92 *Koch Marine Inc v D'Amica Societa di Navigazione ARL (The Elena D'Amico)* [1980] 1 Lloyd's Rep 75 (QBD).

93 Namely, the difference between the amount of hire and the cost of earning it.

94 *New Flamenco* EWCA (n 82) [39] (Longmore LJ).

95 Ibid.

96 *Golden Strait Corpn v Nippon Yusen Kubishika Kaisha* [2007] UKHL 12; [2007] 2 AC 353.

97 [2015] UKSC 43; [2015] 2 Lloyd's Rep 469.

98 *New Flamenco* EWCA (n 82) [35] (Longmore LJ).

99 With whom Lord Neuberger, Lord Mance, Lord Sumption and Lord Hodge agreed.

100 *New Flamenco* UKSC (n 2) [34].

101 Ibid [29].

102 Ibid [33].

subject matter of the charterparty and had nothing to do with the charterers'.[103] Remarkably, it was held that the position was the same regardless of whether or not at the time of the repudiation a substitute two-year time charter, shorter charters, or no work at all had been available in the market, an important respect in which, unfortunately, the facts were unclear. As discussed elsewhere,[104] the first two situations are, or at least ought to be, uncontroversial in the sense that the refusal to take account of the sale is readily justifiable on the basis that the existence of alternative charters would have enabled the owners to restore as nearly as possible the same position that they would have been in if the contract had not been breached, so that their choice not to do so would have constituted an independent decision for which they were responsible, for better or worse. Hence it would have been the exercise of this choice, not the charterers' repudiation, that was the legal cause of the ensuing financial consequences that turned out to be beneficial.[105]

However, it is difficult to accept that the charterers' repudiation was not the legal cause of the benefit derived from the sale in the third situation where there was no work available for the ship at the time the contract was terminated. In this situation the reality is that the owners had no choice other than to sell the ship and therefore, as the arbitrator and the Court of Appeal concluded, the sale was a 'necessity'.[106] Here the benefit obtained from the sale is legally caused by the repudiation because the sale would not have occurred but for the repudiation and there is no voluntary conduct on the part of the claimants that breaks the chain of causation.

It thus appears that, in holding that *irrespective of the state of the market* the sale was not caused by the breach and could not be regarded as a relevant act of mitigation, the decisive factor for the Supreme Court was that the ship was a capital asset that could have been sold at any time, including while the charter remained on foot.[107] As a result, the sale 'was incapable of mitigating the loss of the income stream'.[108] In my view, this is a formalistic distinction that should have little bearing on the question whether the financial consequences of the owners' conduct in response to the breach ought, in principle, to be brought into account in assessing their damages. Not only does the proposition that the sale 'was incapable of mitigating the loss of the income stream' appear inconsistent with the view their Lordships earlier endorsed that the benefit need not be of the same kind

103 Ibid [32].

104 D McLauchlan and A Summers, 'Mitigation and Causation of Benefits' [2018] Lloyd's Maritime and Commercial Law Quarterly 171.

105 There is authority for the view that only where there was a substitute *two-year* charter would the benefit from sale of the ship be caused, not by the breach, but by the owners' independent decision not to take advantage of the market. Thus, in *Spar Shipping A/S v Grand China Logistics Holding (Group) Co Ltd* [2015] EWHC 718 (Comm), [2015] 2 Lloyd's Rep 407 [222], Popplewell J held that an available market requires 'a like-for-like replacement'. On this view, which was endorsed by Longmore LJ in the Court of Appeal in *The New Flamenco* (n 82) [29], even '[f]our successive six-month charters are not a like-for-like replacement for a two-year charter'. However, as Andrew Summers and I have argued (n 104) 180, the existence of an available market should not be determined in such a binary manner. The underlying question must always be: what steps would restore the claimants *as nearly as possible* to the position that they would have been in but for the breach? In determining whether shipowners are engaged in speculation following a repudiated charter, the question should be, not whether there was an available market for a perfect substitute, but whether the owners made a choice not to avail themselves of the closest substitute that was available.

106 *New Flamenco* EWCA (n 82) [11].

107 In this respect the court endorsed Popplewell J's point that the owners might have sold the ship subject to the charter by employing any one of a number of legal mechanisms available for this purpose: *New Flamenco* EWHC (n 81) [70]. See above n 87.

108 *New Flamenco* UKSC (n 2) [34].

as the loss claimed,[109] but it fails to address the correct question. That question was, not whether the owners had a choice whether or not to realise the capital value of the ship at any time, but whether, in the circumstances they faced at the time of the termination of the charter, they had a choice to put themselves, as nearly as possible, in the position they would have occupied if the contract had been performed. In other words, did they have a choice whether or not to restore their non-breach position? And if the true position was that there was no work available for the ship and thus the sale was a practical necessity, no such choice existed and the resulting benefit ought to be brought into account. It was no doubt for this reason that, as noted earlier, in the Court of Appeal Longmore LJ regarded the suggestion that the owners could have sold the ship at any time subject to the charter as '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'.[110] In his Lordship's view, the answer to that question hinged on whether there was an available market for the rehire of the ship. If there was, any loss or gain resulting from the exercise by the owners of a choice not to take advantage of that market is not caused by the breach but by their own independent decision and therefore was for their own account not the account of the defendants. However, if there was not an available market, the sale is not the result of an independent decision and 'there may be no alternative form of mitigation available' other than to sell.[111]

5 Conclusion

Neither of the two decisions of the UK Supreme Court that have been the main subject of this article can be regarded as applying wholly formal reasoning. The judgments in *Swynson* come close to doing so, but in reality their Lordships, while alive to the unfortunate consequences of their decision for Mr Hunt, regarded the law as too clear. It cannot be said that they applied settled rules without giving consideration to the justifications underlying them. They would probably say that any other decision would unsettle the law unduly and potentially be productive of inconvenience and uncertainty in the future. Or they might simply invoke Professor Atiyah's concluding observation in the essay referred to earlier:[112]

> Without necessarily condemning all manifestations of [the trend towards abandoning or limiting formal reasoning in the law of contract] this process seems to me one against which we should be on our guard. Formalism, of course, has a bad name; and to make a decision for formal reasons requires a degree of self-discipline; it requires that we should admit that some other person, some other time, some other place, some other procedure, may be the right one for this decision. But that is often true of decisions in a legal system in which, by and large, everyone can be trusted to play his proper part. *When it is true, we should not be afraid to recognize that to decide a case for formal reasons is to decide it for good reasons.*

The judgment of the Supreme Court in *The New Flamenco*, on the other hand, cannot avoid the charge that it employed, at least in one important respect, formalistic reasoning because, as discussed, it placed reliance on a factor that could not be decisive of the

109 Ibid [30].

110 *New Flamenco* EWCA (n 82) [35].

111 Ibid [29]. As Christopher Clarke LJ pointed out (at [50]), in these circumstances there was no good reason for ignoring 'the benefit of a sale made at the top of a falling market when it is that sale which was both the cause of the benefit and the act of mitigation—a circumstance which precludes it being treated as res inter alios acta'.

112 'Form and Substance in Contract Law' in Atiyah (n 10) 119–20 (emphasis added).

causation issue. Professor Atiyah drew a distinction between *formal* reasoning and *formalistic* reasoning, with the former being 'not per se unjustified or wrong' whereas the latter is.[113] In his view, a court is being formalistic when, for example, it gives 'a formal reason which is not merely bad, but out of place',[114] a criticism that it is arguably not unfair to level at the judgment in *The New Flamenco*. However, it would be misleading to infer that the decision was not influenced by substantive considerations, even though such considerations did not feature in the court's own brief conclusions.[115] This is because earlier in the judgment the court had not simply endorsed the reasoning of Popplewell J in general terms but quoted extensively from it, including the passage in which the latter held that the ruling in favour of the owners could be justified on policy grounds.[116] As noted earlier,[117] his Lordship held that it would be 'unjust and unfair' to allow the charterers to appropriate to themselves the fruits of the owners' original decision to invest in the vessel.[118] When that decision was made they '[took] upon themselves the risk of fluctuations in its capital value . . . and of the financial consequences of a decision as to whether or when to sell',[119] and the charterers should not be allowed to take advantage of what turned out to be a beneficial sale as a basis for denying that loss resulted from their wrongful repudiation. Of course, whether the decision to allow the owners' appeal was actually justified on this basis is open to debate. Based on the several discussions I have had with judges and contract scholars, there are many who favour Popplewell J's point that, regardless of the state of the charter market, the just response was to treat the sale of the ship as a matter for the owners' account and risk so that the capital benefit derived should not be regarded as a relevant compensating advantage that had the effect of extinguishing their damages claim. The benefit was essentially no different than the proceeds of an insurance policy paid for by the claimant. Indeed, they might question whether, if the contract had been performed, the ship would necessarily have been sold upon the expiry of the charter period: the owners might have judged that a rise in the charter market, and consequently an increase in the value of the ship, would soon occur. By contrast, others are firmly of the view that the benefit should be brought into account because the sale was a reasonable step taken to mitigate the damage arising from the charterers' repudiation which, due to the fall in the charter market, resulted in the owners being more than $16m better off than if the contract had remained on foot. Accordingly, applying the fundamental compensatory principle, they suffered no loss, and therefore they should recover nominal damages only. Of course, this just goes to show that Lord Wilberforce's just solution that can be ascribed to reasonable people in the position of the parties[120] may be something on which reasonable minds form different opinions.[121]

113 Ibid 95. See also Atiyah and Summers (n 4) 250 (describing formalistic reasoning as the 'inappropriate use' of formal reasoning).

114 Atiyah and Summers (n 4) 250.

115 *New Flamenco* UKSC (n 2) [29]–[35].

116 Ibid [23].

117 See text at n 90 above.

118 *New Flamenco* EWHC (n 81) [73].

119 Ibid.

120 See text above at n 13.

121 The competing arguments concerning the merits of the owners' claim are discussed further in McLauchlan (n 83).