Assessment of Contractual Damages in the Time of COVID-19

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28 May 2020

ABSTRACT

While the commercial challenges of COVID-19 have thrust questions of force majeure and frustration into the limelight, the important question of what COVID-19 means for contracts terminated before the pandemic has received little attention. With the new economic landscape, parties embroiled in contractual disputes will have to factor in the changing market conditions when evaluating the damages they can expect to recover for breach of contract.

Crucially, despite the market disruptions caused by COVID-19, commercial parties can be assured of compensation for the actual losses suffered as a consequence of contractual breaches, if they have taken steps to mitigate their loss. Meanwhile, parties in breach may rely on COVID-19 as a post-termination event to eliminate or reduce the damages payable, if they can prove that the contract would have been terminated in any event due to COVID-19.

A. INTRODUCTION

The outbreak of COVID-19 and the measures implemented by nations worldwide to minimise its spread have created a new economic landscape and altered market conditions across the world. Crucially, in light of COVID-19, the global economy has experienced a slowdown in trade, lower energy and commodity prices, an increase in the exchange value of foreign currencies, and other effects that have fundamentally changed our economy. In the circumstances, the unfortunate reality for commercial parties is that the pandemic will continue to impair the performance of commercial contracts.

Force majeure and the doctrine of frustration may suggest that parties should be absolved from contractual obligations, either partially or completely, as a result of the occurrence of COVID-19. However, when liability for breach of contracts has been established prior to and during the COVID-19 period, the assessment of contractual
damages for breach of contract may be radically affected by events triggered by the pandemic. It may be necessary for commercial parties embroiled in disputes on breach of contract to revise their assessments of damages by factoring in the changing market conditions in view of COVID-19.

This article seeks to examine two pertinent legal issues that will likely be brought into sharp focus over the coming months when quantifying damages for breach of contract:

1. When are contractual damages assessed; and
2. Whether COVID-19 amounts to a post-termination event which will be taken into account when evaluating damages.

B. WHEN ARE CONTRACTUAL DAMAGES ASSESSED?

(a) The Overriding Principles of Contractual Damages

The date at which contractual damages are assessed should be the one that best serves the overarching contractual principles of compensation and mitigation:

(i) **Compensation**: The rationale behind the award of contractual damages for breach of contract is to ensure that the innocent party is "so far as money can do, be placed in the same situation, with respect to damages, as if the contract had been performed". The overriding rule to compensate innocent parties for all losses flowing directly from the breach is "the bedrock of every assessment of damages".

(ii) **Mitigation**: This principle requires the innocent party to act immediately upon the breach of contract, to seek for alternative performance in the market, if there is an available market. Conversely, in the absence of an available market, the innocent party must act reasonably to mitigate the loss suffered.

(b) The General Rule

Usually, where there is an available market, damages would be assessed at the time of breach, i.e. the date of the accrual of the cause of action (date of breach rule). Under the date of breach rule, the innocent party is presumed to have acted reasonably (to mitigate) by sourcing for replacement of goods in the market at the date when the contract is terminated. As succinctly set out by the (then) Supreme Court of Malaysia in *Eikobina*:

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3 *Tan Sri Khoo Teck Puat v Plenitude Holdings Sdn Bhd* [1994] 3 MLJ 777, per Edgar Joseph Jr FCJ at 787. See also *Robinson v Harman* (1848) 1 Exch 850, per Parke B at 855.
4 *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25, per Lord Blackburn at 855; *Johnson v Agnew* [1980] AC 367, per Lord Wilberforce at 400.
5 *Cheng Chuan Development Sdn Bhd v Ng Ah Hock* [1982] 2 MLJ 222, per Salleh Abas FJ at 227. See also *Miliangos v George Frank (Textiles) Ltd* [1976] AC 443, per Lord Wilberforce at 463; *Johnson v Agnew*, supra n 4.
6 *C Sharpe & Co Ltd v Nosawa* [1917] 2 KB 814
7 *Eikobina (M) Sdn Bhd v Mensa Mercantile (Far East) Pte Ltd* [1994] 1 MLJ 553
“… the normal measure of damages is basically the difference between the contract price and market price at the time of breach where there is an available market for the goods…”

The existence of a market for goods can provide for a straightforward way of avoiding and thereby eliminating the need to calculate complex and case-specific losses. The normal measure of damages is basically the difference between the contract price and market price at the time of breach where there is an available market for the goods.

(c) Impact of COVID-19 on Damages Recoverable

However, COVID-19 and the various lockdown measures implemented across the world are likely to have detrimentally affected the availability of markets for many goods. The restrictions on trade and movement of personnel imposed by governments worldwide means that parties cannot reasonably be expected to have sourced for alternative performances during the lockdown period. Therefore, the date of breach rule would not apply when there is an absence of available markets.

The following are the likely impact which COVID-19 may have if damages are assessed at a date other than the “date of breach”:

(i) Fluctuation of market price: COVID-19 has impacted the price of goods across numerous industries, such as oil and gas and the commodities market, as a result of the decrease in demand from consumers and businesses. As such, if the market value of a particular good increases significantly after COVID-19, the contractual damages recoverable by the innocent party would naturally decrease drastically.

(ii) Fluctuation in currency: for international commercial disputes, damages may be awarded in a currency which has suffered a substantial devaluation as against other foreign currencies since the date of breach.

Evidently, given the hefty financial implications at which damages are assessed, it is crucial for parties in commercial contracts to be aware of the dates other than the “date of breach” where courts would assess contractual damages, especially during the COVID-19 period where there is an absence of an available market.

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9 Eikobina, supra n 7
10 Supra n 8 at 474, Kramer argued that there is also a requirement for it to be “reasonable” for commercial parties to enter into the market to source for alternative performance.
12 See Malaysia Rubber Development Corporation Bhd v Glove Seal Sdn Bhd [1994] 3 MLJ 569. The High Court assessed loss of profit at the sum of RM3.1 million at the date where the gloves were actually resold, after taking into account the decrease in market demand for rubber. The Federal Court, in overruling the High Court’s decision, held that the appropriate date to measure damages is the date of breach, and damages for loss of profit was subsequently evaluated at RM1.2 million. Evidently, there is a stark contrast between the damages awarded at different dates.
(d) ‘Date of Breach’: Rule of Thumb and Not Rule of Law

The date of breach rule, even when it applies, is “not an absolute rule”.\(^{14}\) The court has the discretion to fix such other date as may be appropriate in the circumstances, if the date of breach rule “would give rise to injustice”\(^{15}\) or “where it is necessary to give effect to the overriding compensatory principle”.\(^{16}\)

In this regard, the Malaysian courts would likely evaluate damages on either of the following dates when there are no available markets:

(i) date of trial;  
(ii) date of judgement;\(^{17}\)  
(iii) date of delivery of goods;\(^{18}\)  
(iv) date where goods were eventually resold;\(^{19}\) or  
(v) the reasonable date at which the innocent party is expected to source for an alternative performance after the breach.\(^{20}\)

Ultimately, the date which the court decide to assess contractual damages would be one which best reflects the compensation and mitigation principle:

(i) the award of damages should ensure that the innocent party is compensated for the actual losses suffered, nothing more or lesser than the value of the contractual benefits of which the claimant has been deprived; and  

(ii) the crucial question is when the innocent party can ought reasonably to have mitigated their losses by seeking an alternative performance at an earlier or later date.\(^{21}\)

(e) Summary

The date of breach rule only applies where there is an immediately available market for the sale of a relevant asset or, in the converse case, for the purchase of an equivalent asset.\(^{22}\) While this rule is an appropriate starting point for the assessment of damages, it is to be applied flexibly and not mechanistically. In the absence of an available market during COVID-19, commercial parties should be mindful that contractual damages may be assessed at a later date which best serves the overriding principles of compensation and mitigation.

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\(^{14}\) Johnson v Agnew, supra n 4

\(^{15}\) Bukit Ringgit Holdings Sdn Bhd v Bukit Unggul Golf and Country Resort Sdn Bhd [2016] MLJU 1166. See also Johnson v Agnew, supra n 4.

\(^{16}\) Ageas (UK) Ltd v Kwik-Fit (GB) Ltd [2014] EWHC 2178 (QB), per Popewell J at 37

\(^{17}\) Cheng Chuan Development Sdn Bhd v Ng Ah Hock [1982] 2 MLJ 222

\(^{18}\) Lee Heng & Co v C Melchers & Co [1963] MLJ 47

\(^{19}\) Malaysia Rubber Development Corporation Bhd, supra n 12

\(^{20}\) Kaines (UK) Ltd v Österreichische Warthandelsgesellschaft Austrowaren Gesellschaft mbH [1993] 2 Lloyd’s Rep 1 per Steyn J at 8: “...it is [often] reasonable to allow the aggrieved party a little time to measure the impact of what has happened” but commercial party can be expected to act with reasonable alacrity.

\(^{21}\) Radford v de Froiberville [1977] 1 WLR 1262, per Oliver J at 1286

\(^{22}\) Hooper v Oates [2014] Ch 287, per Lloyd LJ at 38
C. WHETHER COVID-19 CAN ELIMINATE OR REDUCE DAMAGES

Another pertinent issue is whether COVID-19, as a post-termination event, can be taken into consideration to eliminate or reduce the value of contractual damages. The overarching question here is, what happens if the defaulting party can clearly prove that in light of COVID-19:

(i) the contract would in any event have been discharged due to force majeure or frustration after the breach occurred; or

(ii) the contract would in any event been terminated after the breach occurred due to the inability of parties to properly perform their contractual obligations as a consequence of COVID-19.

Following the decisions of *The Golden Victory*[^23] and *Bunge v Nidera*,[^24] it is now clear that post-termination events can be considered when evaluating damages for both long-term and one-off contracts. As enunciated by Lord Sumption in *Bunge v Nidera*, “there is no principled reason why, to determine the value of the contractual performance which has been lost by the repudiation, one should not consider what would have happened if the repudiation had not occurred”, as this seems to be “fundamental to any assessment of damages designed to compensate the injured party for the consequences of the breach”.[^25]

(a) Long-term contracts — *The Golden Victory*

*The Golden Victory* is a significant decision on the assessment of damages for long term contracts, where it was clarified that:

(i) if at the date of breach there is a real possibility that an event would terminate the contract or otherwise reduce those contractual benefits, the quantum of damages must be reduced proportionately to reflect the estimated likelihood of that possibility materialising;

(ii) however, where such an event had already happened by the time the damages were assessed, the court should have regard to what had actually occurred so that estimation was no longer necessary.  

The profound implication of this decision is that: where a long-term contract was breached before a supervening event transpired (i.e. COVID-19), and thereafter the occurrence of the supervening event would certainly have rendered the performance of the contract impossible, the damages during the period of supervening event shall be excluded.

[^23]: *Golden Strait Corpn v Nippon Yusen Kubishika Kaisha* [2007] 2 AC 353 (*The Golden Victory*)
[^24]: *Bunge SA v Nidera BV* [2015] UKSC 43
[^25]: Ibid, as per Lord Sumption at 23
[^26]: *The Golden Victory*, supra n 23, per Lord Scott at 30
This decision is consistent with the compensation principle where the innocent party should not be placed in a better position than if the contract was properly performed. If the contract were to stand, it is apparent that the parties would not have been able to perform the contract during the supervening event, and therefore the innocent party would not have suffered any losses during this period. As articulated by Lord Carswell, the primary objective of awarding contractual damages is to ensure “an accurate assessment of the damages based on the loss actually incurred”.27

(b) One-off contracts — Bunge v Nidera

The significance of the decision in Bunge v Nidera is twofold:

(i) it affirmed the ruling and principles on assessment of damages established in The Golden Victory; and

(ii) it extended the principles in The Golden Victory to one-off contracts and clarified that there should not be any difference between a contract for a one-off sale and a long-term contract.28

(c) Case study — Effect of The Golden Victory on assessing damages affected by COVID-19

Drawing from the facts of and decision in The Golden Victory, a hypothetical scenario relating to the COVID-19 pandemic can be drawn below.

Suppose in February 2015, some shipowners chartered their vessel to the charterers for seven years. The charter party provided that both parties would have the right to terminate the charter in the event of a pandemic. In February 2018, the charterers wrongfully repudiated the charter and the owners accepted the repudiation without prejudice to the right to claim for damages. However, in February 2020, there was an outbreak of the COVID-19 pandemic.

The owners would have argued that damages should reflect the loss of the charterparty over the four years period from the date of breach. However, in light of the ruling in The Golden Victory, the outbreak of COVID-19 in 2020 would have placed

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27 Ibid.
28 Bunge v Nidera, supra n 24, per Lord Toulson at 87 — The relevant criterion is whether the contract is reasonably replaceable by a substitute contract at a readily ascertainable market price, in which case it will ordinarily be right to measure the innocent party’s loss by reference to the substitute contract.
a temporal limit on the damages recoverable by the owners such that no damages would be recoverable for the period from February 2020 onwards.

(d) Significance of taking into consideration COVID-19 when evaluating damages

The implication of The Golden Victory and Bunge v Nidera is that a global pandemic, such as COVID-19, would be regarded as a post-termination event that will be taken into consideration when assessing contractual damages. It is apparent that this would radically affect the amount of damages recoverable.

It bears mentioning that to date, there are no reported case laws in Malaysia on the issue of whether post-termination events can be considered when assessing damages. However, given that (i) the judicial attitude of Malaysian judges in upholding the compensation principle; and (ii) that most common law jurisdictions (i.e. Singapore\(^{29}\)) have expressly recognised the abovementioned principles, it is likely that Malaysian courts would adopt a similar approach towards assessing contractual damages.

D. CONCLUSION

The outbreak of COVID-19 may have a profound impact on the assessment of damages for contracts terminated prior to or during the pandemic. It is therefore crucial for commercial parties involved in disputes on breach of contract to fully apprehend the methods which courts would likely adopt to evaluate damage, by factoring in the changing market conditions caused by COVID-19. In these circumstances, commercial parties may seek to rely on the pandemic to reduce the amount of damages payable by asserting that the contract could not have been performed anyway.

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\(^{29}\) Swiss Singapore Overseas Enterprises Pte Ltd v Exim Rajathi India Pvt Ltd[2010] 1 SLR 573; [2009] SGHC 231. The Singapore High Court recognised the need to take into account supervening events that have occurred post-breach to ensure that the claimant is truly compensated for his or her loss. See also The "STX Mumbai" and another matter [2015] SGCA 35; [2015] 5 SLR 1.