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Construction Law Update

Exception Clauses and Causation – Guidance from the Court of Appeal

A recent Court of Appeal decision considered the extent to which an exceptions clause requires a party to prove that, notwithstanding the force majeure event, it would still have performed its obligations. In the recent case of *Classic Maritime Inc.* ("**CMI**") v *Limbungan Makmur SDN BHD & Anor* ("**Limbungan**"), $20 million in the way of damages was dependant on this interpretation.

Background

CMI (a shipowner) entered into a long-term contract with Limbungan (a charterer), for the transport of iron ore pellets. The iron ore was mined in Brazil, in which the Fundao dam is situated. The dam burst and the production of iron ore in the mine ceased. Limbungan could no longer provide cargoes of iron ore pellets, and CMI claimed damages in excess of $20million. To excuse it from liability, Limbungan relied upon the dam burst as a force majeure event. CMI argued that, but for the dam burst, the shipments would still not have been performed.

Limbungan relied upon clause 32 to defend CMI's claim which stated:

"*Neither the vessel, her master or Owners…shall be Responsible for loss of or damage to, or failure to supply, load, discharge or deliver the cargo resulting from: Act of God,… floods… accidents at the mine or Production facility….or any other causes beyond the Owners' Charterers' Shippers' or Receivers' control; always provided that such events directly affect the performance of either party under this Charter Party…*"

The first decision

In the first instance, the court considered the difference between a contractual frustration clause (which does not require the 'but for' test to be satisfied) and an exceptions clause (which does). The Court held that clause 32 is an exception clause and the use of the phrases "*resulting from*" and "*directly affect*" imports a causation requirement to the clause and that the 'force majeure event' must directly affect the performance of Limbungan's obligations in order to excuse it from liability. On the facts the court concluded that but for the dam burst, Limbungan would not have performed its obligations, its failure to perform could not fairly be said to have 'resulted from' the dam burst and the dam burst could not fairly be said to have 'directly affected' the performance of Limbungan's obligations.

It was also decided that no substantial damages were recoverable. In deciding this, the judge compared CMI's position if Limbungan had been ready and willing to perform and CMI's actual position. Even if Limbungan had been able and willing to ship the cargoes but for the dam burst, CMI would not have been entitled to substantial damages because the dam burst would have prevented Limbungan from shipping any iron ore pellets.

The Court of Appeal's decision

CMI appealed on the issue of damages and Limbungan cross-appealed on the issue of liability.

Limbungan submitted that clause 32 is a force majeure clause, not an exception clause, and that force majeure clauses are typically concerned with events which have an impact on a party's ability to perform and do not require the party affected to prove that, but for the force majeure event, it would, in fact, have performed. Therefore, Limbungan's position was that it was not required to prove that it could or would have performed the contract but for the force majeure event; rather, it was sufficient that the force majeure event in fact rendered any performance impossible.

The Court of Appeal accepted that clause 32 shares some of the features of a typical force majeure clause, however, even if it were correct to characterise the clause as a force majeure clause, that would take the

argument only so far. The question is one of construction of the clause, and the answer to that question is determined by the language of the clause which the parties have chosen, having regard to the context and purpose of the clause.

The Court of Appeal concluded that clause 32 was an exception clause and therefore, Limbungan was required to prove causation, which it failed to do and dismissed the cross-appeal.

What was the position on damages?

It was common ground that, subject only to clause 32, Limbungan's obligation to supply cargoes was an absolute obligation. The value of that performance was the freights which CMI would have earned if the cargoes had been supplied less the cost of earning them. In principle, therefore, the Court of Appeal stated that the comparison which application of the compensatory principle required was different from that carried out by the judge in the first instance. Instead, it was between (1) the freights which CMI would have earned less the cost of earning them and (2) the actual position in which CMI found itself as a result of the breach.

The Court of Appeal concluded that the fact Limbungan was unable to perform even if it had wished to do so is irrelevant to the assessment of damages in circumstances where it undertook an absolute obligation to supply cargoes and clause 32 provides it with no defence. Where it is unable to perform its primary obligation (to supply cargoes) it must instead perform its secondary obligation to pay damages.

CMI was awarded damages of just short of $20million in respect of five shipments.

Analysis

This judgment provides helpful guidance regarding the language used in force majeure and exception clauses, the use of phrases such as "resulting from" and "directly affecting performance" are commonly used in force majeure clauses and are now likely to lead to the application of the "but for" test. This decision clarifies that in cases of breach of an absolute obligation, the reason for failure to perform or subsequent impossibility are irrelevant to calculating expectation damages.