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Damaged goods: High price paid for warranty breach

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NEED TO KNOW

Breach of contract

- *Damages should put the promisee, so far as possible, in the same situation as if the contract had been performed.*
- *Losses from breach of contract recouped through separate commercial transactions by the appellant don't impact on the amount of damages awarded.*
- *Mitigating risk by purchasing similar assets from alternative sources will not be viewed negatively by the courts.*

The High Court has affirmed the principles applied in assessment of damages for breach of contract.

Addressing unusual subject matter, donor sperm used in assisted reproductive technologies (ART), the majority High Court decision in *Clark v Macourt* [2013] HCA 56 confirms the manner in which damages are to be calculated for breach of contract.

The decision illustrates the importance of understanding the way in which the ruling principle can be applied in assessing damages, particularly in unique and factually complex cases.

It also suggests it is appropriate to advise clients to be proactive and mitigate loss if damaged goods are received in breach of contract - purchasing similar assets from alternative sources will not be viewed negatively by the courts. The maxim pacta sunt servanda illustrates the importance our legal system places on preserving the agreements struck by commercial parties. For a practitioner's client, this means that the law of damages will endeavour to place them in as good a position as if the promise had actually been performed.

Facts

The appellant, Dr Clark, and respondent, Macourt, conducted ART medical practices in Sydney. ART treatments are used to induce pregnancy by means other than sexual intercourse and include intrauterine insemination methods. Sperm donated by donors unknown to the patients is commonly used in such procedures. This sperm is usually frozen and stored in containers resembling 'straws'.

In January 2002, Dr Clark and St George Fertility Centre Pty Ltd (a company controlled by the respondent) entered into a deed under which Dr Clark agreed to purchase and St George agreed to sell 'assets' used in or attached to St George's ART practice. The purchase price was to be calculated based on a percentage of Dr Clark's gross fee income in the years following entry into the deed. Under the deed, assets included but were not limited to business records, donor and patient screening records, embryos and sperm. The respondent guaranteed the performance of St George's obligations under the deed. During the course of the litigation, St George went into liquidation.

On completion, St George delivered 3,513 straws of donor sperm. Following completion, the appellant determined that she was only able to use 504 straws, the remaining straws were unusable and non-compliant with the regulatory regime which governed ART practices.

Meanwhile, the appellant had exhausted her stock of usable sperm straws and was unable to find any suitable sperm in Australia that complied with regulatory and legislative requirements. US-based Xytex Corporation was the only supplier of compliant sperm and the appellant began purchasing sperm from it.

Hearing on liability

As a result of what Dr Clark regarded to be breaches of warranty and other obligations under the deed, she only paid $167,000 of what was calculated to be the purchase price and refused to pay the outstanding amount of $219,920. In 2006, St George initiated proceedings against Dr Clark for the remainder of the purchase price. The

appellant counter-claimed against St George and the respondent for damages for breach of warranties under the deed relating to the assets, specifically the sperm.

In 2010, Macready AsJ found St George, and the respondent as guarantor of St George's obligations, liable for various breaches under the deed, including breaches in relation to maintenance of patient records, donor identification requirements, donor consents and screening tests with the respondent acknowledging that "sperm donor records were not maintained in each case as required".[1]

Quantum hearing

The matter was listed for a hearing to determine the extent of the respondent's loss and damage. Gzell J assessed the damages for breach of warranty to be the amount the appellant would have had to pay Xytex to buy 1,996 straws of sperm at the time the contract was breached - this was the amount of "St George sperm" Gzell J held the appellant would have been able to use in her practice due to the operation of the 10-family limit she observed and which was later imposed by the RTAC Code of Practice.[2]

Gzell J awarded damages of $1,020,252. The award of damages for breach of warranty of a specific asset under the deed for an amount higher than the purchase price payable under the deed featured in both the majority in the Court of Appeal and dissenting judgment in the High Court, with the respondent describing the amount as "counter-intuitive".[3]

NSW Court of Appeal judgment

On appeal, the NSW Court of Appeal held that the primary judge had incorrectly characterised the deed as a sale of goods when, in fact, it was a sale of assets of a business. As such, the question of damages could not be assessed as if there had been a contract for the sale of goods.[4] Further, the manner in which the deed was drafted made it difficult to determine what portion of the purchase price could be attributed to the sperm.[5] The court thus reasoned the appellant had not paid anything for the sperm and therefore the appellant did not suffer any loss as the sperm was deemed valueless.[6]

Their Honours also held that the appellant had suffered no loss since she had successfully mitigated it by recovering her expenditure on the Xytex sperm from her patients during the administration of ART treatments.

High Court judgment

The High Court examined the following issues:

- What is the measure of damages recoverable by a purchaser of assets of a business where the vendor has failed to meet its obligations in relation to the delivery of stock of the business? Namely, is it the amount the appellant was unable to recover in using assets in the business or the cost of purchasing compliant assets at the date of breach?
- Did the appellant mitigate her loss by charging her patients fees covering the cost of the replacement Xytex sperm?

The appellant was successful in a majority 4:1 judgment of the court. Further, the appellant was granted an indemnity costs order from 2009.

The majority

Hayne J said the fundamental dispute between the parties was how to apply the ruling principle, not a new examination or a modification to any principle of the law of damages. The difficulty encountered in applying these principles stemmed from a failure to identify the 'loss' when considering compensation for it.[7] His Honour held that, subject to some limitations, damages for breach of contract must be measured by reference to the loss of the value of what the promisee would have received if the promise had been performed.[8] In considering the relevant value of what the appellant did not receive, Hayne J regarded the trial judge's use of the 1,996 straws of replacement Xytex sperm as correct.

For Keane J, the key issue in the appeal was the measure of damages recoverable by a purchaser of assets of a business where the vendor has failed to meet its obligations in relation to the delivery of stock of the business.[9] In their respective judgments, Crennan & Bell JJ and Keane J confirmed the principle in *Tabcorp Holdings Ltd v Bowen Investments Pty Ltd* (2009) 236 CLR 272, which originated in *Robinson v Harman*(1848) 1 Exch 850; 154 ER 363, that damages for breach of contract are to put the promisee, so far as money can do it, in the same situation as if the contract had been performed. The measure is therefore the market price of goods at the time of delivery, less the contract price (if the latter had not been paid to the seller).[10] This is the amount theoretically needed to put the promisee in the position which would have been achieved if the contract had been performed.

The fact that the current case does not involve the transfer of marketable commodities should not and does not displace the effect of the ruling principle.[11]

Keane J also rejected the Court of Appeal's view that the appellant did not suffer any loss because the sperm was 'valueless'. It is uncontroversial to state that the ruling principle is concerned with providing the promisee with compensation for the loss of a benefit; it does not require an apportionment of the components of the bargain. The appellant therefore was not obligated to demonstrate that a portion of the purchase price of the sale of business and assets was the specific amount earmarked for the sperm as her loss is measured to be the value of what St George had promised to deliver to her but failed to do so. The Court of Appeal's finding that there was no way of determining under the deed how much the appellant paid for the 'valueless' sperm is immaterial to the true measure of damages to which the appellant was entitled.[12]

In further contrast to the Court of Appeal's reasoning, the majority of the High Court did not consider the appeal to turn on any distinction between a contract for the sale of goods and a contract for the sale of a business. The ruling principle governing the assessment of damages is applicable in both cases. The High Court also affirmed the primary judge's position that damages should be assessed at the date of breach of contract.

In response to the respondent's contention that the appellant had wholly mitigated her loss by passing on to her patients the reasonable costs of procuring the replacement Xytex sperm, the majority of the High Court held that this approach failed to take into account that the circumstances of the appellant's subsequent dealings with her patients did not avoid, increase or diminish the loss of her bargain for delivery of compliant St George sperm. Moreover, the regulatory and legislative constraints encountered by the appellant on the trade and use of human tissue such as sperm in her medical practice had no necessary relationship with the market price which she may pay to be in as good a position as if St George had performed its promise to deliver sperm compliant with the warranties under the deed.[13]

The High Court also held that it was irrelevant that the appellant recouped the money paid by her for the replacement Xytex sperm from her patients because, if the contract had been performed according to its terms, she would have had compliant St George sperm to use and dispose of as she chose. The respondent further failed to establish an argument of betterment, that is, that the appellant was better off using the replacement Xytex sperm in patient treatments than she would have been if she had used compliant St George sperm.

Gageler J's dissent

In his dissenting judgment, Gageler J did not consider the case fell within the standard category of cases. Namely, that damages can be measured as the difference at the date of delivery, between what the appellant would have obtained in a hypothetical sale of contractually non-compliant goods delivered and what the appellant would have paid in a hypothetical purchase to obtain delivery of contractually compliant goods from another seller. In his Honour's opinion, "the critical difference lies in the limited value to the buyer (Dr Clark) of the performance of the contract by the seller (the company) given the peculiar nature of the asset (frozen sperm) which the company was obliged to deliver under the contract".[14] His Honour reasoned that the value to the appellant was the obtainment of compliant sperm to use in ART treatments for her patients. The appellant would have therefore had the benefit of being relieved of the need to source sperm from Xytex. The appellant was only worse off to the extent that she was obliged to incur but could not recoup from her patients the cost of the Xytex replacement sperm.

A misguided "appeal to intuition"?

How does one view the respondent's submission that it is counter-intuitive that a contract for the sale of assets of a business for a total amount of $386,950 gives rise to an award for damages of $1,246,025 for breach of warranty?

Keane J deals with this head-on stating, "This appeal to intuition is unsupported by evidence ... the fundamental value protected by the law of contract is that pacta sunt servanda, bargains are to be kept. That the contract crystallises a state of affairs in which the purchaser's gain is the vendor's loss is a characteristic of commerce in a capitalistic economy".[15] His Honour also explained that the appellant was obliged to purchase sperm from Xytex and to pay additional storage and transport costs exacerbated by an exchange rate unfavourable to the Australian dollar. This appeal to intuition also ignores the possibility that the appellant could have successfully deployed the St George sperm at a higher turnover now that she had expanded her business by acquiring a competitor. Lastly, the respondent would not have sought the true value of the St George sperm had the respondent and St George kept their contractual obligations.[16]

ENDNOTES

1. *St George Fertility Centre Pty Ltd v Clark* [2011] NSWSC 1276 at [33]; *Macourt v Clark* [2012] NSWCA 367 at [18] and [28].

2. *St George Fertility Centre Pty Ltd v Clark* [2011] NSWSC 1276 at [34]-[36], [47]-[48]; *Macourt v Clark*[2012] NSWCA 367 at [29]-[30] and [148]. "RTAC" is the Reproductive Technology Accreditation Committee, being one of the bodies which regulates ART practices in Australia.
3. *Clark v Macourt* [2013] HCA 56 at [135].
4. *Macourt v Clark* [2012] NSWCA 367 at [8]-[10], [49]-[50] and [67].
5. Ibid at [66].
6. Ibid at [64]-[68].
7. Above n.3 at [8].
8. Ibid at [10]-[12].
9. Ibid at [75].
10. Ibid at [28]; See also *Barrow v Arnaud* (1846) 8 QB 595 at 609-610; McGregor, *McGregor on Damages*, 18th ed, (2009) at 780 [20-004].
11. Above n.3 at [107]; see also *Bellgrove v Eldridge* (1954) 90 CLR 613 at [617]-[618].
12. Above n.3 at [112].
13. Ibid at [38].
14. Ibid at [68].
15. Ibid at [135].
16. Ibid at [135]-[138].