Contract damages and frozen sperm

Felicity Maher reports on *Clark v Macourt* [2013] HCA 56

The unusual facts of this case explain its apparently counter-intuitive result. The High Court confirmed an award of damages in excess of $1 million for breach of a contract for sale of assets of a business where the total purchase price was less than $400,000, the breach related to some only of the assets and there was no claim for loss of profits.

Facts

Dr Clark and Dr Macourt specialised in assisted reproductive technology. In 2002, Dr Clark agreed to buy the assets of St George Fertility Centre Pty Ltd, a company controlled by Dr Macourt. The assets included 3513 'straws' of frozen donated sperm. The total purchase price, calculated according to a complicated formula based on Dr Clark's income, was $386,950.91. Under the contract, the company warranted that the sperm complied with relevant guidelines. In fact, 1,996 straws of the sperm were not as warranted and were unusable. In 2005, having exhausted the stock of usable sperm, Dr Clark bought replacement sperm from the only available supplier, a company in the US (Xytex), for a cost of over $1 million. Dr Clark recouped this cost by charging her patients a fee for use of the replacement sperm.

Proceedings

In the Supreme Court of New South Wales, breach of warranty was made out on the basis of admissions, and the sole issue was the assessment of damages. Gzell J held that the company's breach of warranty deprived Dr Clark of the use of 1,996 straws of sperm and assessed damages as the difference, as at the date of breach, between the amount Dr Clark would have obtained in a 'hypothetical sale' of the unusable straws (assumed to be nil), and the amount she would have paid in a 'hypothetical purchase' of 1,996 replacement straws. The best evidence of this was the amount she in fact paid to Xytex in 2005. Gzell J accordingly awarded damages of $1,246,025.01.[1]

On appeal to the New South Wales Court of Appeal, Tobias AJA (Beazley and Barrett JJA agreeing) reversed this decision, holding that Dr Clark should have no damages for breach of warranty. The decision rested on two broad strands of reasoning. First, as the contract was for the sale of a business, rather than the sale of goods, the measure of damages adopted by Gzell J did not apply. Further, given ethical and legal constraints on Dr Clark's use of the sperm, and the impossibility of apportioning a part of the purchase price to the sperm under the contract, it could not be demonstrated that Dr Clark had actually paid anything for the sperm, so she had suffered no loss from her inability to use it. Second, Dr Clark had mitigated any loss she would otherwise have sustained from her inability to use the sperm, by charging her patients a fee which covered her costs of buying replacement sperm from Xytex.[2]

Dr Clark appealed to the High Court. By a majority of 4:1, the court allowed the appeal.[3]

Majority judgments

Hayne J affirmed the 'ruling principle' that contract damages put the promisee in the position he or she would have been in had the contract been performed.[4] Further, the loss which is compensated is the value of what the promisee would have received if the promise had been performed.[5] Here, if the contract had been performed, Dr Clark would have received a further 1,996 usable straws of sperm. The value of this loss was the amount it would have cost, at the date of breach of the contract, to acquire replacement sperm.[6]

Hayne J also rejected the Court of Appeal's mitigation reasoning, on the basis that Dr Clark obtained no relevant benefit from her subsequent acquisition and use of sperm from Xytex, as it merely replaced what the company had agreed to supply.[7] Further, the commercial consequences flowing from Dr Clark's use of the replacement sperm would have been relevant to assessing the value of what she should have received under the contract only if she had obtained some advantage from its use.[8] The value of that advantage would then have mitigated the loss she otherwise suffered. But the transactions did not mitigate the loss Dr Clark suffered from the company not supplying what it agreed to supply.[9] Accordingly, showing that Dr Clark had recouped from her patients her costs of acquiring replacement sperm from Xytex was irrelevant to deciding the value of what the company should have, but had not, supplied.[10]

Crennan and Bell JJ also affirmed the ruling principle and noted that in a contract for the sale of goods, the prima facie measure of damages is the market

price of the goods at the time of breach.[11] Here, there was nothing to displace the prima facie measure.[12] Like Hayne J, their Honours rejected the Court of Appeal's mitigation reasoning on the basis that Dr Clark's subsequent dealings with her patients did not avoid or diminish the loss of her bargain for the delivery of usable sperm.[13]

Keane J affirmed the ruling principle and noted that it is not displaced by the circumstance that a case does not involve the transfer of marketable commodities.[14] His Honour considered that it was irrelevant that the contract here did not permit a calculation of the price paid by Dr Clark specifically for the sperm. Her loss was not measured by reference to what she outlaid as compared to what she obtained from the company, but by reference to the value of what the company had promised to deliver her but did not.[15] His Honour also affirmed that contract damages are to be assessed as at the date of breach of the contract:

> …not as a matter of discretion but as an integral aspect of the principle, which is concerned to give the promisee the economic value of the performance of the contract at the time that performance is promised.[16]

Keane J then considered the Court of Appeal's mitigation reasoning. The key to rejecting that reasoning was the correct identification of the loss for which Dr Clark sought compensation. That was a loss occurring at completion of the contract, at which time the assets which she acquired were not as valuable as they should have been.[17] The loss was not confined to the expense that Dr Clark incurred (but was able to recoup from patients) in acquiring replacement sperm from Xytex.[18] The value of the sperm lay not in what it might bring in a market for sperm as a commodity, but as stock of a business. As stock of the business they were distinctly inferior.[19] The company's breach meant that Dr Clark's business was not augmented as expected by the addition of a quantity of stock in trade.[20]

Dissenting judgment

Gageler J dissented. His Honour affirmed the ruling principle but added that the promisee cannot recover more than he or she has lost.[21] Gageler J noted that in the standard category of case where a seller fails to deliver goods to a buyer in compliance with a contractual warranty, it is ordinarily appropriate to measure the buyer's damages as the difference, at the date of delivery, between what the buyer would have received in a hypothetical sale of the non-compliant goods, and what the buyer would have paid in a hypothetical purchase of compliant goods from another seller. This gives the buyer the value of the performance of the contract by the seller.[22] However, in his Honour's view, this case did not fit within the standard category. The critical difference here was the limited value to Dr Clark of the performance of the contract by the company, given the peculiar nature of the sperm.[23] The sperm was of no use to Dr Clark except for the treatment of patients in the normal course of her practice. In doing so, Dr Clark was ethically bound not to charge patients more than the costs of acquiring that sperm.[24] Accordingly, the value to Dr Clark was in gaining control over sperm which she could then use, relieving her of the need to acquire it from an alternative source later.[25] Dr Clark was only worse off to the extent that later she was forced to incur, and was not able to recoup from her patients, the cost of sourcing 1,996 straws of sperm from Xytex.[26]

Comments

The High Court's decision affirms that contract damages are measured by reference to the loss of the value of what the promisee would have received if the contract had been performed, not by reference to the difference between what the promisee paid and what he or she received. The decision also affirms that, in all cases, contract damages are to be assessed as at the date of breach.

Of the nine judges who considered the assessment of damages in this case, the final result was supported by only five. The case demonstrates the difficulties of applying well-established principles to unusual facts.

Endnotes

1. *St George Fertility Centre Pty Ltd v Clark* [2011] NSWSC 1276.
2. *Macourt v Clark* [2012] NSWCA 367.
3. *Clark v Macourt* [2013] HCA 56.
4. At [7].
5. At [9].
6. At [12].
7. At [19].
8. At [20].
9. At [21].
10. At [22].
11. At [26], [28].
12. At [30].
13. At [37].
14. At [106]-[107].
15. At [111].
16. At [109].
17. At [128]-[129].
18. At [129].
19. At [134].
20. At [135].
21. At [60].
22. At [67].
23. At [68].
24. At [69].
25. At [70].
26. At [71].