Commercial case updates: Attorney General of the Virgin Islands v Global Water Associates Ltd [2020] UKPC 18

Over the course of the next three months, Sanjay Patel and Anna Hoffmann will look at cases from the last eighteen months that are "hidden gems"; cases on important topics that have flown under the radar, but which commercial practitioners really ought to know about. The series starts with a case from last year on the most important of topics for commercial practitioners: the law of contract damages.

Privy Council reminds us that we don't understand *Hadley v Baxendale: Attorney General of the Virgin Islands (Respondent) v Global Water Associates Ltd (Appellant) (British Virgin Islands)* [2020] UKPC 18

Introduction

1. Thought you understood remoteness of damage in contract? Think again. Last summer the Judicial Committee of the Privy Council issued a judgment which shows quite how easy it is to misapply principles we all thought we knew.

2. *Hadley v Baxendale* (1854) 9 Exch 341 is probably the most well-known contract case in English legal history – it is the seminal case on remoteness of damages. Most of us lawyers believe we understand it (or at least pretend to). However, in *Attorney General of the Virgin Islands (Respondent) v Global Water Associates Ltd (Appellant) (British Virgin Islands)* [2020] UKPC 18 ("*Global Water*"), a case from the construction sector, the Privy Council revisited well known cases on remoteness of damage and overturned a judgment of the Court of Appeal of the British Virgin Islands on the grounds that the principles in *Hadley v Baxendale* were misapplied. It is a sobering lesson that the principles in *Hadley v Baxendale* are better known than understood.

3. In *Global Water* a contractor claimed damages on the basis that its damages for breach of a design and build contract should include profits that it would have earned under a separate operation and maintenance contract. Although the contractor was unsuccessful before the Court of Appeal of the British Virgin Islands, it was ultimately successful before the Privy Council. The case is useful both to show the views of current Supreme Court and Privy Council judges on an important area of contract damages, and will also be of more specific interest to project lawyers and commercial lawyers advising clients on legal risk when they are contracting to develop a new site.

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The Facts and Litigation

4. The Government of the British Virgin Islands ('the Government') entered into two contracts with Global Water Associates Ltd ('GWA') relating to a proposed water treatment plant. The first contract was known as a Design Build Agreement ('the DBA') and the second contract was a Management, Operation and Maintenance Agreement ('the MOMA'). The structure of the deal will be familiar to those involved in PFI projects: GWA agreed to design and construct the water treatment plant under the DBA and then operate it for a period of 12 years under the MOMA.

5. The DBA required the Government to provide a prepared project site, which it failed to do. As a result, the plant was not built. GWA sued the Government and claimed profit that it would have earned for operating the site had it been built; GWA claimed that but for the Government's breach of the DBA it would have earned profit from managing, operating and maintaining the plant during the 12-year term of the MOMA.

6. GWA referred its claim for damages for breach of the DBA to arbitration. The arbitrators held that while there had been a breach of the DBA, the profits which would have been earned under the MOMA were too remote to be recoverable. Proceedings reached the Court of Appeal of the Eastern Caribbean Supreme Court (British Virgin Islands) which also held that the damages claimed were too remote, as the Government could have had a treatment plant built by a third party and then offered it to GWA to operate. As a result, the BVI court held, the parties could not reasonably have foreseen that the breach of the DBA would mean that the operation of the plant under the MOMA would not commence. GWA appealed to the Privy Council.

The Privy Council's legal approach to remoteness

7. GWA's claim for lost profits turned on whether GWA and the Government would have foreseen at the time of entering into the DBA that a breach of that agreement would result in GWA losing profits under the MOMA. A host of familiar authorities on remoteness of damage were considered (*Hadley v Baxendale* itself, *Koufos v C Czarnikow Ltd ("The Heron II")* [1969] 1 AC 350 and *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528 ("*Victoria Laundry*") and summarised in five propositions between paragraphs 31 and 35 of the judgment:

   1) 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. This is the well-known formulation from *Robinson v Harman* (1848) 1 Exch 850 *per* Parke B.

   2)The fact that the type of loss must be contemplated as a *"serious possibility"* is derived from passages of *The Heron II, Victoria Laundry* and *Monarch Steamship Co Ltd v Karlshamns Olifabriker A/B* [1949] AC 196 and is also the test that was approved by Professor Andrew Burrows (now Lord Burrows) in his "Restatement of the English Law of Contract" in relation to remoteness of damage in contract.

   3) 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.

   4) The test to be applied is an objective one. A court must ask what the defendant must be taken to have had in their contemplation, rather than only what they actually contemplated. A court assumes that the defendant at the time the contract was made had thought about the consequences of its breach.

   5) 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.

Decision

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8. Applying these criteria, the Privy Council held that it had been within the reasonable contemplation of the parties that a breach of the DBA (the design and build contract) could result in lost profits under the MOMA (the operation and maintenance contract). Lord Hodge emphasized the following points at paragraph 36 of the judgment when reaching his conclusion:

   a) The contracts had been entered into on the same day and related to the same site and plant. This gave rise to the "special knowledge" required by the second limb of *Hadley v Baxendale*.

   b) The parties expressly agreed in the DBA (i.e. the agreement under which GWA was making a claim) that upon issuance of a Taking Over Certificate the Government would serve a Commencement Notice "indicating the commencement of the management, operation and maintenance phase of the Treatment Plant". The parties therefore expressly agreed in the DBA that upon completion of the DBA works the MOMA would take effect.

   c) The Board also highlighted that there was no express term in the DBA which would limit the Government's liability in damages and that there was no finding by the arbitrators that such a term was to be implied into the DBA.

The practical and legal significance of the decision

9. The framework of contracts between GWA and the Government was hardly novel. It is common for owners of sites to contract with developers or contractors on the basis that they will both develop and operate a site. Take, for instance, the example of an owner of land that approaches a company to develop, market and operate a retirement village on their land. Typically, the owner and the developer will enter into a development management agreement (under which the developer will supervise the construction of the site and, perhaps, market the units of the retirement village) and an operating agreement (under which the developer will run the site once it is constructed). It is common for these two agreements to be executed at the same time, even though the operating agreement will only be performed once the development is complete. This common arrangement mirrors the suite of contracts between GWA and the Government almost perfectly.

10. Putting aside the impact of the case on legal principle, the decision in *Global Water* provides clear guidance as to how an English court will view questions of damages arising from this commonly occurring framework of contracts. The decision in *Global Water* most likely means that, absent special facts or circumstances, if the owner in our example were to breach the development agreement so as to make it impossible for the developer to perform the operating agreement (for instance, by selling the site to a third party) then the developer's damages for breach of the development contract would include lost profits under the operating agreement that can no longer be performed.

11. In a sense, this is hardly surprising. At the time of contracting it would have been obvious to GWA and the Government that if the site was not developed then it could not be operated either; operators cannot operate developments that do not exist. As GWA would not be able to operate the site, it would not be able to earn a profit from doing so.

12. Owners may think, as the arbitrators in the *Global Water* case did, that by entering into two separate agreements for development of the site and operation of the site they are limiting damages for breach of a development agreement only to losses arising under that contract and excluding damages for loss of profit under the separate operation contract. The Privy Council gave this argument short shrift: at paragraph 38 of the decision Lord Hodge made clear that *"the existence of two contracts cannot by itself support the view that the DBA contains an implicit contractual limitation on liability for breach of contract"*.

13. The academic interest in the case is that the decision in *Global Water* narrows the application of the 2008 House of

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Lords decision in *The Achilleas* [2009] AC 61, a decision that neither the Privy Council, House of Lords or Supreme Court had considered at all since 2008:

a) *The Achilleas* was a charterparty case where the late redelivery of a ship resulted in the owner losing profit on an agreed follow-on charter: as a result of the delay, the owner had to renegotiate the rate of the follow-on charter to reduce it by a substantial margin. As damages for late redelivery, the owner claimed the difference between the original rate and the reduced rate over the period of the follow-on fixture. However, the general understanding in the industry was that a charterer's liability for delayed redelivery was limited to the difference between the market rate and the charter rate during the period that the owner was deprived of use of the ship (and not an owner's whole loss during the course of a follow-on fixture). In *The Achilleas* the majority found that the charterer had not "assumed responsibility" for the loss arising from the renegotiation of the rate of the follow-on charter and, as a result, that loss was too remote and could not be recovered by the owner.

b) Since the decision in *The Achilleas*, lower courts, practitioners and academics have puzzled over how *The Achilleas* applies in practice. In order to determine that a type of loss was in the reasonable contemplation of the parties, does a claimant also need to show that the party breaching the contract assumed responsibility for the type of loss that their counterparty suffered (as suggested in *The Achilleas*)?

c) The strong indication in *Global Water* is that the answer to that question is "no" except where the loss has been caused by market volatility. In paragraph 26 of Lord Hodge's judgment in *Global Water* he held that it was not necessary for the Court to consider questions of assumption of responsibility raised in *The Achilleas* because in *Global Water* it was "*not concerned in this appeal with the recoverability of damages caused by unusual volatility in the market or questions of market understanding*". The effect of the decision is that *The Achilleas* does not set out (or, perhaps, no longer sets out) general principles of remoteness of damage, but instead applies specifically to the narrower situation where a loss is largely attributable to market volatility.

14. It is hard enough to stay abreast of relevant domestic authorities, let alone appeals to the Privy Council from the British Virgin Islands. However, as the judgment in *Global Water* is a recent, clear description of the principles of remoteness of damage, it is probably a judgment that every commercial practitioner ought to read.

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