The High Court's unfortunate analysis in *Clark V Macourt;*

Let's hope it's not a seminal decision

By Michael Mazzone, Partner

The decision in *Clark v Macourt*[1] is a terrific example of the idea that the High Court is right because it's final, not final because it's right.

The High Court has ruled that in quantifying the damage a person has suffered as a result of breach of contract, the actual loss suffered by the person is wholly and utterly irrelevant. Well the Court didn't actually say that, but that is indeed the effect of the decision.

Let me explain. In 2002, the good Dr Clark purchased a fertility clinic for the princely sum of $387,000. Included in the purchase, was a stock of semen straws. As it turned out, 1,996 of the straws were unusable. Unfortunately for the poor defendants who had guaranteed its obligations, the vendor had warranted that the straws were useable.

Some months after the purchase of the business, Dr Clark went shopping overseas to acquire a replacement stock of straws for about $400,000. It was the case however, that the replacement price for the straws at the time of breach would have amounted to about $1,000,000. Ouch. Unsurprisingly, Dr Clark sued the guarantors for damages for breach of warranty. The case went to the High Court on the question of how one calculates damages for the breach of the warranty.

The case had one particular complicating factor. It is illegal and unethical for Dr Clark to profit from the sale of human tissue in Australia. So, Dr Clark simply could not charge her patients more for a straw of semen, than she paid herself. But, she could recover the cost from her patients. It transpired that the good doctor did just that, but not a cent more.

So let's pause there for one moment. Dr Clark, who had purchased a business which included 1,996 straws of worthless semen, was able to replace those straws and recover the replacement cost from her clients. Let's compare that to her position if the straws had been useable. She would not have been able to charge her clients for them. Well she might have been able to charge something, but she could not have recovered their market price. Financially, except for the actual costs associated with administrative inconvenience of acquiring the replacement straws, Dr Clark was no better and no worse off whether the straws were useable or not. Economically, the effect of the breach of warranty was negligible for Dr Clark.

When the Court came to assess the quantum of damages, the High Court by a 4-1 majority said that that fact did not matter. The measure of damages was determined at the date of breach and was calculated to put the plaintiff in a position, as far as money could do, into the situation she would have been in, had the contract been performed. That is, the value of that which Dr Clark did not receive measured at the date of breach. In this case, the Court determined that that number was approximately $1,000,000, being the cost of acquiring the replacement of the straws at the date of delivery.

1 [2013] HCA 56

Level 7, 9 Hunter Street
Sydney NSW 2000
Australia
DX 707 Sydney

T +61 2 9222 8000
F +61 2 9222 8008
W diamondconway.com.au
E mail@diamondconway.com.au

Accredited specialists in:
Business Law, Family Law, Immigration Law and Wills and Estates Law

Liability limited by a Scheme approved under Professional Standards Legislation

Hayne J saw the subsequent purchase of the replacement straws as not impacting on the question of damages as it "left her neither better nor worse off than she was before she undertook the transactions."[2] For Hayne J, Dr Clark's actions in purchasing replacement straws and recovering the cost of them cancelled themselves out and left her in the same position she was financially at the date of breach.

For Crennan and Bell JJ, putting Dr Clark into the same positon as if the contract had been performed manifested itself as the difference between the market price of the straws at the time of contractual delivery less the contract price. The personal circumstances of Dr Clark, were irrelevant:

"It is the plaintiff's objectively determined expectation of recoupment of expenses which is protected by an award of damages for loss of a bargain. This explains the prima facie measure of damages at common law in respect of a sale of goods stated in *Barrow v Arnaud*, and codified subsequently in sale of goods legislation. The measure is the market price of goods at the contractual time for delivery, less the contract price (if the latter has not been paid to the seller). This is the amount of money theoretically needed to put the promisee in the position which would have been achieved if the contract had been performed. Subject to being displaced for some reason, this is the applicable measure, notwithstanding the circumstance that a buyer is a non-profit organisation, or that the buyer is constrained in relation to market regulation and control as to the price at which the buyer could sell to a subsequent purchaser."[3]

So for Crennan and Bell JJ, Dr Clark's subjective circumstances and the constraints on her ability to profit from the semen, did not affect her fundamental contractual right to have been supplied with the 1,996 straws of usable semen.

"Regulatory constraints on a promisee's subsequent dealings with goods have no necessary relationship with the market price which a promisee may pay to be in as good a position as if a promisor had performed"[4]

What the Court did was mandate a financial windfall for Dr Clark. The good Dr Clark, was materially financially better off as a result of the breach of warranty, than would have been the case if there had been no breach. The Court calculated her damages based on the replacement price of the warranted straws, irrespective of the fact that she suffered no financial detriment from the breach and could not have profited from the value of the straws that were supplied to her.

It was Gageler J alone, who was able to find the flexibility to see that it is the loss to the plaintiff that is the object of the exercise.

"The assessment of compensatory damages for breach of contract at common law is accordingly subject to the "ruling principle" that the injured party "is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed" as well as to its corollary that the injured party "**is not entitled, by the award of damages upon breach, to be placed in a superior position to that which he or she would have been in had the contract been performed**"[5] [my emphasis]

Except for Gageler J, each of the Justices found that Dr Clarke's personal circumstances to be wholly irrelevant in determining the damages she received!

Let me say that again if it hasn't sunk in. In applying the rule that damages are calculated by reference to the amount of money required to put you into the position as if the bargain had been performed, the Court has mandated that the actual impact of the breach on financial position of the plaintiff does not matter.

2 At [19]
3 At [28]
4 At [38]
5 At [60]

Windfall anyone?

The good thing from all of this is that it will be fairly rare that the subjective circumstances of the parties are relevant to the calculation of damages. Mostly, the damages will be the same, irrespective of the particular circumstances of the buyer. Accordingly, I suspect that this decision will not be a fertile branch of bad law, haunting the lower Courts and litigants for years to come.

However, there is another aspect of the decision that is less striking but perhaps has greater long term implications. The High Court determined damages by reference to the value of the straws. But of course, Dr Clark did not buy straws. Well yes, she bought straws, but only in the way that you buy tyres when you buy a car. What Dr Clark bought was a business.

So what the High Court has ruled is that that you can isolate any warranted item and independently assess the effect of a breach of that warranty on that item, independently of the overall transaction taking place. And it doesn't matter that the parties themselves didn't separately assign a value to the particular item.

It is possible to envision circumstances when this approach would be appropriate (for example when the buyer has spotted a particular item of value and has done a particularly good deal). But really, shouldn't the damages have been assessed by reference to the difference between the value of the business as warranted (ie with good straws) and the market value of the business as sold (ie with the useless straws)? Or to put it another way, shouldn't the damages reflect the impact of the straws on the value of the business? That way, other aspects of the bargain, which might have been traded off in the sale are properly brought to account between the parties. Further, assessing damages in this way, more accurately reflects the way that the parties themselves valued their bargain.

If this case was looked at in that way, how is it possible that the straws themselves (which were only one of the business's assets) could independently be worth more than the sale price of the business (which included that straws)? Of course, it could not. But it appears that the High Court has created a muddle that will be blighting us for the foreseeable future.

Vendors need to be particularly careful with warranties after this decision.

Disclaimer

This document was prepared by Diamond Conway Lawyers. It contains information of a general nature only and is not intended to be used as advice on specific issues. Opinions expressed are subject to change. Although Diamond Conway gathered the information contained in this document from sources deemed reliable, and has taken every care in preparing the document, it does not guarantee the document's accuracy or completeness. Diamond Conway disclaims responsibility for any errors or omissions.