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# Deceit, difference in value and date of assessment

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**Case Comment**
**Deceit, Difference in Value and Date of Assessment**
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In *OMV Petrom SA v Glencore International AG [2016] EWCA Civ 778*, the Court of Appeal assessed damages for deceit following fraudulent misrepresentation by the seller of several cargos of oil. The court considered the application of the "date of assessment" principles developed in *Smith New Court Securities Ltd v Citibank NA [1997] A.C. 254; [1996] 4 All E.R. 769*, in circumstances in which the buyer had not discovered the fraud until several years after the oil had been refined and sold to sub-buyers. The dispute centred on whether the sub-sales, concluded after the fraud took place, could be relied upon by the fraudulent seller to reduce the damages payable to buyer. The Court of Appeal concluded that they could not. Whilst it is difficult to have sympathy for the fraudster in these circumstances, the court's approach involves a misunderstanding of the date of assessment principles established in *Smith New Court Securities* and other more recent decisions.

Between 1993 and 1996, the defendant seller supplied around 80 cargos of crude oil to the claimant Romanian state oil company on CIF Constantza terms. All of the cargos were sold as established "brands" of crude that the claimant preferred for its refineries. However, unbeknownst to the claimant, 32 of the 80 cargos were in fact bespoke blends of other crudes that the defendant had deliberately mixed to resemble brands and then disguised by forged documents. These bespoke blends were cheaper to produce and supply than the brands, but had similar characteristics and yields, so the deception could not be and was not initially detected by the claimant (who tested the cargos) or its banks. The fraud was only discovered a decade later from a whistleblower. By that time the claimant had long-since supplied the cargos to its subsidiary oil refining companies, which had refined the oil and sold the products to their customers.

At first instance, Flaux J. held that the defendant was liable in deceit and assessed damages as being the difference between the price that the claimant had paid for the cargos (on the basis that they were branded crude) and the market value of the bespoke blends fraudulently substituted by the defendant. The components of the bespoke blends together had a market value approximately $14m less than those of the brands. To this Flaux J. added a further "discount" of around $26m to reflect the lower price at which bespoke blends tended to sell as compared with equivalent established brands, because of the additional uncertainties that arose from using untried blends in the refining process. The date for assessing the relevant market value was taken to be the date of the bill of lading (which the parties agreed was more appropriate than the date of the contract).

On appeal as to the assessment of damages, the defendant argued that Flaux J.'s award overcompensated the claimant in light of subsequent events. In particular, it argued that the discount reflected the risks that an untried blend might result in lower than expected yields or damage to the buyer's refinery, but as things turned out, none of these risks eventuated. Instead, the defendant argued, damages should be assessed using a

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"comparative yield" approach, which involved comparing the yields that would have been obtained by the promised brands with the yields in fact obtained from the fraudulently supplied bespoke blends.

The Court of Appeal rejected the defendant's arguments and upheld Flaux J.'s award. It concluded that in a case where property is acquired as a result of the defendant's fraud, the loss was the overpayment (at [40] and [77]) and "the basic measure of damages is the price paid less… its value at the date of acquisition" (at [38]). In the present case, this valuation was to be carried out as at the bill of lading date, that "being the date upon which [the claimant's] loss crystallized"; further, "[w]hat happened after the bill of lading date does not affect the value of the blend on that date" (at [49]) and so "the fact that refining led to no problems [was] something which should enure to the benefit of [the claimant]" (at [61]). The decision thus appears to accord with the so-called "breach date rule", that damages are assessed "as at" the date of breach (in this case the bill of lading date) regardless of subsequent events, at least where those subsequent events make things better and not worse for the claimant.

In reaching its conclusion, the Court of Appeal considered the principles set out in *Smith New Court Securities*. There, the House of Lords held that in a deceit case (although expressly referring to other tort cases) the value of property acquired should usually be taken as at the date of acquisition, however "such general rule is not to be inflexibly applied" (at 267 per Lord Browne-Wilkinson). In reviewing this authority, the Court of Appeal in *OMV* reasoned that "[t]he purpose of the flexibility of approach about the valuation date to which Lord Browne-Wilkinson referred was to ensure that the person duped should not suffer an injustice by failing to recover full compensation ... There is no need to adopt such an approach in order to relieve the fraudster from the general rule as to damages" (at [39]; see also [169] in the decision of Flaux J.). In other words, the Court of Appeal considered that departure from the so-called "general rule" could only work one way: in favour of the innocent party, but never to the advantage of the wrongdoer.

The defendant's status as a fraudster clearly weighed heavily in the Court of Appeal's reasoning, which emphasised a policy of discouraging wrongdoing and preventing the defendant from profiting from its wrong (at [57] and [78]). However, for deterrence or punishment, the claimant and court could have looked to the criminal law, which in England and Wales would have included fraud/deception offences. The approach in *OMV* is contrary to the legal principle that mitigation and causation apply in exactly the same way regardless of the defendant's intentional wrongdoing. In *Smith New Court Securities*, although the House of Lords held that the remoteness rule did not apply to cases of fraud, it emphasised that "it must still be shown that the entire loss suffered by [the defendant] is a direct consequence of the fraudulently induced transaction" (Lord Browne-Wilkinson at 267 and Lord Steyn at 281-5); in particular, mitigation "has no special features in the context of deceit" (at 285 per Lord Steyn).

Writing in this journal ((2014) 130 L.Q.R. 259), we have previously highlighted the fallacy of the breach date rule, explaining that it is really just a common but not invariable incident of mitigation, which is itself an aspect of causation. This understanding of mitigation and its application to the market rule has subsequently been put beyond doubt by the Supreme Court in *Bunge SA v Nidera BV [2015] UKSC 43; [2015] 3 All E.R. 1082* at [17] per Lord Sumption and at [76]-[82] per Lord Toulson.

Unfortunately, the decision in *OMV* exhibits several of the errors that we cautioned against in our article. It marks an unwelcome return to viewing the difference in value at the date of breach as though it were an abstract measure of damages (for a rebuttal of this view, see 266-269 of our 2014 article), whereas its application is really limited to circumstances in which the claimant could have resorted to the market to obtain substitute performance, but chose not to.

The first main error exhibited in *OMV* was the failure, at both first instance and in the Court of Appeal, to assess what would have happened but for the defendant's breach. Under the compensatory principle, it is axiomatic that damages aim to put the claimant in the same position as if the breach had not occurred. As we have previously explained, the application of this principle requires a comparison between the position that the claimant is in as a result of the breach (the "breach position") and the hypothetical position that it would have been in but for the breach (the "non-breach position").

At first instance, Flaux J. found that if the defendant had disclosed the true position that the cargos included bespoke blends rather than brands, then "everything would have unraveled and [the claimant] would either have not paid at all or insisted upon reimbursement" (at [26]). However, this does not complete the assessment of the claimant's non-breach position, because it omits any finding as to what the claimant would have done instead. There were two main possibilities. The claimant might either have rejected the defendant's cargos altogether and purchased the required brands elsewhere, or it might alternatively have continued with the purchase of the defendant's bespoke blends, but at a lower price. Although Flaux J. acknowledged both of these possibilities, he did not seem to think that it was necessary to choose between them (at [14], [19] and [157]).

Yet, the distinction between buying different cargos or buying the same cargos for less is of the utmost importance. If the evidence had shown that the claimant would still have purchased the blends but at a lower price, then it would be true to say that the fraud caused the claimant to "overpay", and correct to award damages by reference to the discount that would have been secured but for the deceit. But on this basis there would be no need to ask about the value of the cargos actually acquired, whether at the date of breach or any other date, because these cargos would have been acquired anyway. This was exactly the approach taken by the Court of Appeal in the deceit case of *Clef Aquitaine Sarl v Laporte Materials (Barrow) Ltd [2001] QB 488; [2000] 3 W.L.R. 1760*, where it was held that the claimant "suffered no loss from the transaction save only from having entered into that transaction rather than a still more profitable one" (at 498 per Simon Brown L.J.).

However, on the evidence in *OMV*, the *Clef Aquitaine* approach is inapposite. The claimant contended that it would have rejected the defendant's cargos altogether and purchased the desired brands elsewhere on the market (at [176] of Flaux J.'s judgment and [33] of the appeal judgment). Despite regarding the claimant's hypothetical conduct as mostly unimportant, the Court of Appeal seemed willing to accept this evidence (at [11]). On this basis, although in some sense the claimant "overpaid" for the oil actually supplied, this sum does not constitute the claimant's loss in a legal sense. The overpayment relies on a comparison between the price actually paid versus the oil actually received, whereas the compensatory principle requires a comparison with what would have happened but for the breach, and based on the available evidence, this involved the purchase of different oil at the same (or a similar) price. The correct comparison is therefore between the consequences of receiving bespoke blended oil (the breach position) as against receiving branded oil (the non-breach position).

The Court of Appeal's second error was to overlook the important fact that the claimant was unaware of the fraud when it supplied onwards the oil (and when its subsidiaries refined the oil and sold the products on). Where a buyer of goods is instantly aware of the breach, it can usually mitigate its loss by resorting promptly to the market to purchase substitute goods of the contractual specification. In these circumstances, as Lord Toulson summarised in *Bunge*, the defendant "is not liable to the innocent party for the adverse effect of market changes … nor is the innocent party required to give credit to the guilty party for any subsequent market movement in favour of the innocent party" because "[t]he speculation which way the market will go is the speculation of the claimant" (at [80]). Damages are assessed as if the claimant had resorted to the market at the date of breach, even if in fact it did not; this is what often gives the illusion of a "breach date rule".

However, the breach date assessment only applies where the claimant had a "free choice whether to re-enter the market" at that date (*Bunge* at [80] per Lord Toulson; see further, in deceit, Toulson J.'s earlier comments in *Standard Chartered Bank v Pakistan National Shipping Corp [1999] 1 All E.R. (Comm) 417; [1999] 1 Lloyd's Rep. 747* at 432-433). In another recent decision, *Fulton Shipping Inc v Globalia Business Travel SAU ("The New Flamenco") [2016] EWCA Civ 1299; [2016] 1 W.L.R. 2450,* the Court of Appeal similarly emphasised that the market price rule "depends on there being an available market which the innocent party decides for reasons of his own to ignore" (at [25] per Longmore L.J.). It follows that this rule has no application where for whatever reason the claimant had no choice to resort to the market for substitute performance. On the facts of *OMV*, the claimant had no choice to sell the bespoke blends and purchase replacement brands, because it had already supplied the blends to its subsidiaries by the time it discovered the fraud. In these circumstances, there is no speculation or other break in the chain of causation and the defendant is responsible for all of the actual consequences of the breach, for better or worse.

Thus, in *OMV* the Court of Appeal misunderstood the importance of the distinction between patent and latent breaches. As we have previously highlighted, this distinction fully explains the two apparently irreconcilable Court of Appeal decisions in *Slater v Hoyle & Smith Ltd [1920] 2 K.B. 11* and *Bence Graphics International Ltd v Fasson UK Ltd [1998] Q.B. 87; [1997] 3 W.L.R. 205.* In *Slater* the claimants were aware of the breach but then freely chose not to resort to the market to purchase substitute goods; by contrast in *Bence* the claimants did not discover the breach until after they had already sold on the defective goods to sub-buyers. In *OMV*, the Court of Appeal rejected the application of *Bence* on the mistaken basis that it was inconsistent with the earlier decision in *Slater* (at [45]). However, the two cases are distinguishable and it is *Bence* not *Slater* that provides the apt analogy to *OMV*, because in the latter case the claimant only discovered the fraud long after the oil had already been supplied on.

Where the claimant is unaware of the breach, the rules of mitigation and "legal causation" have no application; unless the remoteness rule applies, there is thus no legal principle to prevent all actual harms and benefits up to the date of trial being taken into account in the assessment of the claimant's loss. In other words, a simple application of compensatory principle is all that is required. In *OMV*, it was accepted that the claimant's use of the blends might have resulted in significant harm from fire or rust damage to the claimant's subsidiaries' refineries, or through impaired yields (at [31]). If these losses had been suffered, they would have been recoverable in full (and without any application of the remoteness principle, which is inapplicable in cases of deceit). This follows directly from the decision in *Smith New Court Securities*.

However, it is important to be clear about *why* subsequent events were taken into account in *Smith New Court Securities*. It was not because the defendant was a fraudster, as the Court of Appeal in *OMV* appeared to assume (at [39] and [69]). Instead it was because, as Lord Steyn reasoned, the claimant "was truly locked into the transaction by reason of the fraud perpetrated on it and the causative influence of the fraud is not significantly attenuated or diluted by other causative factors acting simultaneously with or subsequent to the fraud" (at 285). As Lord Browne-Wilkinson also observed, the claimant was "not aware of the fraud" and "the fraud continue[d] to influenc[e] the conduct of the plaintiff after the transaction is complete"; until it discovered the breach, the claimant was not "freed from any continuing adverse impact of the defendant's wrongful act" (at 261 and 266). This reasoning applies in exactly the same way to subsequent gains as to losses. In other words, even if the shares had risen in value in *Smith New Court Securities* between the date of acquisition and the date of discovery, giving the deceived claimant a profit, the claimant could not have opted to recover the difference between the price paid and the value of the shares at the date of acquisition. The application or non-application of the rules of mitigation and causation always cut both ways.

As things turned out in *OMV*, the only actual harm proved by the claimant was the relatively small reduction in the value of the distillate yield, valued at around $5.5m, as the claimant group apparently refined and sold on the bespoke blends without any other adverse consequences (or, at least, none were evidenced or proved: [47]). Further, this $5.5m was a loss to the subsidiaries not the claimant, and the claimant led no evidence that a reduced yield at its subsidiaries' refineries would affect the price paid to it or the value of the claimant's shares in the subsidiaries. The claimant had taken the high risk approach of seeking jackpot damages without pleading its actual losses even as an alternative measure (c.f. *Senate Electrical Wholesalers Ltd v Alcatel Submarine Networks Ltd [1999] 2 Lloyd's Rep 423 per Stuart-Smith L.J.* at [54]). On a correct application of the principles developed in *Smith New Court Securities* it should have paid the price for this approach and recovered no damages at all.

We reiterate the view that date of assessment problems are really aspects of mitigation and causation, and not an invitation for judges to exercise discretion based on policy or other considerations. Since our earlier article, several cases including *Hirtenstein v Hill Dickinson LLP [2014] EWHC 2711 (Comm)* at [117]ff and *Thai Airways International Public Company Ltd v KI Holdings Co Ltd [2015] EWHC 1250 (Comm); [2016] 1 All E.R. (Comm) 675* at [33]ff, as well as *Bunge* and *The New Flamenco* mentioned above, have confirmed that approach (although none of these were cited to the court in *OMV*). And *Smith New Court Securities* already made clear that mitigation and causation apply no differently in deceit to other cases. In *OMV*, the proper award should have been compensation for all actual losses proven to have been suffered up to trial and beyond. In this case, because the claimant chose to resist investigation of post-acquisition events (at [178] in the decision of Flaux J.), those losses were zero.