

# Court Of Appeal Rules On What Constitutes Reasonable Mitigation Of Losses

## Introduction

Where there is a breach of contract, the innocent party is required to act reasonably to mitigate its losses. This standard of reasonableness is often a difficult concept to pin down. Faced with this very issue, the Singapore Court of Appeal in *The "Asia Star"* [2010] SGCA 12 undertook an incisive review of the principles behind the duty to mitigate in its analysis of what an innocent party is required to do to be acting 'reasonably' in the context of a failure to present a seaworthy vessel at the commencement of a voyage charter.

In this case, the Appellant failed to deliver a vessel to the Respondent in breach of a charterparty. However, the Respondent did not charter an alternative vessel, which it knew to be available at the material time, allegedly because of the higher freight costs. The Court held that the costs were not prohibitively high, and that the Respondent's inaction constituted a failure to act reasonably to mitigate its losses.

The Honourable Judge of Appeal V K Rajah, delivering the judgment of the Court, explained the standard of reasonableness as an attempt to reflect commercial and fact-sensitive fairness. Hence any inquiry as to what is "reasonable" is necessarily heavily factual, and allows a certain subjective sympathy for the innocent party.

Notably, it was observed that innocent parties should seek to inform defaulting parties of any courses of action they consider taking to mitigate their losses. This goes towards fulfilling the requirement of 'reasonableness', as well as to encourage communication between the parties and minimize economic wastage.

## Brief Facts

- (1) The Appellant was the owner of the *Asia Star*. The Respondent was an experienced and fairly substantial trading company, which had entered into a charterparty with the Appellant for the charter of the *Asia Star*.
- (2) The shipment was to fulfill the Respondent's contractual obligation to sell edible oil to a Turkish company ("*Agrima*"). The Respondent also had contracts to purchase oil products from three suppliers.

- (3) Due to inclement weather delaying the vessel's approach voyage, as well as tank contamination concerns, the Appellant was unable to deliver the *Asia Star* within the agreed loading period.
- (4) The Respondent attempted to secure an alternative vessel to carry its cargo, but negotiations with the owners of the only other available vessel ("*the Puma*") fell through, ultimately because the freight rate was (as the Court found) marginally higher.
- (5) As a result, Agrima and one of the suppliers cancelled their contracts with the Respondent, while the other two suppliers sought to penalise the Respondent for the delay.
  - a. The Respondent thus claimed against the Appellant for the cancelled contracts, the money paid in settlement to Agrima, and the penalties levied by the suppliers.
  - b. The Appellant sought to argue that the Respondent ought to have chartered the *Puma* to transport the cargo and thereby mitigate its losses.

## Issue

The appeal was concerned principally with the measure of damages to be awarded. A key issue was whether the Respondent had acted reasonably to mitigate its losses after it learnt that the Appellant would not be able to deliver the *Asia Star* as promised:-

- Specifically, if the Respondent ought to have - in mitigation - chartered the *Puma* as an alternative vessel, then the damages would be the difference between the freight costs of the *Puma* and that of the *Asia Star*, which was in the region of US\$400,000.
- If it was not so required to act, the Respondent would be entitled to its entire claim for all losses incurred, which were more than US\$1.6mil.

## Holding Of The Court Of Appeal

The Court held that the Respondent had failed to act reasonably to mitigate its losses in failing to charter the *Puma* as a replacement vessel, and also in failing to inform the Appellant of this possible alternative course of action. Therefore, it was only entitled to damages in the region of US\$400,000.

### General law on mitigation

An innocent party is under a duty to act reasonably to mitigate its losses after it becomes aware of a breach of contract. It is not entitled to claim that part of its loss which could have been avoided.

The Court espoused a number of principles to be observed in any inquiry as to the reasonableness of mitigation efforts.

- (i) The general purpose of the inquiry is to achieve commercial and fact-sensitive fairness. Reasonableness is thus a flexible concept, and the Court has considerable discretion in evaluating the facts to reach a commercially just determination.
- (ii) It may appear unfair to impose any 'duty' on an innocent party; therefore, the Court does not apply too high a standard of reasonableness. While the test is objective, the Court takes into account subjective circumstances such as the innocent party's financial position.
- (iii) The inquiry is very much a factual one, so that case precedents are of limited guidance.
- (iv) Generally, the Court will not apply too unsympathetic and meticulous a scrutiny of the actions taken by an innocent party to mitigate its loss. However, this principle applies more strongly where the innocent party has engaged in some disputed act of mitigation, rather than mere inaction.
- (v) The duty to mitigate has its limits; an innocent party is not expected to incur great expense or put itself to great inconvenience to mitigate its losses.

### **Whether the Respondent acted reasonably**

The Court considered whether the additional US\$400,000 to charter the *Puma* justified the Respondent's decision to forego chartering that vessel to lift the cargo.

It was held that this additional sum was not so large as to justify the Respondent's inaction, considering the losses to be incurred in the alternative:-

- (i) The Respondent would have made a profit of around US\$1.5mil from its contract with Agrima. Inaction would thus result in an expected total loss of this amount.
- (ii) In contrast, the additional cost of chartering the *Puma* as a mitigation measure was less than a third of that sum.

The Respondent also argued that spending the additional US\$400,000 on the *Puma* would have been too huge a drain on its resources. This argument was rejected:-

- (i) It is true that an innocent party will not be prejudiced by its financial inability to take steps in mitigation. If its position is aggravated because it lacks the means to mitigate its losses, the defaulting party remains liable for the total loss.
- (ii) However, on the facts, the sum of US\$400,000 was not shown to be financially prohibitive to the Respondent. The burden of proof was on the Respondent, but no objective evidence was adduced.
- (iii) The Court also considered the fact that the Respondent was a large company with many years of trading experience under its belt. Furthermore, it was willing to offer

the owners of the *Puma* a sum that was US\$200,000 above the freight cost of the *Asia Star*.

A somewhat half-hearted attempt by the Respondent to prove its own "impecuniosity" was rejected by the Court as "unconvincing", as was a professed concern that the Respondent would incur substantial dead freight in chartering the *Puma*, which was a larger vessel.

Notably, the Court also found that the Respondent should have notified the Appellant of the option of chartering the *Puma* at the higher freight rate. The Court admonished that:-

- (i) Where substantial additional expenditure has to be incurred in mitigation, the innocent party should inform the defaulting party of its proposed course of action so both parties can consider, holistically, how to minimize their losses (*Mitchell v Hahl* (1862) 175 ER 1250).
- (ii) This would help satisfy the innocent party's duty to mitigate, as well as resolve its concerns and hesitancy over incurring additional costs in mitigation where there is no assurance that such costs can be recovered.
- (iii) It would also encourage communication between the parties as regards the various mitigation measures available, as well as to minimise avoidable economic wastage.

## Concluding Words

This decision provides an authoritatively thorough guide as to what an innocent party should do to mitigate its losses in the event of a breach of contract, as well as the approach that a Singapore court is likely to take in determining the reasonableness of such actions (or inaction).

Importantly, an innocent party should certainly seek to communicate its alternative options to the defaulting party in order to reach a more informed decision, as well as to enhance the defensibility of its decision as to whether the option eventually chosen is more reasonable or not.

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