

AN UNSOUND RULE FOR THE ASSESSMENT OF CONTRACT DAMAGES

*David McLauchlan**

This article challenges the long-standing rule concerning the assessment of damages for breach of contract that, where the contract allows for alternative methods of performance by the promisor, damages are to be calculated by reference to the minimum level of performance provided for in the terms of the contract. It is argued that the rule is inconsistent with the compensatory principle and that, since it has been undermined by various qualifications or exceptions that severely curtail its operation, it would improve the coherence of the law of damages if it were abandoned.

I INTRODUCTION

In the recent case of *Forest Holdings Ltd v Mangatu Blocks Incorporation*¹ the Court of Appeal in a judgment delivered by Goddard J endorsed and applied the following statement of principle in *McGregor on Damages*:²

... where the defendant has the option of performing a contract in a variety of ways, damages for breach by him must be assessed on the assumption that he will perform it in the way most beneficial to himself and not in that most beneficial to the claimant. This was well settled in the 19th century, but finds its main applications later. The simplest illustration is that of the defendant who has promised to do one of two things and fails to do either. Here the damages will be assessed on the basis of the alternative less burdensome to the defendant.

The context was a claim for damages arising out of the defendant's premature termination of a contract conferring on the plaintiff a forestry right over land owned by the defendant. This constituted a

* Professor of Law, Victoria University of Wellington | Te Herenga Waka; Professorial Fellow, The University of Melbourne; Honorary Professor, The University of Queensland. This article revises and repeats the arguments first made by the author in "The Minimum Performance Rule in Contract Damages" [2019] LMCLQ 75.

1 *Forest Holdings Ltd v Mangatu Blocks* [2020] NZCA 212 at [36].

2 James Edelman *McGregor on Damages* (20th ed, Sweet & Maxwell, London, 2018) at [10–106].

wrongful repudiation because the defendant had failed to give the plaintiff 120 days' notice of default as required by the contract. The contract could only be terminated if the plaintiff's defaults were not remedied within that period. Despite an arbitrator's finding of fact that the defaults were not capable of being remedied in time, the plaintiff persisted with a claim for damages premised primarily on the contention that the defendant would not necessarily have terminated the contract on the expiry of the notice period. However, the Court of Appeal held that, in accordance with the principle stated in *McGregor*, damages should be calculated on the assumption that the defendant would have given the required notice on the day it purported to terminate the contract (10 July 2013) and that the contract would in fact have been validly terminated after 120 days.³ There was no need for a factual inquiry into whether either of these events would have been likely to occur.⁴ Accordingly, the various judgments in the High Court discussing the plaintiff's entitlement to, inter alia, loss of chance damages on the basis that it might have been able to persuade the defendant during the 120-day notice period not to terminate the contract "proceeded on an incorrect premise".⁵

This is a curious and unsatisfactory case. It is questionable whether the principle stated in *McGregor* required the Court to assume that the defendant's purported termination of the contract with immediate effect was, contrary to the facts, a notice giving the plaintiff 120 days to remedy the default.⁶ Be that as it may, however, most observers who are familiar with the law of damages for breach of contract are likely to regard the further ruling that the law presumes that the defendant would have cancelled after 120 days as uncontentious. They will accept unquestioningly that such damages are to be calculated by reference to the minimum level of performance consistent with the terms of the contract, ie, the performance "least burthensome"⁷ to the defendants. This rule, which finds its most common application in cases where the contract allows for alternative methods of performance by the defendant promisors, is usually said to be justified on the basis that defendants cannot be liable for not doing what they are not obliged to do.⁸ Accordingly, it is not by reference to what the defendants *would* have done if the contract had not been breached that damages are to be assessed. That is irrelevant. Rather it is what the defendants *could* have done without breaching the contract

³ *Forest Holdings Ltd*, above n 1, at [38].

⁴ At [38].

⁵ At [39].

⁶ In fact, the arbitrator had found that, on the balance of probabilities, the defendant "would have issued a notice to remedy *shortly after* 10 July 2013". See *Forest Holdings Ltd v Mangatu Blocks Incorporation* [2018] NZHC 3272 at [18] (emphasis added).

⁷ *Cockburn v Alexander* (1848) 6 CB 791 at 814, 136 ER 1459 (Comm Pleas) at 1469 per Maule J.

⁸ *Abrahams v Herbert Reiach Ltd* [1922] 1 KB 477 (CA) at 482 per Scrutton LJ.

that will determine the quantum of recovery. As Scrutton LJ explained in *Withers v General Theatre Corp Ltd*:⁹

Now where a defendant has alternative ways of performing a contract at his option, there is a well settled rule as to how the damages for breach of such a contract are to be assessed. ... A very common instance explaining how that works is this: A. undertakes to sell to B. 800 to 1200 tons of a certain commodity; he does not supply B. with any commodity. On what basis are the damages to be fixed? They are fixed in this way. A. would perform his contract if he supplied 800 tons, and the damages must therefore be assessed on the basis that he has not supplied 800 tons, and not on the basis that he has not supplied 1200 tons, not on the basis that he has not supplied the average, 1000 tons, and not on the basis that he might reasonably be expected, whatever the contract was, to supply more than 800 tons. The damages are assessed ... on the basis that the defendant will perform the contract in the way most beneficial to himself and not in the way that is most beneficial to the plaintiff.

His Lordship also gave the following example:¹⁰

[Consider] a lease for seven, fourteen or twenty-one years which is wrongfully determined at the end of five years by the landlord. On what basis are damages to be assessed? Answer: On the basis that the landlord can determine the lease in seven years, and therefore the plaintiff can only recover damages on the assumption that he had only two more years of the lease to run.

The rule has a long pedigree.¹¹ It has been endorsed on several occasions by the senior common law courts: for example, by the Supreme Court of Canada in *Hamilton v Open Window Bakery Ltd*¹²

9 *Withers v General Theatre Corp Ltd* [1933] 2 KB 536 (CA) at 548–549.

10 At 549–550.

11 See in addition to *Withers v General Theatre Corp Ltd*, above n 9: *Cockburn v Alexander*, above n 7; *Re Thornett & Fehr and Yuills Ltd* [1921] 1 KB 219 (KB); *Lavarack v Woods of Colchester Ltd* [1967] 1 QB 278 (CA); *Phoebus D Kyprianou Co v Wm H Pim Jnr & Co* [1977] 2 Lloyd's Rep 570 (QB) at 580–581; and *Mulvenna v Royal Bank of Scotland plc* [2003] EWCA Civ 1112. The rule was also accepted by the Court of Appeal in *Maredelanto Compania Naviera SA v Bergbau-Handel GmbH (The Mihalis Angelos)* [1971] 1 QB 164 (CA) (expressly by Edmund Davies LJ at 203 and implicitly by Lord Denning MR at 196), but the ruling that the shipowners could not recover substantial damages for the charterers' (assumed) repudiation was plainly based on the arbitrators' finding that, if the repudiation had not occurred, the charterers would "beyond doubt" have cancelled the charterparty pursuant to an express cancellation clause.

12 *Hamilton v Open Window Bakery Ltd* [2004] 1 SCR 303. See the persuasive critique of this case and the minimum performance rule by Michael G Pratt "Damages for Breach of Contract with Alternative Performances" in Jeff Berryman and Rick Bigwood (eds) *The Law of Remedies: New Directions in the Common Law* (Irwin Law, Toronto, 2010) 105. See also the excellent discussion of the rule by David Pearce "Of Ceilings and Flaws: An Analytical Approach to the Minimum Performance Rule in Contract Damages" (2016) 36 OJLS 781.

and the New Zealand Supreme Court in *Paper Reclaim Ltd v Aotearoa International Ltd*.¹³ In the latter case Blanchard J, delivering the judgment of the Court, described the rule as "well-settled" and, after noting its acceptance in leading texts,¹⁴ said:¹⁵

In *Lavarack v Woods of Colchester Ltd* [1967] 1 QB 278 (CA) at p 294 Diplock LJ said that the assumption to be made is that the defendant has performed or will perform his legal obligations under his contract with the plaintiff and nothing more. The principle goes at least as far back as *Cockburn v Alexander* (1848) 6 CB 791 and has recently been affirmed by the Supreme Court of Canada in *Hamilton v Open Window Bakery Ltd* [2004] 1 SCR 303. *The plaintiff is entitled only to the performance by the defendant which is the least burdensome for the defendant.*

Inherent in this and other standard formulations of the rule are two propositions. First, the court must assume that, but for the breach, the promisors would have chosen to perform at the minimum level necessary to satisfy their legal obligations and, secondly, that this level of performance is the one that is least burdensome (or more profitable) for the promisors. Strictly speaking, these propositions are logically disconnected because the former will not necessarily be determinative of the latter. The performance that is least burdensome for the promisors will be affected not simply by the scope of the promise but also by the circumstances pertaining at the time performance is required. Thus, in the case of Scrutton LJ's above example of the contract for 800 to 1,200 tons of a certain commodity, there might be any number of reasons why it would be less burdensome for the seller to deliver 1,200 tons. There might be cost savings in acquiring or, as the case may be, manufacturing the larger quantity. Or that quantity might already be in transit before the seller decides to divert it to another buyer at a higher price in circumstances where rendering the minimum performance would have resulted in the seller incurring substantial storage costs, perhaps greater than the increase in price from the second sale. Here, but for the breach, it would have been less burdensome for the seller to deliver 1,200 tons than 800 tons. This tends to suggest that what lies behind the minimum performance rule is primarily a concern to restrict the claimant's damages by reference to the level of performance

13 *Paper Reclaim Ltd v Aotearoa International Ltd* [2007] NZSC 26, [2007] 3 NZLR 169 at [23]. The position in Australia is less certain. The rule was accepted by the New South Wales Court of Appeal in *Biotechnology Australia Pty Ltd v Pace* (1988) 15 NSWLR 130 (NSWCA) and *TCN Channel 9 Pty Ltd v Hayden Enterprises Pty Ltd* (1989) 16 NSWLR 130 (NSWCA), but in the latter case subject to the qualification (at 156) that the rule "does not require the assessment of damages to be based on a fiction in disregard of the actual facts". The Court accepted the plaintiffs' argument (at 150) that it should not be assumed that "a defendant would have adopted one method of performance when the facts belie that possibility".

14 *Paper Reclaim Ltd*, above n 13, at [23]; Harvey McGregor *McGregor on Damages* (17th ed, Sweet & Maxwell, London, 2003) at [8–060] (see now 20th ed, above n 2, at [10–106]); and HG Beale (ed) *Chitty on Contracts* (29th ed, Sweet & Maxwell, London, 2004) at [26–041] (see now 32nd ed, 2015, at [26–075]).

15 *Paper Reclaim Ltd*, above n 13, at [23], n 30 (emphasis added).

that would have complied with the terms of the contract entered into rather than a concern to minimise the burden to the defendant that rendering the alternative performance might entail.

Be that as it may, in this article it will be suggested that the rule is unsound and ought no longer to be followed. Two main arguments are made. First, the rule is inconsistent with the compensatory principle under which damages for breach of contract are to be assessed. Secondly, in any event, it has been undermined by various qualifications or exceptions so that little of substance remains and therefore expositions of the law that commence with a statement of the rule are potentially misleading.

II AN EXCEPTION TO THE COMPENSATORY PRINCIPLE?

It is axiomatic that the purpose of damages for breach of contract is to put the claimants in the same position that they would have occupied if the breach had not occurred. This "compensatory principle" was described by Lord Bingham in the well-known case of *The Golden Victory* as "the governing principle in contract".¹⁶ In the case of claims for alleged financial loss, and assuming that there are no issues concerning remoteness or mitigation, application of the principle requires the court to determine and award a sum that represents the difference between the claimants' actual position as a result of the breach (their "breach position") and their position if the contract had not been breached (their "non-breach position").¹⁷ Determination of the latter will usually focus solely on the question concerning the extent to which the claimants would have been better off if the contract had been performed: for example, how much more valuable would the subject matter have been, or what greater profits would have been made, if it had the warranted quality? There will be no issue as to how the defendants would have acted if there had been no breach because that will be fixed by the terms of the contract that prescribe the promised performance.

However, that will not be so where the contract gives the defendants a discretion as to the level of performance to be provided. A contract for the sale of goods may give the sellers an option to deliver *x* or *y* quantity, or an employment contract may provide for payment of discretionary bonuses or an entitlement to participate in a pension scheme that may be discontinued at any time by the employer. Here, a counterfactual question does *prima facie* arise as to how the defendants would have acted if they had not refused to deliver the goods or they had not wrongfully dismissed the employee, as the

16 *Golden Strait Corp v Nippon Yusen Kubishika Kaisha (The Golden Victory)* [2007] UKHL 12, [2007] 2 AC 353 at [9]. The other Law Lords expressed similar sentiments. Thus, the principle was described by Lord Scott (at [29]) and Lord Brown (at [83]) as "fundamental" and by Lord Scott as "overriding" (at [35] and [37]) and "clear" (at [38]).

17 This terminology originates in Andrew Dyson and Adam Kramer "There is No 'Breach Date Rule': Mitigation, Difference in Value and Date of Assessment" (2014) 130 LQR 259 at 261.

case may be.¹⁸ Nevertheless, according to the minimum performance rule that question need not be addressed because it must be assumed that the defendants would have provided the least extensive (or least burdensome) performance consistent with the terms of the contract. Thus, in the above example where the sellers repudiate a contract under which they undertook to deliver *x* quantity of goods or (the larger) *y* quantity, damages must be assessed on the basis that they would have chosen to deliver the former. Of course, if the court were to ask the counterfactual question, the same conclusion might well be justified because the reality is that sellers who are faced with the realisation or advice that they will be liable in damages if they do not perform, will ordinarily choose to provide the minimum level of performance, ie, they will deliver *x* quantity. But what if there is compelling evidence that, but for the breach, they would more likely have chosen to deliver *y* quantity because, for example, it would have been more cost efficient to manufacture, or buy in, that larger quantity? The minimum performance rule says that this is irrelevant. It suffices that the sellers *could* have delivered the lower quantity without breaching the contract. However, this seems beside the point if the compensatory principle is being applied because here the task of the court is to determine what on the balance of probabilities *would* have happened if the breach had not occurred. And since the evidence establishes that, had the sellers chosen to perform rather than render themselves liable to pay damages, they would likely have delivered *y* quantity, the buyers' damages should in principle be assessed on that basis. The position should be no different than in the reverse situation where the terms of the contract repudiated by the seller entitled the buyer to nominate *x* or *y* quantity. Here the measure of damages should require a determination of the quantity that the buyer would have nominated if the contract had not been repudiated.¹⁹

18 See the discussion of this question, and the assumptions on which it should be approached, by Pratt, above n 12, at 120–123. The author suggests (at 120) that "[i]t seems paradoxical to ask how a promisor who (for whatever reason) opted *not* to perform *would* have performed if he *had* performed" and later concludes (at 123) that:

In order to determine how the breaching promisor would have chosen to perform, the court must hold the past entirely fixed except that it must assume that at the time that performance became due, the promisor was compelled to perform his promise, and thus to choose how to perform it.

Query, however, whether the question is "paradoxical" since the assumption regarding performance is inherent in the very nature of a counterfactual question. It is also debatable whether it is strictly correct to build into the counterfactual the notion of the defendant preferring not to perform, or being compelled to perform, as opposed to performing willingly. See further text following n 71 below.

19 Compare *Kyprianou*, above n 11. In an action for damages by the sellers in respect of the buyers' non-acceptance of specified quantities of beans "10 per cent more or less at buyers' option", Kerr J accepted the buyers' argument that, since their legal obligation was to take 90 per cent of the specified quantities, damages should be assessed on that basis "because it must be assumed in their favour that they would have performed the contract in the way most beneficial to themselves" (at 581). According to the minimum performance rule "the probability as to what would have happened if the buyers had performed clearly appears to be irrelevant" (at 581).

III THE ALLEGED JUSTIFICATION FOR THE RULE

As foreshadowed, the commonly expressed justification for the minimum performance rule is that promisors cannot be liable for their failure to do something that they did not promise to do so that, where the contract provides for alternative methods of performance, the promisees' loss must necessarily be assessed on the basis of the minimum that was promised. As Diplock LJ explained in *Lavarack v Woods of Colchester Ltd*, a claimant is "only entitled to be compensated for the loss of those benefits which he would have been legally entitled to claim if his contract had been performed".²⁰

It will be noted that the previous paragraph contains two related propositions. First, one cannot be liable for failing to do what was not promised. Secondly, and seemingly as a corollary of the first, damages cannot be recovered in respect of lost benefits that were not the subject of a contractual promise.²¹ It will be argued below that both propositions require qualification and that they do not justify a minimum performance rule.

A No Liability for Failing to Do What Was Not Promised

In his convincing critique of the minimum performance rule, Professor Michael Pratt gave the following example.²² "Suppose that I agree to supply you with two, three, or four widgets, at my discretion" and that "you have good reason to believe that I will choose to supply you with four widgets". It is clear that I am not in breach if I deliver only two widgets. I have performed my promise. But what if I repudiate the contract and fail to supply any widgets at all? Might there be circumstances in which you ought to be able to recover damages for my failure to supply four widgets? The answer,

²⁰ *Lavarack*, above n 11, at 296.

²¹ It was on these assumptions that the Supreme Court of Canada in *Hamilton*, above n 12, at [14]–[15] curiously described the plaintiff's argument that the assessment of damages necessitated "an inquiry into how the defendant would likely have performed his or her obligations under the contract, hypothetically, but for his or her repudiation" as involving a "tort-like analysis". The Court appears to have been contrasting the tort damages inquiry into what the plaintiff's position would have been if the wrong had not been committed with the position in cases of "breach of contracts with alternative performances" where "it is not necessary that the non-breaching party be restored to the position they would likely, as a matter of fact, have been in but for the repudiation" (at [17]). Thus, the phrase "tort-like analysis" was a description of the *consequence* of the minimum performance rule, not a *justification* for it. Since both the tort and contract measures of damages have the same basic purpose of putting the plaintiffs in the position they would have been in if the wrong—the tort or breach of contract—had not been committed, it would have been simpler to say that the ordinary contract measure is *displaced* where the contract provides for alternative methods of performance.

²² Pratt, above n 12, at 115.

in principle, is yes where there is evidence establishing that if I had not repudiated the contract I would likely have delivered four widgets. As Michael Pratt explains:²³

By holding me liable at the remedial stage for depriving you of four widgets, the law is not holding me to a promise (to provide four widgets) that I did not make. Rather, it is responding to the fact that had I not breached I would have performed the promise (to supply two, three, or four widgets) that I did make by supplying you with four widgets.

It might be objected that by supplying you with four widgets I would not be *performing* my promise but *exceeding* it. When I agree to provide you with two, three, or four widgets I give you reason to believe that I might, at my sole discretion, decide to supply you with three or four widgets, but I *only promise* to provide you with two. Two widgets is the extent of my legal commitment. Since my promise extends only to two widgets, moreover, it follows that my breach deprives you of only two widgets and your damages must be assessed on that basis.

This objection is mistaken. It does not follow from the fact that I only promised to provide you with two widgets so my breach deprived you of only two widgets. Clearly one can perform a promise by exceeding its minimum requirements, that is, by doing more than what was promised. Had I supplied you with, say, four widgets I would have performed my promise. (I did not promise *not* to provide more than two widgets, after all.) And since I could have performed my promise by exceeding its minimum performance, it follows that my breach could have deprived you of more than this minimum performance. But for my breach I might have supplied you with two, three, or four widgets. Moreover, if the evidence reveals that I would have supplied you with, say, four widgets had I not breached, then my breach deprived you of four widgets, not two, and your damages ought to reflect this loss.

Of course, in the absence of such evidence, the court is well justified in confining the damages to the loss resulting from the failure to supply two widgets, but this ought not to be because there is a minimum performance *rule* but because it is the reasonable or normal inference as to what would likely have happened absent that evidence.

23 At 115–116. See also the similar conclusion, albeit explained in more complex Hohfeldian terms, of Pearce, above n 12. In general terms, the author argues (at 783) that:

... where a promise provides for alternative ways of performance, the promisee may be seen to enjoy contingent rights to each alternative, and not, as the minimum performance rule holds, merely a right to the least onerous alternative. Given that the claimant's damages should reflect 'the value of the contractual benefit to which he was entitled but of which he has been deprived' [*The Golden Victory*, above n 16, at [32] per Lord Scott], it follows that the claimant is entitled to compensation which reflects the value of his contingent right to the alternative which the defendant would have chosen. In this way, damages are to be based on how the defendant *would*, and not *could*, have performed his promise.

B No Liability for Benefits That Were Not the Subject of a Contractual Promise

In principle, the fact that the lost benefits in respect of which damages are claimed were not the subject of a contractual promise will not necessarily prevent recovery of those benefits where they represent reasonably foreseeable consequential losses arising from the breach of a promise that was made. Thus, if I repudiate my contract to provide you with a machine that I am aware, or at least ought to be aware, is required for your manufacturing business, I will be liable to pay damages for profits lost until you are able to mitigate your loss by acquiring a replacement machine elsewhere. It is irrelevant that I made no promise that you would make the profits in question. My liability is only subject to the doctrines of remoteness and mitigation of damage (assuming, of course, that the contract did not limit or exclude liability). As Michael Pratt explains:²⁴

The problem with the argument from the scope of the promise is that it fails to properly distinguish between the scope of a promise and the extent of the damages for its breach. The scope of a promise defines the extent of the promisor's primary obligation to perform and thus the circumstances under which he acquires a secondary obligation to pay damages. But it does not define the extent of those damages. The amount of damages payable on breach is a function, not of the scope of the promisor's primary obligation, but of the profit or value that would have accrued to the promisee if the promisor had satisfied that obligation. This value is not part of what is promised and the promisor acquires no primary obligation to provide it. The seller who agrees to supply machinery to a manufacturer does not promise the manufacturer the profits that the machinery will yield when it goes on line. Having breached its promise, however, the seller is liable for damages assessed on the basis that it deprived the manufacturer of these unpromised profits.

A logical corollary of this argument is that such consequential loss might extend to loss of what we might term an entirely non-contractual benefit. Thus, a wrongfully dismissed employee might recover in respect of the loss of the bonus that the employer generously and habitually gave to all his employees at Christmas time. It also follows that consequential loss might extend to loss flowing from the failure to provide an alternative, more onerous performance where it is established that, if the contract had not been repudiated, this alternative performance would have been provided. For example, if the defendant repudiated a contract to provide two or three machines for use in the claimant's manufacturing business, there seems no reason in principle why the latter should not be

24 Pratt, above n 12, at 116–117. Pearce, above n 12, at 793 puts the same point as follows:

There is nothing intrinsically heterodox in the principle that the content of the secondary obligation to compensate may reflect a level of performance greater than that which would have been sufficient to discharge the primary obligation to perform. What would constitute the floor as regards discharge of the primary obligation need not represent the ceiling for the secondary obligation.

able to recover profits lost from its inability to use three machines if, but for the breach, that was the number that would likely have been provided.

The argument that no claim can be made in respect of unpromised benefits has also arisen in the context of other aspects of the law of damages. The most interesting of these concerns claims for wasted expenditure (so-called "reliance damages") and, in particular, the validity of the High Court of Australia's decision in the leading case of *Commonwealth of Australia v Amann Aviation Pty Ltd*.²⁵ So far as material for present purposes, the case concerned the wrongful repudiation by the Commonwealth of a contract under which Amann was to provide aerial surveillance services for a term of three years. Amann's claim for damages of over \$5.2 million in respect of expenditure wasted in preparing to perform the contract (plus certain breach-related costs) faced a number of difficulties, including that, on the surface, only about \$1.3 million of the expenditure would have been recouped if the contract had been performed. The contract was prima facie a losing one because the total expenditure required to perform the contract was some \$3.9 million more than the contractual remuneration and, most importantly, the contract contained no right of renewal. Nevertheless, the High Court, by a majority of 4:3, upheld the award by the Full Court of the Federal Court of the full amount of the wasted expenditure. On the basis of previous well established authority,²⁶ Amann were entitled to the benefit of a presumption of recoupment and the Commonwealth had failed to discharge the onus placed on them of proving on the balance of probabilities that the net value of the benefits to Amann from the contract would not have covered the expenditure incurred by the latter prior to the cancellation. This was primarily because, although there was no *right* of renewal, the *prospect* of renewal was a significant commercial advantage that had been lost as a result of the Commonwealth's repudiation and, since the value of that advantage could not be accurately quantified, the

25 *Commonwealth of Australia v Amann Aviation Pty Ltd* (1991) 174 CLR 64.

26 *Bowlay Logging Ltd v Domtar Ltd* (1978) 87 DLR (3d) 325 (BCSC), aff'd (1982) 135 DLR (3d) 179 (BCCA); *C & P Haulage (a firm) v Middleton* [1983] 1 WLR 1461 (CA); and *CCC Films (London) Ltd v Impact Quadrant Films Ltd* [1985] QB 16 (QB).

Commonwealth could not discharge the onus of proving that the benefits accruing to Amann were less valuable than the expenditure incurred.²⁷

It has recently been argued that the only benefits that should be taken into account in determining whether the presumption of recoupment might be capable of rebuttal by the defendant are those that the latter has expressly or impliedly promised to provide.²⁸ Consequential benefits that the claimant expected to derive from the defendant's performance, but were not the subject of a promise, should not be considered. As a result, strong exception is taken to the ruling by Mason CJ and Dawson, Brennan and Deane JJ in *Amann Aviation* that the prospect of renewal of the surveillance contract was a significant commercial advantage that had been lost as a result of the Commonwealth's repudiation and therefore should be brought into account in determining whether the presumption of recoupment had been rebutted.²⁹ It did not suffice, as Mason CJ and Dawson J held, that the benefit was within the reasonable contemplation of the parties.

If this is correct, the case was wrongly decided because only Brennan J found that the prospect of renewal was the subject of an implied promise. It ought to have been held that the presumption of recoupment had been rebutted since the only other benefit of the contract to Amann was the remuneration payable by the Commonwealth and this was less than the total of the expenditure that had been incurred and remained to be incurred. In my view, however, it should suffice that the prospect of renewal was judged to be a valuable benefit *in fact* that would have accrued to Amann if the contract had been performed. One might argue that the commercial advantage was not as

27 The significance of the prospect of renewal appears to have been misunderstood by some commentators. Thus, Hugh Davis "The Problems with *Amann*: Would an Agreement-Centred Approach to Remoteness Benefit Australian Jurisprudence?" (2017) 42(2) *Univ of Western Australia L Rev* 1 at 10 suggests that "the Court found that the defendant, having repudiated the contract, was liable for the loss suffered by Amann based on the possibility the contract might otherwise have been renewed" so that "a party to a contract can be liable for the consequences of its not doing what it was not required to do, merely because they are not otherwise unforeseeable". See also Andrew Tettenborn "*Hadley v Baxendale* Foreseeability: a Principle Beyond Its Sell-by Date?" (2007) 23 *JCL* 120 at 136, n 84:

A defendant, having repudiated an ongoing contract, was held liable for losses based on the prospect that the contract might otherwise have been renewed, despite the fact that it was under no obligation to renew it at all, on the ground that those losses were foreseeable.

In fact it was common ground that Amann had no claim in respect of losses incurred through not getting a renewal, precisely because no promise of renewal had been made. What the majority held was that the prospect of renewal was a valuable commercial advantage that had to be taken into account in determining whether the presumption of recoupment had been rebutted by the defendant.

28 David Winterton "*Commonwealth v Amann Aviation Pty Ltd* Twenty Five Years On: Re-examining the Problem of Pre-breach Expenditure in Contract Law" in Simone Degeling, James Edelman and James Goudkamp (eds) *Contract in Commercial Law* (Thomson Reuters, Sydney, 2016) 333 at 339–343.

29 *Amann Aviation*, above n 25. Deane J also referred to the prospect that the aeroplanes would be worth much more than the assumed salvage value at the end of the three-year term. See further n 33 below.

substantial as some of the Judges suggested, but that is beside the point. In determining whether a presumption of recoupment has been rebutted, the court is surely entitled to have regard to all benefits of financial value that would have resulted from performance by the defendant of its obligations.

It is interesting in this context to consider the reasoning of Brennan J. It is true that his Honour referred at various stages to an implied promise of the commercial advantage. For example, he said:³⁰

The Commonwealth's promise to engage Amann to provide the service for three years *carried with it the promise* that Amann, by performing the contract, could work itself into a secure position as an equipped and established provider of the service and could thereby acquire a most substantial advantage in tendering for any succeeding contract. This was not an incidental benefit flowing merely from a trader's reputation as a successful contractor; it was *a benefit which was implicit in Amann's right to perform the particular contract*, having regard to the nature of the work, the capital and equipment required to perform it, the Commonwealth's practice of letting tenders for the work and the limited competition among tenderers to do it.

However, he also said:³¹

The relevant principle is that when *performance* of a contract by a defendant (including the permitting of the plaintiff to perform his obligations under the contract) would have *resulted* in the plaintiff's acquiring a particular commercial advantage but the advantage is lost by reason of the defendant's breach, the loss of the advantage is compensable and its value is to be taken into account in assessing a plaintiff's damages.

And earlier he said:³²

In evaluating a plaintiff's benefits under a contract, the court does not look solely at the express terms of the contract but evaluates the plaintiff's rights to benefits of any kind, whether those benefits are expressed by the terms of the contract or are ascertainable by reference to circumstances extrinsic to those terms. Thus a hairdresser's assistant who was wrongfully dismissed was held entitled to recover not only damages for lost wages but also a sum representing the tips which he would have received, and an artist's opportunity of gaining fame and reputation by performing a theatrical engagement must be evaluated in assessing damages when the engagement is wrongfully terminated ... In cases of this kind, the contract is found to contain by implication a promise to give the plaintiff an opportunity to acquire the unexpressed benefit ... and damages are awarded for breach of that promise.

What the Judge said, in effect, is that where performance of a contract will result in the promisee acquiring a particular (one would assume, reasonably foreseeable) unexpressed benefit, a term will be

30 At 111–112 (emphasis added).

31 At 104 (emphasis added).

32 At 102.

implied that obliges the promisor to give the promisee the opportunity to acquire that benefit. This seems to be an overly elaborate way of saying that anticipated, but unexpressed, benefits of a contract that are lost as a result of the defendant's non-performance may be the subject of a damages award.³³ The reality is that, in the two examples referred to in the last quoted passage, damages are awarded for the foreseeable consequential losses resulting from the wrongful termination, not for breach of the posited implied term. And, if that is correct, the value of consequential benefits that would have resulted from performance should, in principle, be brought into account in a case like *Amann Aviation* in determining whether the defendant has rebutted the presumption of recoupment.

IV THE QUALIFICATIONS TO THE RULE

There are some well-recognised qualifications to the minimum performance rule that have the effect of casting further doubt on whether it ought to be retained.

A Events Extraneous to the Contract

In the leading case of *Lavarack v Woods of Colchester Ltd* the plaintiff's contract of employment with the defendant provided for a salary "and such bonus (if any) as the directors of [the defendant] shall from time to time determine".³⁴ It was held by the Court of Appeal (Lord Denning MR dissenting) that the damages for his wrongful dismissal did not include an amount in respect of the increased salary paid to other employees—an increase that the Master ruled he would have received if the contract had remained on foot—when the defendant decided to end the bonus scheme. The plaintiff was not contractually entitled to a bonus let alone to any additional salary paid in lieu thereof

33 The judgment of Deane J is more transparent and convincing in this respect. In his view it sufficed that the Commonwealth's breach of contract deprived Amann of either the chance of obtaining a renewal or the chance of selling their aeroplanes to a new provider at a price higher than the written-down book or remainder value. It was essentially a consequential loss. And in the context of Amann's claim for wasted expenditure the chance of renewal was a consequential benefit of the contract that had to be brought into account in determining whether the Commonwealth had rebutted the presumption of recoupment. Compare the judgment of Gaudron J, who was the fourth member of the majority despite holding that there was only a practical or evidentiary onus on the Commonwealth. In her view, it was impossible to say that the contract would have been unprofitable, principally because it was likely that the aeroplanes would have been worth much more than their written-down book value at the end of the contract period. This benefit could not have been the subject of a promise by the Commonwealth yet, if valid (see *Winterton*, above n 28, at 346), it was clearly a factual benefit that would have to be accounted for in determining whether the contract was a losing one.

34 *Lavarack*, above n 11, at 286.

and his damages had to be calculated on the assumption that "the defendant has performed or will perform his legal obligations under his contract with the plaintiff and nothing more".³⁵

In reaching this decision Diplock LJ distinguished *Bold v Brough, Nicholson & Hall Ltd*,³⁶ another wrongful dismissal case. There the contract in question entitled the plaintiff to pension contributions so long as the pension scheme continued. Damages were recovered in respect of the pension benefits that would have been received even though the defendant employer could terminate the scheme on six months' notice. At the time of trial, the scheme remained on foot and it was found that the defendant, "a substantial company",³⁷ was unlikely to discontinue it in the future. In *Lavarack* Diplock LJ said that this decision did not:³⁸

... involve any departure from the principle that the injured party is only entitled to be compensated for the loss of those benefits which he would have been legally entitled to claim if his contract had been performed.

It was a case where:³⁹

... the employers' discretion to continue or discontinue the pensions scheme was not a discretion as to the manner of performing their contract of service with the plaintiff but a discretion as to the way in which they would conduct their business as a whole.

Where the contractual obligations of the defendant are dependent on the occurrence of "events extraneous to the contract",⁴⁰ including events that are within the defendant's control:⁴¹

35 At 294. See also *Beach v Reed Corrugated Cases* [1956] 1 WLR 807 (QB) where a wrongfully dismissed company director failed to recover damages in respect of the loss of benefits under the company's retirement benefit scheme for directors in circumstances where the company had the right to discontinue at any time either the whole scheme or the participation of any director in it. However, *Lavarack* was distinguished in *Horkulak v Cantor Fitzgerald International* [2004] EWCA Civ 1287, [2004] IRLR 942 where the Court said (at [48]):

The broad principle that a defendant in an action for breach of contract is not liable for doing that which he is not bound to do will not be applicable willy-nilly in a case where the employer is contractually obliged to exercise his discretion rationally and in good faith in awarding or withholding a benefit provided for under the contract of employment.

36 *Bold v Brough, Nicholson & Hall Ltd* [1964] 1 WLR 201 (QB).

37 At 212.

38 *Lavarack*, above n 11, at 296.

39 At 296.

40 At 295.

41 At 295.

... one must not assume that he will cut off his nose to spite his face and so control these events as to reduce his legal obligations to the plaintiff by incurring greater loss in other respects.

It is difficult to accept this distinction between cases where the promisor's obligation is dependent on "events extraneous to the contract", where it is permissible to address the counterfactual question concerning the promisee's non-breach position, and cases where the terms of the contract give the promisor a discretion concerning the extent of its performance, where it must be assumed that the promisee would have received the minimum permitted level of performance, even if it is highly likely that such performance would have been exceeded. Since "events extraneous to the contract" include those within the promisor's control, both scenarios give the latter a discretion as to the benefits to be conferred on the promisee. Accordingly, there seems to be no good reason for the court to be able to decide the counterfactual question in the first but not in the second. One can understand the Court's unwillingness in *Bold* to limit the plaintiff's damages since it was clear that the benefits in question would have been received if the plaintiff had not been dismissed. At the time of trial the pension scheme remained in existence and it was unlikely to be discontinued thereafter since such a step by a large company "with subsidiaries and many employees" would have been "disastrous to its relations with all its employees".⁴² But why should the position be different in a case not involving so-called extraneous events where it is established that but for the breach the promisor would have exceeded the minimum performance required by the terms of the contract because, say, it was significantly more cost efficient to do so? Diplock LJ's argument that a court should not assume that the promisor will cut off his nose to spite his face is equally applicable in such a situation.

B Breach of a Single Obligation of Uncertain Content

It is now well established that where there is a single, albeit broadly defined, obligation, rather than alternative obligations, the assessment of damages for breach of that obligation requires the court to conduct the counterfactual inquiry into the level of performance that would have been received if the contract had been fulfilled, not the bare minimum performance that would have satisfied the obligation. Thus, to take an example modelled on the facts and reasoning in *Abrahams v Herbert Reich Ltd* where the distinction was first adopted,⁴³ suppose you enter into a contract with me to publish a book of my essays on the law of contract. The contract provides for a royalty of 10 per cent of the sale proceeds but omits many details such as the price and number of copies to be printed. If you repudiate the contract, my damages are to be assessed on the basis of how the contract would have been performed (the number of copies printed and sold and the price charged) if the contract had not been repudiated. You cannot reduce the damages by arguing, with the benefit of hindsight, that a print run of 500 copies would satisfy the obligation to publish the book if the court should determine

42 *Bold*, above n 36, at 212.

43 *Abrahams*, above n 8.

that, despite my limited stature as an author, in all the circumstances a reasonable estimate is that you *would have* printed and sold 2,000 copies if you had not got cold feet.

In my view, the distinction between a single obligation of uncertain scope and alternative obligations is altogether too fine because the reality is that it can have the effect of imposing a liability to pay damages assessed by reference to a level of performance more extensive than that which would have satisfied the obligation in question. Thus, suppose that in the above example you did not repudiate the contract. Instead, you decided to lower the risk of losses from the venture by printing 500 copies. I might be dissatisfied but I would find it extremely difficult to establish that you were in breach of your contract to "publish" the book.

Nevertheless, the distinction was endorsed by the English Court of Appeal in the now leading case of *Durham Tees Valley Airport Ltd v bmibaby Ltd*.⁴⁴ In this case the defendant airline repudiated a contract to have two passenger aircraft operating exclusively from the claimant's airport for a term of 10 years. Having construed the contract as imposing an obligation on the defendant to operate the aircraft commercially "in a real and genuine sense",⁴⁵ the Court proceeded to consider the approach to assessing the damages recoverable by the claimant. It rejected the defendant's argument that its liability should be calculated by reference to the minimum level of performance that the contract permitted. Instead it was held that the assessment "should extend to a calculation of how the contract would have been performed at the relevant time had it not been repudiated",⁴⁶ an approach that was "best fitted to serve the cardinal compensatory principle in the present instance".⁴⁷ Patten LJ explained the nature of the task as follows:⁴⁸

The court, in my view, has to conduct a factual inquiry as to how the contract would have been performed had it not been repudiated. Its performance is the only counter-factual assumption in the exercise. On the basis of that premise, the court has to look at the relevant economic and other surrounding circumstances to decide on the level of performance which the defendant would have adopted. The judge conducting the assessment must assume that the defendant would not have acted outside the terms of the contract and would have performed it in his own interests having regard to the relevant factors prevailing at the time. But the court is not required to make assumptions that the defaulting party would have acted uncommercially merely in order to spite the claimant. To that extent, the parties are to be assumed to have acted in good faith although with their own commercial interests very much in mind.

44 *Durham Tees Valley Airport Ltd v bmibaby Ltd* [2010] EWCA Civ 485, [2011] 1 Lloyd's Rep 68.

45 At [59] per Patten LJ.

46 At [69] per Patten LJ.

47 At [145] per Toulson LJ.

48 At [79].

This unquestionably represents a substantial inroad into the minimum performance rule and provides further support for the argument that the rule ought to be abandoned. The decision plainly rendered the defendant potentially liable for failing to provide a service that, if the contract had remained on foot, it was not obliged to provide.

Nevertheless, it has to be said that some of the reasoning in support of rejecting the defendant's argument is not without difficulty. Thus, Toulson LJ in his otherwise persuasive judgment emphasised that "[t]here is good practical reason"⁴⁹ for holding that:⁵⁰

... where a contract imposes a single obligation, rather than alternative obligations, compensation is to be based on the probabilities of the case – on the remuneration which the claimant might reasonably be expected to receive – and not on the bare minimum necessary to have amounted to performance of the contract.

At various stages his Lordship described the task of "seek[ing] to identify a range of reasonable methods of performance, of which the least advantageous to the claimant would provide the measure of damages"⁵¹ as "very difficult",⁵² "impossible"⁵³ and not "viable",⁵⁴ whereas it was "more possible",⁵⁵ "conceptionally and practically simpler"⁵⁶ and "just"⁵⁷ to embark on "a broad brush assessment"⁵⁸ of the level of performance that the defendant would have provided but for the repudiation. However, his Lordship conceded later in his judgment that "it may be difficult for a court to assess how the [defendant] would have been likely to have fulfilled [its] obligation, if it had not repudiated the contract", particularly since the material on which the assessment has to be based may often be "exiguous".⁵⁹ He thought that the court must do the best it can on the basis of the available material, meagre or otherwise, to assess the claimant's likely non-breach position.⁶⁰ This lends further

49 At [132].

50 At [131].

51 At [144].

52 At [132].

53 At [132].

54 At [144].

55 At [132].

56 At [136].

57 At [144].

58 At [132].

59 At [147].

60 At [147] (the difficulty facing the court "is no reason for not making the best assessment that it can").

credence to the argument that it is unsatisfactory to draw a distinction between different categories of case in which the defendant had a degree of choice as to how to perform. Regardless of whether the contract imposes a single obligation of the type discussed above or alternative obligations, it should be legitimate for a court to inquire into what the defendant *would* likely have done if the contract had not been breached, rather than confining itself to a determination of what *could* have been done without breaching the contract. In other words, there is no good reason why there should be an inflexible rule for cases within the latter category of alternative obligations that the court is unconcerned with how the contract would have been performed so that the damages must be assessed on the basis least favourable to the claimant or least burdensome to the defendant.

C Breach of Duty of Care

There is authority for application of an approach analogous to that in *Durham Tees* where the issue concerns the measure of damages for breach of a contractual duty of care. In such cases the courts have generally refused to entertain arguments that the damages should be assessed by reference to the conduct, usually the provision of information on which the claimant has relied, that the defendant could have engaged in without being negligent. Thus, in the case of a claim against a negligent valuer, the court's task is to determine:⁶¹

... the figure which it considers most likely that a reasonable valuer, using the information available at the relevant date, would have put forward as the amount which the property was most likely to fetch if sold upon the open market.

The leading case is the decision of the Privy Council in *Lion Nathan Ltd v C-C Bottlers Ltd*.⁶² It concerned a negligent forecast by the vendor of a company that the company's earnings during the two months prior to settlement would be \$2.2 million, whereas the actual earnings were only \$1.2 million. Counsel for the vendor, Jonathan Sumption QC, invoked the minimum performance rule and argued that, in assessing the damages recoverable by the purchaser, "the court should choose the highest figure, which on the information reasonably available at the time of the forecast, could without negligence have been put forward as the mean".⁶³ However, Lord Hoffmann, delivering the judgment of their Lordships, disagreed. In the circumstances "the only rational course open to a court is to choose the figure which it considers that a forecast made with reasonable care was most likely to have

61 *South Australia Asset Management Corp v York Montague Ltd* [1997] AC 191 (HL) at 221 per Lord Hoffmann.

62 *Lion Nathan Ltd v C-C Bottlers Ltd* [1996] 1 WLR 1438 (PC).

63 At 1446.

produced".⁶⁴ The eventual decision that damages should be assessed on the basis that, if proper care had been taken, the vendor would have got the forecast right, ie \$2.2 million, is questionable,⁶⁵ but that point is beyond the scope of this article.

D Breach of Negative Obligations

It has been held that the minimum performance rule has no application where there has been a breach of a negative obligation, for example, a duty not to disclose or use confidential information. Thus, in *Jones v Ricoh UK Ltd* Roth J held that where such a breach occurs:⁶⁶

... the court is not concerned with determining a benefit which the defendant should have provided. The counter-factual is the case where the defendant would *not* have done what he did do. The focus of inquiry is accordingly on the loss that has been caused by the defendant acting as he did, not on the benefit that would have been provided if the defendant had acted as he should have done.

Accordingly, damages for breach of a confidentiality obligation were to be assessed by first considering the use that had been made by the defendant of the confidential information and then asking the counterfactual question as to what would have happened if the obligation had not been breached, an inquiry that "can be conducted only on the basis of the balance of probabilities".⁶⁷

This view is endorsed by Adam Kramer in his excellent text on contract damages. He argues that:⁶⁸

... it is difficult to see how the [minimum performance] rule could be applied in negative covenant cases. In such cases the contract does not provide for alternative methods of performance or a fixed tolerance for performance (of which it might be assumed that the defendant would have chosen the least burdensome),

64 At 1447. See also the assessment of damages for the tort of negligence in *Robbins v London Borough of Bexley* [2013] EWCA Civ 1233 on the basis (at [69]) that "the defendant ... would have acted in a way which was more favourable to the claimant than the fulfilment of his duty strictly required", for this was to do "no more than reflect the actual consequences to the claimant of the breach of duty on which he sues". The case is usefully discussed in Sandy Steel "Defining Causal Counterfactuals in Negligence" (2014) 130 LQR 564.

65 Lord Hoffmann had earlier said (at 1442) that, since the vendor had only given a warranty that the forecast had been prepared with reasonable care, there was "no analogy with a warranty of quality", yet the outcome of the case was the same as if a warranty had been given that the forecast earnings would be achieved. See the discussion of this and other aspects of the case in David McLauchlan "Some Issues in the Assessment of Expectation Damages" [2007] NZ L Rev 563 at 580–585.

66 *Jones v Ricoh UK Ltd* [2010] EWHC 1743 (Ch) at [74].

67 At [75]. These observations were made in a decision on a summary judgment application and, when the case came on for trial, Judge Hodge QC (*Jones v IOS (RUK) Ltd* [2012] EWHC 348 (Ch) at [85]–[86]), while not questioning the distinction between positive and negative obligations, was "not persuaded that the 'minimum performance' or 'least onerous obligation' principle is engaged at all in the present case".

68 Adam Kramer *The Law of Contract Damages* (2nd ed, Hart Publishing, Oxford, 2017) at [13–67].

instead merely providing for what the defendant must not do. Accordingly, on the authority of *Durham Tees Valley Airport*, in a negative covenant case the inquiry into what the defendant would have done is a question of fact and not a question of the minimum obligation principle.

However, the better explanation may simply be that the loss resulting from breach of a negative obligation will invariably be consequential loss and, as discussed earlier in this article, the rule does not restrict recovery of damages for such loss.⁶⁹

V CONCLUSION

It is understandable that the courts would be at least cautious about investigating the counterfactual position of the promisee where there has been repudiation of a contract providing for alternative methods of performance. It is perhaps understandable also that they would ordinarily commence the often difficult task of assessing damages in such cases, a task that "involves assuming that what has not occurred and never will occur has occurred or will occur",⁷⁰ by making the further assumption that, if the contract had not been repudiated, the promisor would have provided the minimum or least burdensome permitted level of performance. As Russell LJ pointed out in *Lavarack*:⁷¹

... an employer whose attitude to the employee has reached the stage that he is prepared to sack him out of hand is, to say the least, an unlikely source of future generosity.

In other words, it is reasonable to assume that such an employer, or indeed any promisor who prefers to be rid of its contractual obligations, would have chosen the least burdensome method of performance had the contract not been breached. However, it is questionable whether this is always the correct starting point. When we assume, for the purpose of assessing the claimant's non-breach position, the existence of an alternative world in which the defendant would have performed, might it sometimes be more appropriate to assume a world in which the defendant is willing, rather than compelled, to perform?⁷² Even if that is not so and Russell LJ's observation is appropriate, "[o]ne may question", as pointed out by Judge Hodge QC in *Jones v IOS (RUK) Ltd*, "whether such an attitude merits the application of a blanket rule of law, operating by way of an irrebuttable presumption, governing the hypothetical future actions of the contract-breaker".⁷³ That, of course, has been the question posed and answered in this article.

⁶⁹ See further Pearce, above n 12, at 794–796.

⁷⁰ *Lavarack*, above n 11, at 294 per Diplock LJ.

⁷¹ At 294.

⁷² I am indebted to Andrew Summers for this point.

⁷³ *Jones*, above n 67, at [86].

The following main points have been made. First, the minimum performance rule is neither required by nor consistent with the compensatory principle under which the object of contract damages is to put the plaintiffs in the position they would have occupied if the contract had not been broken. Assuming that there are no issues concerning remoteness or mitigation of damage, the court must form a judgment as to what performance the promisor *would* have provided and what benefits to the plaintiffs *would* have resulted.

Secondly, the scope of the obligation breached does not necessarily limit the damages recoverable. A claim may be made in respect of benefits lost as a consequence of the breach even though those benefits were not the subject of a contractual promise, provided of course that they were within the reasonable contemplation of the parties at the time of the contract. Similarly, the fact that the contract provided for alternative methods of performance and that the promisor *could* have chosen the alternative less favourable to the promisee than that on which the damages claim is premised ought not to limit the damages if there is good reason to find that, but for the breach, the more favourable alternative would have been provided. Such good reason will obviously exist where rendering the minimum performance would result, in the colourful words of Diplock LJ, in the defendant cutting off its nose to spite its face, but the principle is not confined to such situations.

Thirdly, in any event the minimum performance rule is now the subject of so many substantial qualifications that its operation has been severely curtailed. It would improve the coherence of the law of damages if it were jettisoned altogether.

