SUBSTITUTIVE DAMAGES AND MITIGATION IN CONTRACT LAW

Tension between Two Competing Norms

While one aim of contract damages is to seek a substitute for performance for the plaintiff, mitigation attempts to effect a just allocation of burdens and benefits between plaintiff and defendant. First, plaintiffs cannot recover avoidable loss, which reflects the court's desire to encourage self-help, among other things. Second, courts take into account avoided loss, which involves a simple mathematical *quid pro quo*, but it is suggested that courts should be cognisant of the distributive ramifications when mitigation has not in fact taken place or the plaintiff is not subject to claims by third parties.

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I. Introduction

1 There has been much attention on substitutive interpretations of contract law damages, particularly in light of Winterton's recent lucid and thought-provoking book on the topic.[1] Although substitutive accounts differ in their detail, in broad terms they commonly conceptualise at least some forms of damages for breach of contract as providing a pecuniary substitute for either the plaintiff's "performance

* I presented thoughts on mitigation to the Melbourne Law School Faculty Research Seminar Series on 12 May 2014, to the Melbourne Law School Obligations Group on 5 June 2014, and at the Obligations VII Conference in Hong Kong on 17 July 2014. My ideas have changed, but the feedback I received from conference participants and from Matthew Bell, Michael Bryan, Michael Crawford, Sirko Harder, Matthew Harding, Robyn Honey, Adam Kramer and Jeannie Paterson has been invaluable. Particular thanks are due to Elise Bant for inviting me to contribute to this issue and for her comments and suggestions. Also thanks to Angela Kittikhoun and Adam Kramer for their feedback on the draft of this paper, and to the anonymous referee for his or her useful comments. The usual disclaimer applies.

1 David Winterton, *Money Awards in Contract Law* (Oxford: Hart Publishing, 2015).

interest"[2] or a purported right to performance.[3] Such damages are usually distinguished from other forms of contractual damages which are said to compensate for pecuniary losses flowing from the breach (whether those damages for "pecuniary loss" are conceived of as damages for difference in value or damages for "consequential losses").[4]

2 I am generally sympathetic to the notion that contract damages act (at least in part) as a substitute for performance itself.[5] Indeed, such a substitutive understanding seems a good way to begin to approach the famous statement by Parke B in *Robinson v Harman*:[6]

> The rule of the common law is, that where the party sustains a loss by reason of a breach of contract, he 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.

On this approach, the object of at least some forms of contract damages is to provide a pecuniary substitute for the promised performance to put the plaintiff in the next-best position to actual performance itself (or in the case of Robert Stevens, to compensate for the right to performance itself). This approach requires courts to identify where the plaintiff would have been had the contract been performed and then to make a damages award that will, so far as money can do it, place the plaintiff in an equivalent position.

3 However, there is still disagreement as to precisely which awards are substitutive and how such awards should be measured. These

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2 See, *eg*, Brian Coote, "Contract Damages, *Ruxley*, and the Performance Interest" (1997) 56 Camb LJ 537; Ewan McKendrick, "The Common Law at Work: The Saga of *Alfred McAlpine Construction Ltd v Panatown Ltd*" (2003) 3 OUCLJ 145; Charlie Webb, "Performance and Compensation: An Analysis of Contract Damages and Contractual Obligation" (2006) 26 OxJLS 41; David Pearce & Roger Halson, "Damages for Breach of Contract: Compensation, Restitution and Vindication" (2008) 28 OxJLS 73; Stephen Smith, "Substitutionary Damages" in *Justifying Private Law Remedies* (Charles E F Rickett ed) (Oxford: Hart Publishing, 2008) at p 93; and James Edelman, "Money Awards of the Cost of Performance" (2010) 4 J Eq 122.

3 Robert Stevens, "Damages and the Right to Performance: A Golden Victory or Not?" in *Exploring Contract Law* (Jason Neyers, Richard Bronagh & Stephen Pitel eds) (Oxford: Hart Publishing, 2009); David Winterton, *Money Awards in Contract Law* (Oxford: Hart Publishing, 2015).

4 I argue elsewhere that all forms of damages act as a substitute for the performance interest, broadly speaking: see Katy Barnett, "Great Expectations: A Dissection of Expectation Damages in Contract in England and Australia" (2016) 33(3) JCL (forthcoming).

5 In Katy Barnett, *Accounting for Profit for Breach of Contract: Theory and Practice* (Oxford: Hart Publishing, 2012), "substitutability" is advanced as a criterion for the award of disgorgement for breach of contract.

6 (1848) 1 Ex 850 at 855; 154 ER 363 at 365.

fractures tend to be revealed when assessing the role and propriety of rules that operate to limit the defendant's scope of liability for the plaintiff's loss. Concepts such as mitigation and rules of remoteness operate to reduce damages awards in a way which seems fundamentally to contradict or undermine the substitutive aim of contract damages. Some scholars respond to that challenge by rejecting those doctrines as unprincipled or unnecessary. In recent writings, for example, Stevens and Winterton respectively argue that the doctrine of mitigation does not apply to awards for direct loss in contract as opposed to awards for consequential loss (in Stevens' terms)[7] or to money awards which substitute for performance as opposed to money awards which compensate for loss (in Winterton's terms).[8] These scholars are, if you like, "hard substitutivists", in that they argue that for those categories of contractual damages which they identify as substitutive, substitution is the sole aim, whether it is a substitute for the right to performance (Stevens) or for performance itself (Winterton). On these accounts, mitigation does not operate as a principled limit on such awards. Stevens then favours a "difference in value" measure as the primary approach to valuing the "right to performance" for which a substitutive monetary award must be made,[9] while Winterton takes a rather more expansive approach to the proper measure of actual performance, which allows for damages for difference in value and for cost-of-cure to *both* be substitutionary in different circumstances.[10]

4 By contrast, I am what one might call a "soft substitutivist"[11] as I do not contend that the substitutive aim operates to "trump" other doctrines such as mitigation, rendering them irrelevant. In this article, I posit rather that the doctrine of mitigation is in direct tension with the substitutive aim, and that this tension permeates a large range of awards. This has been recognised in the well-known case of *British Westinghouse Electric & Manufacturing Co Ltd v Underground Electric Railways Co of*

7 Robert Stevens, "Damages and the Right to Performance: A Golden Victory or Not?" in *Exploring Contract Law* (Jason Neyers, Richard Bronagh & Stephen Pitel eds) (Oxford: Hart Publishing, 2009) at pp 181–182.

8 David Winterton, *Money Awards in Contract Law* (Oxford: Hart Publishing, 2015) at pp 165–166.

9 Robert Stevens, "Damages and the Right to Performance: A Golden Victory or Not?" in *Exploring Contract Law* (Jason Neyers, Richard Bronagh & Stephen Pitel eds) (Oxford: Hart Publishing, 2009) at p 190.

10 David Winterton, "Money Awards Substituting for Performance" [2012] LMCLQ 446 at 451; David Winterton, "Case Note: *Clark v Macourt* – Defective Sperm and Performance Substitutes in the High Court of Australia" (2014) 38 MULR 755 at 775–780.

11 I am indebted to Adam Kramer for coining this term in our e-mail discussions.

London Ltd[12] ("*British Westinghouse*") when Viscount Haldane LC said:[13]

> The first [principle of contract damages] is that, as far as possible, he who has proved a breach of a bargain to supply what he contracted to get is to be placed, as far as money can do it, in as good a situation as if the contract had been performed. The fundamental basis is thus compensation for pecuniary loss naturally flowing from the breach; but this first principle is qualified by a second, which imposes on a plaintiff the duty of taking all reasonable steps to mitigate the loss consequent on the breach, and debars him from claiming in respect of any part of the damage which is due to his neglect to take such steps.

On my account, this tension is justified because the mitigation rule reflects a well-recognised and overriding general policy of the law in favour of encouraging self-help by plaintiffs, and is concerned with issues of distributive justice. On this approach, damages for breach of contract act as a substitute for performance itself, but the doctrine of mitigation necessarily limits the extent to which they can ever be *fully* substitutive.

5 Thus, far from being irrelevant to the measure of contract damages, the doctrine of mitigation implicitly and necessarily applies to damages awards made according to a "difference in value" measure. It follows that these awards are never solely substitutionary. The difference in value measure applies to marketable commodities precisely because in such cases a substitute can be obtained, and the courts expect a plaintiff to do so. More generally, this approach to mitigation is consistent with the law's broader policy to encourage self-help on the part of a plaintiff,[14] which necessarily and properly limits the extent to which damages can ever be entirely substitutive.

6 This article will be laid out as follows. Part II[15] shows how the tension between mitigation and substitutive awards raises localised questions of distributive justice in the sense of an allocation of benefits and burdens between plaintiff and defendant (and sometimes third parties). Part III[16] sets out the general nature of mitigation and explains that mitigation is *implicitly* built into some measurements for "direct loss" or "substitutive awards". The effect is to dilute the substitutive nature of the award. The question then becomes why the

12 [1912] AC 673.

13 *Westinghouse Electric & Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd* [1912] AC 673 at 689.

14 Mitigation applies across tort and contract, even to torts such as deceit: see, *eg*, *Doyle v Olby (Ironmongers) Ltd* [1969] 2 QB 158 at 168, *per* Winn LJ.

15 See paras 7–9 below.

16 See paras 10–18 below.

law has approached damages in this way, given that (as discussed above) a substitutive approach may be regarded as the general starting point for such awards. Part IV[17] addresses this through examining the concept of *avoidable loss* in mitigation. It identifies the general policy behind the concept of avoidable loss as being concerned to encourage self-help – where the defendant cannot be forced to perform and will not do so, the plaintiff is best placed to help herself if she has access to substitute performance in the market. The law accordingly deems plaintiffs with access to substitute performance in the market as having effected self-help, even where that is contrary to the proven facts. Part V[18] then turns to the treatment of *avoided loss* in mitigation. This is quite different to avoidable loss. The policy behind it is simply a mathematical *quid pro quo*: just as the defendant must pay if the plaintiff gets a worse performance by seeking a substitute performance, the defendant can benefit if the plaintiff gets a better performance through exercising self-help and obtaining a substitute. However, if the plaintiff gets an identical performance to that which was promised, the court simply awards the cost of the substitute. Distributive questions are raised if the plaintiff then further exercises self-help by passing on the costs of purchasing the substitute to third party purchasers, as in *Clark v Macourt*.[19] That case is discussed and it is suggested that the result is insufficiently cognisant of the distributive ramifications of the decision. The article then moves to consider a further difficult situation of betterment, which arises where a sub-sale to a third party leaves the plaintiff in a better factual position than she would have been if the contract had been performed. As McGregor has noted, this is not strictly speaking part of proper mitigation at all. Here the policy of the law has generally been to ignore sub-sales. It is suggested that while the law should generally ignore the possibility or fact of sub-sale, the defendant ought to be able to bring the sub-sale into the account where, following the breach, mitigation has not taken place and the plaintiff is not subject to a claim by third parties.

II. Localised questions of distributive justice: The tension between mitigation and substitutive awards

7 It is suggested that the tension between the mitigation requirement and providing a full pecuniary substitute for performance raises a question of "localised" distributive justice[20] between the parties. Gardner suggests that the central norm constituting tort law is one of

17 See paras 19–24 below.
18 See paras 25–59 below.
19 (2013) 253 CLR 1; [2013] HCA 56.
20 Stephen Perry, "The Moral Foundations of Tort Law" (1991) 77 Iowa L Rev 449 at 461.

corrective justice, but that tort law cannot help but also raise questions of "localised" distributive justice between the parties, precisely because it involves corrective justice.[21] The same arguably can be said for contract law: the fundamental aim of contract law, and of many of the remedies which arise upon breach, is to correct the breach and to provide an adequate substitute for performance, but this is not the *only* norm informing contract law. Corrective justice is at the core of expectation damages, but, as with tort, localised questions of distributive justice necessarily arise between the parties to the contract. Courts must accordingly decide on a distribution of corrective entitlements. Moreover, courts are sometimes faced with the question of whether or not they should take into account the interests and losses suffered by third parties and this clearly also raises distributive issues.

8 The following analysis shows that courts attempt a just distribution of contractual rights and duties, and the policies behind the law of mitigation inform that distribution. While the central norm of contractual damages awards is corrective (to provide a fair substitute for performance for a plaintiff who has been deprived of performance), the doctrine of mitigation discloses that there are other norms at play: distributive norms which involve a distribution of burden and benefit between the plaintiff and the defendant. Sometimes cases involve the passing-on of burdens or benefits to third parties, but as we shall see, courts applying mitigation principles often exclude any consideration of third party issues and confine themselves to a strictly localised distribution between plaintiff and defendant.

9 This article suggests that the central distributive norm behind mitigation concepts (particularly avoidable loss) is a desire to promote self-help on the part of plaintiffs, who are best placed to remedy breaches if the defendant cannot or will not perform and the court will not order specific relief. This underlying policy is reflected in the nature of the mitigation requirement, to which we now turn.

III. The nature of mitigation

10 Mitigation limits the availability of damages for a plaintiff who has suffered a breach of contract where it would be reasonable for her to take action to avoid the consequences of breach.[22] In short compass, it

21 John Gardner, "What is Tort Law for? Part 2: The Place of Distributive Justice" in *Philosophical Foundations of Tort Law* (John Oberdiek ed) (Oxford: Oxford University Press, 2014) at p 337.

22 Harvey McGregor (with contributions by Martin Spencer & Julian Picton), *McGregor on Damages* (London: Sweet & Maxwell, 19th Ed, 2016) at para 9-002. See *The Asia Star* [2010] 2 SLR 1154 at [24].

requires damages to be assessed as if the plaintiff had acted reasonably, even if she did not act reasonably.[23] McGregor states that the doctrine of mitigation has three aspects:[24]

> (1) The first … rule is that the claimant must take all reasonable steps to mitigate the loss to him consequent upon the defendant's wrong and cannot recover damages for any such loss which he could thus have avoided but has failed, through unreasonable action or inaction, to avoid. *Put shortly, the claimant cannot recover for avoidable loss.*
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> (2) The second rule is the corollary of the first and is that, where the claimant does take reasonable steps to mitigate the loss to him consequent upon the defendant's wrong, he can recover for loss incurred in so doing; this is so even though the resulting damage is in the event greater than it would have been had the mitigating steps not been taken. *Put shortly, the claimant can recover for loss incurred in reasonable attempts to avoid loss.*
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> (3) The third rule is that, where the claimant does take steps to mitigate the loss to him consequent upon the defendant's wrong and these steps are successful, the defendant is entitled to the benefit accruing from the claimant's action and is liable only for the loss as lessened; this is so even though the claimant would not have been debarred under the first rule from recovering the whole loss, which would have accrued in the absence of his successful mitigating steps, by reason of these steps not being ones which were required of him under the first rule. In addition, where the loss has been mitigated other than by steps taken by the claimant subsequent to the wrong, the claimant can again recover only for the loss as lessened, provided that the benefit gained is not to be regarded as collateral. *Put shortly, the claimant cannot recover for avoided loss.*
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> [emphasis added]

McGregor specifies that "avoided loss" is not simply the result of carrying out a so-called "duty" to avoid loss; it occurs where an aggrieved party has gone further than he needed and avoided *more* loss than required by law.[25] To an extent, as we shall see, these rules overlap.

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23 Andrew Dyson & Adam Kramer, "There Is No 'Breach Date Rule': Mitigation, Difference in Value and Date of Assessment" (2014) 130 LQR 259 at 259. See also *The Asia Star* [2010] 2 SLR 1154 at [30].

24 Harvey McGregor (with contributions by Martin Spencer & Julian Picton), *McGregor on Damages* (London: Sweet & Maxwell, 19th Ed, 2016) at paras 9-004–9-006. These rules have been criticised as unnecessarily complex – the second and third rules simply provide that mitigatory principles do not apply: Adam Kramer, *The Law of Contract Damages* (Oxford: Hart Publishing, 2014) at p 348; *Thai Airways Public Co Ltd v KI Holdings Co Ltd* [2015] EWHC 1250 at [33], *per* Leggatt LJ.

25 Harvey McGregor (with contributions by Martin Spencer & Julian Picton), *McGregor on Damages* (London: Sweet & Maxwell, 19th Ed, 2016) at para 9-103;

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11 The doctrine of mitigation applies to both contract and tort law, but it has particular "bite" in contract law, where it is presumed that a plaintiff will go out and seek a substitute performance after the contract has been breached. In this article, I focus on contract law, but the policy of self-help permeates private law, even in areas where the wrong done to the plaintiff is deliberate, as in deceit.[26]

12 Mitigation explicitly enters into contract law as a separate stand-alone doctrine used to limit the availability of damages in particular circumstances.[27] However, it is also implicitly applied in the choice of measure of damages. As McGregor, Dyson and Kramer have argued, mitigation (in the sense of avoidable loss) is built into damages calculated on the basis of difference in value, particularly for contracts for sale of goods.[28]

13 Kramer analyses mitigation in a way which is illuminating for present purposes. He argues that where a court has decided that a loss should be mitigated, courts contrast the *hypothetical* breach position (the hypothetical gains and harms which would have occurred but for the plaintiff's failure to mitigate) and the non-breach position (the hypothetical gains and harms that would have occurred but for the breach). Any actual losses that are suffered after the failure to mitigate are not compensated because the law takes the position at a certain point that a plaintiff should attempt to mitigate.[29]

14 Mitigation is built into difference in value damages, as can be seen from the example of a sale of goods contract. Sale of goods legislation provides that the *prima facie* measure of damages is the difference between the contract price and the market price of the goods at the time when they ought to have been delivered (or, if no time was

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Harvey McGregor, "Mitigation in the Assessment of Damages" in *Contract Damages: Domestic and International Perspectives* (Djakhongir Saidov & Ralph Cunnington eds) (Oxford: Hart Publishing, 2008) at p 338.

26 See n 16 above.

27 See, *eg*, *Burns v MAN Automotive (Aust) Pty Ltd* (1986) 161 CLR 658, judgment of Brennan J (dissenting). Brennan J's judgment, although dissenting, is the vastly superior judgment in this case.

28 Harvey McGregor (with contributions by Martin Spencer & Julian Picton), *McGregor on Damages* (London: Sweet & Maxwell, 19th Ed, 2016) at paras 9-034–9-041; Harvey McGregor, "Mitigation in the Assessment of Damages" in *Contract Damages: Domestic and International Perspectives* (Djakhongir Saidov & Ralph Cunnington eds) (Oxford: Hart Publishing, 2008) at pp 332–333; Andrew Dyson & Adam Kramer, "There Is No 'Breach Date Rule': Mitigation, Difference in Value and Date of Assessment" (2014) 130 LQR 259 at 269–271. *Cf* Stephen M Waddams, *The Law of Damages* (Toronto: Canada Law Book Co, 5th Ed, 2012) at para 15.100, which argues that the rule is one of convenience.

29 Adam Kramer, *The Law of Contract Damages* (Oxford: Hart Publishing, 2014) at p 345.

fixed, at the time of refusal to deliver).[30] This measure is premised on the basis that a reasonable buyer will mitigate and purchase substitute goods once the seller's breach is known.[31]

15 It is helpful to illustrate the integration of mitigation and measures of loss with an example involving non-delivery of goods. Suppose that Kevin ("K") contracted with Lilian ("L") for the supply of 100 red apples for which K has agreed to pay $100. He plans to sell the apples to consumers for $200. L breaches and fails to supply the red apples by the stipulated date. The measure of loss as adopted in sale of goods legislation assumes that K mitigates his loss by purchasing 100 red apples from Marcia ("M") instead, for which he must pay the market price (as at the date of breach). This is $150. In order to work out what a fair pecuniary substitute for actual performance would be, the court must compare K's promised position (what Kramer calls the "hypothetical non-breach position") with his assumed position after mitigation (what Kramer calls the "hypothetical breach position").[32] K's assumed act of mitigation required him to pay $50 more to receive the promised apples. If K has not yet paid L the contract price, the court simply gives K the difference between the contract price ($100 with L) and the market price at the date of delivery ($150 in a stable market). The difference is $50, the additional cost of securing substitute performance. If K has paid the contract price to L, the court will require L to refund the contract price plus the $50 difference to K. However effected, in both instances K is provided with a pecuniary substitute for actual performance. It no longer matters to K that L failed to supply him with apples because he is now in the position that he would have been in if L had performed.

16 Pivotally, if K does not purchase substitute apples from M, the court still *deems* him to have done so. The measure of damages will still be the difference between the position he would have been in had L performed the contract and the position he would have been in had he behaved reasonably and purchased substitute apples on the market. The fact that he has not in fact acquired substitute apples (and so lost the full $100 profit) is irrelevant. The substitutive damages awarded to him assume mitigation, and mitigation is implicitly built into the difference in value measure both at common law and under statute.

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30 Australia: see, *eg*, Sale of Goods Act 1923 (NSW) s 53(3); Goods Act 1958 (Vic) s 57(3); Singapore: Sale of Goods Act (Cap 393, 1999 Rev Ed) s 50(3); UK: Sale of Goods Act 1979 (c 54) (UK) s 50(3). This will be adjusted where the buyer has paid the purchase price.

31 *Radford v De Froberville* [1977] 1 WLR 1262 at 1285; *Manwelland Pty Ltd v Dames & Moore Pty Ltd* [2001] QCA 436; (2001) ASAL 55-074 at [11].

32 Adam Kramer, *The Law of Contract Damages* (Oxford: Hart Publishing, 2014) at p 345.

17 As I have noted above,[33] Stevens and Winterton argue that mitigation is *not* present for awards for direct loss (Stevens)[34] or money awards which substitute for performance (Winterton).[35] Stevens then favours a "difference in value" measure as the primary measure for measuring the "right to performance",[36] whereas Winterton argues that damages for difference in value and for cost-of-cure can *both* be substitutionary in different circumstances.[37] I agree with Winterton that damages for both difference in value and cost-of-cure can be substitutes for performance itself. However, it is not quite correct to say that mitigation does not apply to such awards. Certainly, mitigation *as a separate legal doctrine* is not applicable, but mitigation is built in to difference-in-value calculations, as just illustrated, and it affects both the measure of damages and the date at which such damages are calculated. Difference in value generally applies to marketable commodities because in such cases a substitute can be obtained, and the courts deem that a plaintiff will do so. Cost-of-cure damages are awarded because it is decided that the aim of the contract cannot be met by requiring the plaintiff to seek a substitute in mitigation, but only by a cure. The choice to apply mitigatory principles is arguably implicit rather than explicit in these cases, but it is still very much present.

18 The question is then *why* courts choose to limit the availability of damages in this way given that the fundamental aim of damages is to provide a pecuniary substitute for performance. This will be explored below in the discussion first of avoidable loss, and then of avoided loss.

IV. Avoidable loss: Policy and problems

19 As employed in the context of the mitigation doctrine, the concept of avoidable loss signifies that a defendant's liability will be

33 See para 3 above.

34 Robert Stevens, "Damages and the Right to Performance: A Golden Victory or Not?" in *Exploring Contract Law* (Jason Neyers, Richard Bronagh & Stephen Pitel eds) (Oxford: Hart Publishing, 2009) at pp 181–182.

35 David Winterton, *Money Awards in Contract Law* (Oxford: Hart Publishing, 2015) at pp 165–166.

36 Robert Stevens, "Damages and the Right to Performance: A Golden Victory or Not?" in *Exploring Contract Law* (Jason Neyers, Richard Bronagh & Stephen Pitel eds) (Oxford: Hart Publishing, 2009) at p 190. Dyson and Kramer have cogently criticised Stevens' understanding of difference in value as an abstract measure: Andrew Dyson & Adam Kramer, "There Is No 'Breach Date Rule': Mitigation, Difference in Value and Date of Assessment" (2014) 130 LQR 259 at 266–270.

37 David Winterton, "Money Awards Substituting for Performance" [2012] LMCLQ 446 at 451; David Winterton, "Case Note: *Clark v Macourt* – Defective Sperm and Performance Substitutes in the High Court of Australia" (2014) 38 MULR 755 at 775–780.

confined to those losses which would have been suffered if the plaintiff's conduct had been reasonable.[38] In other words, she must go out and attempt to mitigate her losses by taking reasonable ameliorating action.

20 But then a question arises as to why the law has made a decision that it is reasonable to expect a plaintiff to mitigate and in what circumstances this will occur. Dyson and Kramer argue that mitigation comes down to questions of causation, in the broader sense which includes legal causation[39] (also known as scope of liability or "remoteness"). In his dissenting judgment in *Burns v MAN Automotive (Aust) Pty Ltd*,[40] Brennan J makes the point that remoteness and mitigation are interwoven:[41]

> A party who, when he gives a warranty, has such knowledge that he can foresee that the loss which will result from a breach of the warranty, has such knowledge that he can foresee that the loss which will result from a breach of the warranty will continue until the other party acts to stop the loss, can foresee that the loss will continue until it is reasonable to expect that the injured party will act to stop it. Foreseeability extends until it would be unreasonable for the injured party to fail to act to mitigate his loss, and the onus of proving such a failure is on the party in breach.

Thus, a defendant will no longer be liable for loss once a reasonable person would expect a plaintiff to mitigate that loss, and the loss becomes too remote. However, this only gets us so far. *Why* does a court decide that certain losses are caused by the defendant's breach and other losses are caused by the plaintiff's failure to help herself? And *why* do we decide that it is reasonable to expect a plaintiff to help herself?

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38 Harvey McGregor (with contributions by Martin Spencer & Julian Picton), *McGregor on Damages* (London: Sweet & Maxwell, 19th Ed, 2016) at para 9-004; Michael G Bridge, "Mitigation of Damages in Contract and the Meaning of Avoidable Loss" (1989) 105 LQR 398 at 398; Andrew Dyson & Adam Kramer, "There Is No 'Breach Date Rule': Mitigation, Difference in Value and Date of Assessment" (2014) 130 LQR 259 at 259.

39 Andrew Dyson & Adam Kramer, "There Is No 'Breach Date Rule': Mitigation, Difference in Value and Date of Assessment" (2014) 130 LQR 259 at 263. As many scholars observe, factual causation alone cannot adequately explain the rule: see Michael G Bridge, "Mitigation of Damages in Contract and the Meaning of Avoidable Loss" (1989) 105 LQR 398 at 401–402; Harvey McGregor (with contributions by Martin Spencer & Julian Picton), *McGregor on Damages* (London: Sweet & Maxwell, 19th Ed, 2016) at para 9-018; Stephen M Waddams, *The Law of Damages* (Toronto: Canada Law Book Co, 5th Ed, 2012) at para 15.70; and Tham Chee Ho, "Damages Based on Compensation II" in *The Law of Contract in Singapore* (Andrew Phang Boon Leong gen ed) (Singapore: Academy Publishing, 2012) at paras 22.115–22.117.

40 (1986) 161 CLR 658.

41 *Burns v MAN Automotive (Aust) Pty Ltd* (1986) 161 CLR 658 at 673, *per* Brennan J.

21 Remoteness decisions always involve considerations of policy on the part of the court. Robertson has argued that the policy considerations underlying imposition of liability for negligence can be divided into two categories: those which deal with interpersonal justice between claimant and defendant, and those which deal with the broader community welfare effects of imposing liability.[42] It is arguable that this division between different kinds of policy questions is one which can be applied to private law more broadly.

22 When it comes to mitigation and its relationship with remoteness, it is suggested that one of the important motivating policies is a desire to incentivise self-help.[43] Because of the generally voluntary nature of contractual undertakings, self-help has more of a role in contract law generally than it does in an area such as tort,[44] although there are still limitations.[45] The law provides incentives via the doctrine of mitigation to encourage a rational plaintiff to fix the breach herself where this is appropriate and possible. Thus, for certain kinds of transactions, courts do not compensate plaintiffs for losses which the plaintiff could avoid, because they treat the plaintiff as a rational agent who will help herself where the contracted for good or service is readily available on the market. A dominant concern is community welfare: it is suggested that our contract law reflects a policy that it is economically efficient (and therefore for the benefit of society as a whole) if those who suffer from contractual breaches help themselves when they are better placed to do so than the court or the unwilling defendant. Economic efficiency in this sense is concerned with allocating liability in a way which leads to the lowest cost of breach and of the costs of avoiding breach.[46] In economic terms, the plaintiff is the "least cost avoider",[47] and

42 Andrew Robertson, "Rights, Pluralism and the Duty of Care" in *Rights and Private Law* (Donal Nolan & Andrew Robertson eds) (Oxford: Hart Publishing, 2012) at p 435; Andrew Robertson, "On the Function of the Law of Negligence" (2012) 33 OxJLS 31; Andrew Robertson, "Policy-based Reasoning in Duty of Care Cases" (2013) 33 Legal Stud 119.

43 Michael G Bridge, "Mitigation of Damages in Contract and the Meaning of Avoidable Loss" (1989) 105 LQR 398 at 409–410 also identifies this as a rationale.

44 Katy Barnett & Sirko Harder, *Remedies in Australian Private Law* (Melbourne: Cambridge University Press, 2014) at pp 302–303.

45 See, *eg*, the rule against penalties: *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205; *Cavendish Square Holding BV v Talal El Makdessi* [2015] UKSC 67; *Paciocco v Australia and New Zealand Banking Group Ltd* [2016] HCA 28.

46 Ronald H Coase, "The Problem of Social Cost" (1960) 3 J Law Econ 1; Guido Calabresi, *The Cost of Accidents* (New Haven: Yale University Press, 1970) at pp 135–152; Guido Calabresi & A Douglas Melamed, "Property Rules, Liability Rules, and Inalienability: One View of the Cathedral" (1972) 85 Harv L Rev 1089 at 1094.

47 Guido Calabresi & A Douglas Melamed, "Property Rules, Liability Rules, and Inalienability: One View of the Cathedral" (1972) 85 Harv L Rev 1089 at 1094.

(*cont'd on the next page*)

accordingly, she is the person who can most efficiently heal the breach if the defendant cannot be forced to do so.

23 However, the Singapore Court of Appeal has observed in *The Asia Star*[48] that efficiency alone cannot be an explanation for mitigation and that multiple policy concerns are at play.[49] It seems that this must be correct. As Waddams has observed, if the plaintiff fails to buy in a rising market there is no waste of community resources, yet the defendant is not held liable.[50] He suggests that another policy behind mitigation reflects the fact that it is unfair to require a defendant to compensate a plaintiff where the plaintiff could have avoided the loss, and that if a plaintiff is wasteful, it should not be at the defendant's expense[51] – an interpersonal justice concern. I suggest further that the unfairness may arise because the plaintiff is often better situated than the court *or* the defendant to heal the breach because she is already participating in the market and has better knowledge and control of the transaction. Thus a second interpersonal justice concern relates to which party has most control over the transaction.[52] Thirdly, Dyson and Kramer have suggested that autonomy concerns also drive the court's approach to mitigation.[53] Autonomy is particularly important to contract (as a voluntarily undertaken obligation) and the court is concerned to foster freedom of choice on the part of all parties to the contract. Consequently, where the plaintiff does not mitigate in the way assumed by the courts, both the positive and the negative consequences of that autonomous choice are often ignored, particularly if the action is not linked to the breach.[54] All of these concerns involve wider questions of distributive justice beyond the simple correction of the breach.

Pareto optimality is an economic concept used to ascertain whether a particular allocation of resources in society is economically efficient. It is achieved if there is no other allocation in which some other individual is better off and no individual is worse off. It focuses on allocative efficiency, not distributive efficiency or fairness.

48 [2010] 2 SLR 1154.

49 *The Asia Star* [2010] 2 SLR 1154 at [26]–[29].

50 Stephen M Waddams, *The Law of Damages* (Toronto: Canada Law Book Co, 5th Ed, 2012) at para 15.70.

51 Stephen M Waddams, *The Law of Damages* (Toronto: Canada Law Book Co, 5th Ed, 2012) at para 15.70. See also *Darbishire v Warran* [1963] 1 WLR 1067, cited by Waddams. *Cf The Asia Star* [2010] 2 SLR 1154 at [27].

52 John Gardner, "What Is Tort Law for? Part 2: The Place of Distributive Justice" in *Philosophical Foundations of Tort Law* (John Oberdiek ed) (Oxford: Oxford University Press, 2014) at pp 347–348 talks of the "responsibility norm" as a means of parcelling out rights and duties between two parties.

53 Andrew Dyson & Adam Kramer, "There Is No 'Breach Date Rule': Mitigation, Difference in Value and Date of Assessment" (2014) 130 LQR 259 at 265.

54 Adam Kramer, *The Law of Contract Damages* (Oxford: Hart Publishing, 2014) at p 359.

24 That being said, the court does not *force* the plaintiff to mitigate, and there is no "duty" to mitigate.[55] The court simply does not compensate the plaintiff for any losses she in fact made after mitigation became reasonable. While an incentive to mitigate is present, the court does not coerce a plaintiff because after all, she was the person who first suffered the loss as a result of the defendant's breach. (Similarly, the onus of proving failure to mitigate lies on the defendant for this reason.)[56] Moreover, it is important to note that if mitigation is unreasonable or impossible to achieve for some reason, the court will *not* expect the plaintiff to mitigate. Thus, as Dyson and Kramer have noted, if a plaintiff is legally "locked out" or practically "locked out" from accessing the market, she may recover her losses up until such time as mitigation becomes reasonable or possible (which may be some time in the future, or never).[57]

V. Avoided loss and betterment

25 A corollary of the principle of mitigation is that a plaintiff can recover losses incurred in reasonable attempts to mitigate, even if the losses are greater than they would have been had the plaintiff done nothing.[58] We have seen that the law seeks to provide incentives for plaintiffs to mitigate. If plaintiffs try to access a reasonable substitute performance which leads them to suffer greater loss, then they should still be compensated for that loss, particularly as the defendant was the party who created the need to mitigate in the first place by his breach (a moral consideration focusing on the wrongdoing). However, there are also other pragmatic policy reasons. To do otherwise would disincentivise plaintiffs from seeking to exercise self-help and would profoundly undermine the policy behind the mitigation principle. This is reflected in the avoidable loss principles of mitigation, discussed earlier.[59] However, it is also relevant to the issue of avoided loss to which we now turn.

26 With regard to avoided loss, the defendant is entitled to benefit from any mitigating steps taken by the plaintiff, even when it would

55 Harvey McGregor (with contributions by Martin Spencer & Julian Picton), *McGregor on Damages* (London: Sweet & Maxwell, 19th Ed, 2016) at para 9-017; Tham Chee Ho, "Damages Based on Compensation II" in *The Law of Contract in Singapore* (Andrew Phang Boon Leong gen ed) (Singapore: Academy Publishing, 2012) at para 22.114.

56 *TCN Channel 9 Pty Ltd v Hayden Enterprises Pty Ltd* (1989) 16 NSWLR 130 at 158.

57 Andrew Dyson & Adam Kramer, "There Is No 'Breach Date Rule': Mitigation, Difference in Value and Date of Assessment" (2014) 130 LQR 259 at 276–281.

58 Harvey McGregor (with contributions by Martin Spencer & Julian Picton), *McGregor on Damages* (London: Sweet & Maxwell, 19th Ed, 2016) at para 9-005.

59 See paras 19–24 above.

have been reasonable for the plaintiff not to have taken those steps.[60] Thus, if the plaintiff gets a *better* product when she buys a substitute in mitigation of her loss, damages will be reduced. This raises a difficulty for courts in awarding damages for breach of contract. It is generally thought that the plaintiff should not be put in a better position by an award of damages than she would have been in if the contract had been performed. Thus, in *Commonwealth of Australia v Amann Aviation Pty Ltd*,[61] Mason CJ and Dawson J said:[62]

> The corollary of the principle in *Robinson v Harman* is that a plaintiff 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.

Law and economics writers distinguish between "the bargain principle" (bargains should be performed according to their terms) and "the indifference principle" (contractual remedies should be structured so that the plaintiff should be indifferent between the defendant performing on the one hand and the defendant breaching and paying damages on the other).[63] Generally speaking, contract damages are designed to leave a plaintiff in an equal factual situation than she would have been in had the defendant not breached: in other words, the plaintiff should be indifferent to the defendant's breach. However, as we have seen, sometimes she will be in a factually worse situation because of a failure to mitigate or because of other costs associated with breach.[64] In other cases, awards of damages leave a plaintiff in a *better* position than if the contract had been performed, as in *Clark v Macourt*, where the plaintiff passed on the cost of acquiring a substitute performance to third-party consumers. It is necessary to deal with these latter cases because they form a central plank of the argument that, in some instances, courts are not concerned with actual losses but with

60 *British Westinghouse Electric & Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd* [1912] AC 673 at 688–690, *per* Viscount Haldane LC.

61 (1991) 174 CLR 64.

62 *Commonwealth of Australia v Amann Aviation Pty Ltd* (1991) 174 CLR 64 at 82.

63 Richard Craswell, "Contract Remedies, Renegotiation, and the Theory of Efficient Breach" (1988) 61 S Cal L Rev 629; Melvin A Eisenberg, "Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law" (2005) 93 Cal L Rev 975 at 977–979. See also Daniel Friedmann, "Economic Aspects of Damages and Specific Performance Compared" in *Contract Damages: Domestic and International Perspectives* (Djakhongir Saidov & Ralph Cunnington eds) (Oxford: Hart Publishing, 2008) at p 67.

64 Melvin A Eisenberg, "Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law" (2005) 93 Cal L Rev 975 at 989–996; Melvin A Eisenberg, "The Disgorgement Interest in Contract Law" (2006) 105 Mich L Rev 559 at 571–572.

substituting for the right to performance (Stevens),[65] or with substituting for the actual performance (Winterton);[66] thus, it is said that mitigation is "not relevant".

27 It should be emphasised that "avoided loss" does not cover situations where the plaintiff has simply avoided a loss by obtaining a substitute performance. Avoided loss only covers situations where an aggrieved party has gone further than she needed and avoided *more* loss than is reasonable in the circumstances.[67] This is sometimes known as a "betterment discount".[68] Indeed, in the High Court of Australia decision in *Clark v Macourt*, it was taken as axiomatic that only better or worse substitutes were relevant for the purposes of the principle of mitigation, but no real justification was given for this rule.[69] However, if the plaintiff has obtained a substitute which is identical in quality and specifications, her damages will be measured by the value expended to acquire the substitute, even where that value is vastly greater than the original contract price (so long as the amount is "reasonable").[70] One reason may be that if the plaintiff gets an exact substitute, then it is fair simply to recompense her for the market value she paid for that substitute as the best measure of this loss, given the intrinsically substitutive nature of contract damages. Nonetheless, this principle may be problematic where the costs of the substitute performance are passed on to subsequent third parties, as in *Clark v Macourt*: in such cases the factual loss does not square with the normative loss of performance.

28 The paradigmatic case of avoided loss is *British Westinghouse*. The plaintiffs purchased steam turbines from the defendants for use in their railway. The turbines were defective and did not comply with the contractual specifications. The plaintiffs used the defective turbines for a time, but ended up purchasing turbines from a different company to replace them. These replacement turbines were more efficient than the old turbines and put the plaintiffs in a better position than they would

65 Robert Stevens, "Damages and the Right to Performance: A Golden Victory or Not?" in *Exploring Contract Law* (Jason Neyers, Richard Bronagh & Stephen Pitel eds) (Oxford: Hart Publishing, 2009).

66 David Winterton, *Money Awards in Contract Law* (Oxford: Hart Publishing, 2015); David Winterton, "Money Awards Substituting for Performance" [2012] LMCLQ 446.

67 Harvey McGregor, "The Role of Mitigation in the Assessment of Damages" in *Contract Damages: Domestic and International Perspectives* (Djakhongir Saidov & Ralph Cunnington eds) (Oxford: Hart Publishing, 2008) at pp 336–337.

68 See Adam Kramer, *The Law of Contract Damages* (Oxford: Hart Publishing, 2014) at pp 137–141 which argues that betterment is the "flip side" of mitigation – reasonable cost of repair is recoverable.

69 *Clark v Macourt* (2013) 253 CLR 1; [2013] HCA 56 at [18]–[22], *per* Hayne J, and at [142]–[143], *per* Keane J.

70 *Clark v Macourt* (2013) 253 CLR 1; [2013] HCA 56 was such a case.

have been in if the contract had been performed. In fact, they were better off than they had been with the old turbines and made a profit through installing the new turbines. Viscount Haldane LC (with whom all of the other judges agreed) found that the diminution of loss could be taken into account and operated to reduce the plaintiffs' damages to nil. It was said that the plaintiffs' actions in buying the better replacement turbines arose out of the consequences of the breach and formed part of the continuous dealing with the situation in which the plaintiffs found themselves.[71]

29 These cases perhaps reflect the formulae used more than anything else: again, it is an arithmetical *quid pro quo*. If the plaintiff is worse off or better off as a result of the breach, it will be taken into account. If the plaintiff is left in an identical situation, the court is generally satisfied that a reasonable substitute performance has been obtained and compensates the plaintiff for that.

30 As noted, a difficult situation arises where the plaintiff obtains an identical performance (neither better nor worse than the original promised performance) and the costs of obtaining that performance are passed on to subsequent purchasers. The conventional wisdom in contractual mitigation is that passing-on is immaterial and that the entire cost of the substitute is awarded, as in *Clark v Macourt*, discussed below.[72] This case seems to support the arguments of Stevens and Winterton that courts favour fully substitutive awards.[73] However, it will be suggested that *Clark v Macourt* was wrongly decided because it did not adequately take into account the distributive justice ramifications of the decision. A better way of approaching this case would be for the court to face distributive questions head on. The proper corrective starting point for the assessment of damages would be that the buyer should be entitled to a substitute for performance, but in circumstances where cost of self-help had actually been passed on to third parties, the defendant should not be required to compensate the plaintiff for that notional loss.

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71 Recently, in *Thai Airways Public Co Ltd v KI Holdings Co Ltd* [2015] EWHC 1250 at [45], Leggatt LJ argues that *British Westinghouse Electric & Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd* [1912] AC 673 is not a case of avoided loss, and:

> … simply demonstrates that, provided the claimant's response to the breach is one which a reasonable person could be expected to adopt, the measure of damages is the loss which the claimant has actually suffered taking account of both costs and benefits resulting from the defendant's breach of contract.

72 See paras 29–31 below.

73 Katy Barnett, "Contractual Expectations and Goods" (2014) 130 LQR 387; David Winterton, "Case Note: *Clark v Macourt* – Defective Sperm and Performance Substitutes in the High Court of Australia" (2014) 38 MULR 755 at 774.

A. Passing on costs of obtaining substitute performance to subsequent purchasers

31 *Clark v Macourt* concerned a contract for the sale of an *in vitro* fertilisation business for A$386,950.91. Assets of the business included 3513 straws of donor sperm, which the purchaser proposed to use in the course of her own *in vitro* fertilisation business. Clause 5.1(a) of the contract of sale warranted that the sperm complied with certain guidelines, but it transpired that at least 1996 straws did not comply with the warranty and had to be discarded. The purchaser was obliged to obtain replacement sperm from an American company, Xytex, at a cost of about A$1m. The evidence disclosed that she passed the costs of acquiring the donor sperm onto her patients. The purchaser sought damages of around A$1m, which was clearly a much greater amount than the price of the business under the contract of sale. At first instance, Gzell J awarded the plaintiff A$1,246,025.01,[74] but the award was overturned by the New South Wales Court of Appeal.[75] A majority of the High Court of Australia reinstated the award of the trial judge.[76]

32 The majority decided that the loss was not simply the difference in value between the business as supplied and the value of a business which had warranty compliant sperm.[77] Instead, the correct measure was to award the difference in value between what it cost the plaintiff to procure a substitute performance and the market value of the sperm received (which was nil). In dissent, Gageler J said that the value to the plaintiff was not the value of the goods at the time of delivery, and that the true value of the sperm was that the plaintiff could gain "control over a stock of frozen sperm which she could then use for the treatment of her patients in the normal course of her practice".[78] On this approach, the plaintiff was factually no worse off as a result of the breach because she could (and did) pass on the costs of obtaining alternative frozen sperm to her patients.[79] Gageler J used the concept of "value" in the sale of goods legislation to deal with mitigation, which, as mentioned previously, states that "avoided loss" generally only captures expenditure where the purchaser puts herself in a better position by mitigating.

33 It is suggested that cases such as these involve a distributive question. This case draws in the question of distribution to third parties:

74 *St George Fertility Centre Pty Ltd v Clark* [2011] NSWSC 1276.
75 *Macourt v Clark* [2012] NSWCA 367.
76 Hayne J, Crennan and Bell JJ and Keane J. Gageler J dissented.
77 This finding has been criticised: John W Carter, Wayne Courtney & Greg J Tolhurst, "Issues of Principle in Assessing Contract Damages" (2014) 31 JCL 171 at 189–194.
78 *Clark v Macourt* (2013) 253 CLR 1; [2013] HCA 56 at [71], *per* Gageler J.
79 *Clark v Macourt* (2013) 253 CLR 1; [2013] HCA 56 at [71]–[72], *per* Gageler J.

To what extent should it be taken into account that the buyer in this case is not the ultimate bearer of the burden for which she is getting compensated? She passed on the burden to third-party patients instead. Those who focus simply on the corrective status of contractual awards (such as Winterton and Stevens) see the outcome as just, because the buyer still suffered a normative loss, and any subsequent passing-on to other parties is irrelevant. However, others have criticised the decision.[80] It is suggested that the discomfort lies in an awareness of distributive norms and in the nature of the transaction itself. In that regard, the court had noted that the purpose of the contract was not to make a profit, and indeed the buyer could *not* make a profit according to the legislative scheme.[81] Further, it is arguable that the third-party patients would have been willing to pay a premium for the service, although this was not considered by the court.[82] Consequently, the passing on to third parties of the costs of self-help should have been taken into account.

B. Cases where the plaintiff is left better off as a result of third-party actions

34 A second situation of avoided loss occurs where the plaintiff ends up better off as a result of third-party actions. These situations arise when Alphonse ("A") contracts with Barbie ("B") to supply her with 100 widgets. In anticipation of receiving the widgets, B makes a sub-sale contract with Cuthbert ("C"). After the sub-sale contract has been entered into, A breaches. There are three possible breaches: A fails to deliver the widgets at all (non-delivery); A delivers defective widgets; or A delays in delivery. Ordinarily, when the breach occurs, B will mitigate her losses flowing from the breach by A by obtaining a substitute performance from elsewhere so that she can perform the contract with C, and the law assumes this to be the case. However, in some cases the party in the position of B is put in a *better* factual position than she would have been in if A had not breached. This is because C, the third party to the contract, may be content to let the contract lapse, or may accept defective goods at the regular price, and B does not actually mitigate. Nonetheless, the law deems B to have mitigated and on-sold to C, which gives her more than she would have had if A had performed. I explore the reasons behind the courts' decisions in these cases (both in relation to goods and defective land) and suggest resolutions to the

80 John W Carter, Wayne Courtney & Greg J Tolhurst, "Issues of Principle in Assessing Contract Damages" (2014) 31 JCL 171 at 189–194; Katy Barnett, "Contractual Expectations and Goods" (2014) 130 LQR 387 at 390–391; Adam Kramer, *The Law of Contract Damages* (Oxford: Hart Publishing, 2014) at p 142.

81 *Clark v Macourt* (2013) 253 CLR 1; [2013] HCA 56 at [142], *per* Keane J.

82 Katy Barnett, "Contractual Expectations and Goods" (2014) 130 LQR 387 at 390–391.

tension between the desire to provide a fair substitute for performance and the need to mitigate.

35 The general policy behind the assumption that the plaintiff in the position of B has mitigated is one of incentivising self-help. However, this general policy comes into conflict with other policy considerations which underlie mitigation, including the presumption of plaintiff autonomy. The plaintiff in B's position chooses not to mitigate as a matter of fact, and the courts are sometimes content to let the plaintiff live with the consequences of this, whether positive or negative. However, much depends upon the timing of the breach and the plaintiff's knowledge of the breach. The distributive questions here are not like the ones just canvassed in relation to *Clark v Macourt*: they focus on a just distribution between the plaintiff and the defendant solely, notwithstanding that third-party action led to the plaintiff's betterment.

C. Goods

(1) Non-delivery

36 In the cases that follow, courts awarded plaintiffs damages calculated according to difference in value for non-delivery of goods. However, the plaintiffs did not suffer the full loss of the difference in value as a matter of fact because they had arranged prior to the breach to on-sell the goods to a third party for a price lower than the market price. Consequently, the defendants argued that they should not bear the burden of paying the full contractual damages award.

37 In *Rodocanachi Sons & Co v Milburn Brothers*[83] ("*Rodocanachi*"), the plaintiffs chartered a ship from the defendants. The cargo was lost by reason of the ship's master's negligence. Prior to the breach, the plaintiffs had entered into a sub-sale stipulated as dependent on the arrival of the cargo. The plaintiffs claimed the market value of the lost cargo as at the time the goods should have been delivered. The defendants argued that the plaintiffs had entered into a contract of sale for less than the market value, and that this should be taken into account. The Queen's Bench Division (correctly) did not do so, given that the sub-sale fell through. Lord Esher MR famously said:[84]

> [T]he value is to be taken independently of any circumstances peculiar to the plaintiff. It is well settled that in an action for non-delivery or non-acceptance of goods under a contract of sale the law does not take into account in estimating the damages anything that is accidental as

83 (1886) 18 QBD 67.

84 *Rodocanachi Sons & Co v Milburn Brothers* (1886) 18 QBD 67 at 77.

> between the plaintiff and the defendant, as for instance an intermediate contract entered into with a third party for the purchase or sale of the goods.

38 Instead, the Queen's Bench awarded damages at the market rate. McGregor has noted that there was no necessity to go into the market, and no chance of the plaintiffs being sued by the third parties as the contract had been expressed as "to arrive" (that is, subject to the safe arrival of the goods). Given that the goods had not arrived, the plaintiff could not be liable to the third party.[85] If the plaintiffs had been required to go into the market and purchase a substitute, then perhaps it would be appropriate to take this into account.

39 Similarly in *Williams Brothers v Ed T Agius Ltd*[86] ("*Williams Brothers*"), the defendants failed to deliver coal to Italy as agreed. The plaintiffs claimed the difference in price between the contract price and the market value at the time of breach. The defendants argued that the true measure of the loss should be the difference between the contract price and the price for which the plaintiff had arranged to sell the coal to a third party (a lower price than the market price). The contract with the third party had been entered into before breach. The House of Lords followed *Rodocanachi* and found that the subsequent contract was not relevant. Instead they awarded the full difference in market value. The case was even more extraordinary than *Rodocanachi* as the third party had sold the subject matter of the contract back to the defendant and ceded all rights and liabilities to the defendant, so again, there was no necessity for the plaintiff to go onto the market and the plaintiff would not be sued by the third party.[87]

40 McGregor has questioned these cases on the basis that they did not take into account the fact that there was no necessity in fact for the plaintiff to mitigate in either case, and furthermore, there was no possibility of liability towards the third-party sub-buyer. He notes that both *Rodocanachi* and *Williams Brothers* have been questioned in other cases involving subsequent sub-sales.[88] However, Kramer argues that the difference in market value was the correct measure as, in his view, each plaintiff could have been expected to go out on the market and buy

85 Harvey McGregor (with contributions by Martin Spencer & Julian Picton), *McGregor on Damages* (London: Sweet & Maxwell, 19th Ed, 2016) at para 9-172.

86 [1914] AC 510.

87 Harvey McGregor (with contributions by Martin Spencer & Julian Picton), *McGregor on Damages* (London: Sweet & Maxwell, 19th Ed, 2016) at para 9-172.

88 Harvey McGregor (with contributions by Martin Spencer & Julian Picton), *McGregor on Damages* (London: Sweet & Maxwell, 19th Ed, 2016) at para 9-173, citing *Altonpride v Canbright Ltd* (31 July 1998) (QB) (unreported); *Sony Computer Entertainment UK Ltd v Cinram Logistics UK Ltd* [2008] EWCA Civ 955; and *Oxus Gold plc v Templeton Insurance Ltd* [2007] EWHC 770.

a substitute (and the fact that they did not do so was speculation on their part which should not be taken into account in calculation of damages).[89]

(2) Defects

41 If the plaintiff successfully manages to sell defective goods to a third party for the regular price, it is sometimes said that this is irrelevant, and that a defendant should not be able to take advantage of the plaintiff's commercially shrewd nature. This approach is typified by the decision of the English Court of Appeal in *Slater v Hoyle & Smith Ltd*[90] ("*Slater v Hoyle*"). The plaintiffs sought to argue that the defendant's successful sale to third parties of some of the defective goods for the contract price should be taken into account in calculating damages. The English Court of Appeal said that the subsequent contract with the third party would not be taken into account. Warrington LJ said, "[I]t seems to me immaterial that by some good fortune, with which the plaintiffs have nothing to do, he [the defendant] has been able to recoup himself what he paid for the goods."[91] Similarly Scrutton LJ said that facts which were *res inter alia acta* (peculiar to the purchaser) were not relevant in these cases, and it was perfectly possible that a purchaser might not be able to resell goods and might have to purchase substitutes from the market.[92] The High Court accepted *Slater v Hoyle* as representing Australian law in *Clark v Macourt*, although as discussed above, Crennan and Bell JJ left room for other approaches.[93]

42 *Slater v Hoyle* can be contrasted with the later English Court of Appeal case, *Bence Graphics International Ltd v Fasson UK Ltd*[94] ("*Bence Graphics*"). The purchaser received defective vinyl film from the supplier, from which it made labels for shipping containers. The defect was not immediately evident. After some time, customers of the purchaser reported that the labels were defective and peeled. The court did not measure the supplier's liability according to the difference between the value of product supplied and the value of non-defective film, but on the purchaser's liability to third parties (in fact, only one third party brought a claim against it, which was subsequently settled). It was held that the *prima facie* measure of damages for breach of

89 Adam Kramer, *The Law of Contract Damages* (Oxford: Hart Publishing, 2014) at p 102.

90 [1920] 2 KB 11. See similarly *Auspac Trade International Pty Ltd v Victorian Dairy Industry* (22 February 1994) (CA Vic) (unreported).

91 *Slater v Hoyle & Smith Ltd* [1920] 2 KB 11 at 18.

92 *Slater v Hoyle & Smith Ltd* [1920] 2 KB 11 at 22–23.

93 *Clark v Macourt* (2013) 253 CLR 1; [2013] HCA 56, at [29], *per* Crennan and Bell JJ, [55], *per* Gageler J, and [134], *per* Keane J.

94 [1998] QB 87.

warranty provided by s 53(3) of the UK Sale of Goods Act 1979[95] was displaced where it had been in the contemplation of the parties at the time of making the contract that the goods sold would be used in making a product which would be on-sold to third parties.[96] The decision has been criticised on the basis that it confuses questions of remoteness with questions of mitigation.[97] *Bence Graphics* has not been definitively adopted or rejected in Australian law, although Crennan and Bell JJ cite it with apparent approval in *Clark v Macourt*.[98] However, it has been noted that this apparent endorsement does not sit well with the High Court's acceptance of *Slater v Hoyle* or the result in *Clark v Macourt*.[99]

43 Kramer and Dyson have distinguished *Slater v Hoyle* from *Bence Graphics* on the basis that the defects in the goods were discovered at different times.[100] The defect in *Slater v Hoyle* was patent – in other words, the plaintiff was fully aware of the defect before he on-sold the goods to third parties. They posit that where a defect is patent, the plaintiff is expected by law to go to the market to ameliorate any losses. The fact that the court ignored the subsequent on-sale at full market price is a result of the preference for contract law to prioritise party autonomy. The court ignores whether the plaintiff loses or gains as a result of her choice not to mitigate.

44 By contrast, the defect in *Bence Graphics* was latent – in other words, the plaintiff was unaware of the defect when he on-sold the goods to third parties. Accordingly, the plaintiff could not possibly be expected to mitigate at the time when it received the goods, and it recovered its actual losses as a result (*without* any operation of the mitigation rule). I would still posit that the actual losses should include not only the claim by the third party purchaser, but also for any loss of goodwill and costs arising from the need to deal with the defective goods received from the defendant, as well as for any remaining vinyl film which could no longer be sold once the defect became evident.

45 It is suggested that Kramer and Dyson's explanation makes sense. There can be no obligation to mitigate on a plaintiff when the

95 c 54.

96 Otton and Auld LJJ. Thorpe LJ dissented.

97 Guenter H Treitel, "Damages for Breach of Warranty of Quality" (1997) 113 LQR 188; Cynthia Hawes, "Damages for Defective Goods" (2005) 121 LQR 389.

98 *Clark v Macourt* (2013) 253 CLR 1; [2013] HCA 56 at [29]. See also *Onesteel Manufacturing Pty Ltd v BlueScope Steel (AIS) Pty Ltd* (2013) 85 NSWLR 1; [2013] NSWCA 27 at [171].

99 Katy Barnett, "Contractual Expectations and Goods" (2014) 130 LQR 387 at 389.

100 Andrew Dyson & Adam Kramer, "There Is No 'Breach Date Rule': Mitigation, Difference in Value and Date of Assessment" (2014) 130 LQR 259 at 273–275.

defect is not yet known, and this principle applies not only to contract law, but also to tort law.[101] If we are going to prioritise self-help, it must be made clear that no obligation to mitigate accrues until the plaintiff knows of the need to mitigate her losses.

(3) Delay

46 The result in *Wertheim v Chicoutimi Pulp Co*[102] ("*Wertheim*") stands in contrast to the results in *Rodocanachi, Williams Brothers* and *Slater v Hoyle*.[103] In that case, the plaintiff contracted for delivery of goods to arrive between 1 September and 1 November 1900. The defendant was late in delivering the goods. The market price at time of delivery was 70s/ton. By the time the goods were delivered, the market price had fallen sharply to 42s 6d/ton, but the plaintiff still managed to on-sell the goods for close to the earlier market price (65s/ton). The subsequent sale *was* taken into account, and the plaintiff's damages were calculated according to the difference between the market price at the time of delivery and the price for which he had on-sold the goods. The House of Lords said that the general rule was that stated in *Rodocanachi*, but if the purchaser actually managed to sell the goods at a greater price than the market value, the presumption of *Rodocanachi* was rebutted. Lord Atkinson said:[104]

> The loss he sustained must be measured by that price [the price of the subsequent contract], unless he is, against all justice, to be permitted to make a profit by the breach of contract, be compensated for a loss he never suffered, and be put, as far as money can do it, not in the same position in which he would have been if the contract had been performed but a much better position.

47 In *Williams Bros*, Lord Dunedin distinguished the result in *Wertheim* on the basis that was a case not of non-delivery but of late delivery.[105] The plaintiff did not have to mitigate in relation to the contract with the third party (unless the third party had terminated the contract for delay). However, the third party did not terminate. It is suggested that *Wertheim* was correct, as there was no reason for the plaintiff to exercise self-help. It is worth noting also that *Wertheim* has

101 See, *eg*, *Downs v Chappell* [1997] 1 WLR 426: the owner of a bookshop was not obliged to mitigate losses when misrepresentation as to a book store business were unknown, but once the misrepresentation was known and no reasonable mitigating action was taken, the owner could not recover subsequent losses incurred.

102 [1911] AC 301.

103 Adam Kramer, *The Law of Contract Damages* (Oxford: Hart Publishing, 2014) at pp 106–108 says the inconsistencies can be explained by remoteness rules.

104 *Wertheim v Chicoutimi Pulp Co* [1911] AC 301 at 308.

105 *Williams Brothers v Ed T Agius Ltd* [1914] AC 510 at 522.

been affirmed by two judges in *Golden Strait Corp v Nippon Yusen Kubishika Kaisha*,[106] an affirmation that McGregor regards as entirely correct.[107] Given that the plaintiffs in *Williams Bros* and *Rodocanachi* also did not have to mitigate (because the third party sub-purchasers could not sue them), the same reasoning as that used in the *Wertheim* reasoning applies.

48 McGregor has suggested that the solution may be that regardless of whether the breach was non-delivery, delay or defects, the sub-sale should *prima facie* be ignored, but the seller should be able adduce facts to the contrary *if* he can show that the buyer has not bought substitute goods and is not subject to a damages claim.[108] This would make the outcomes in *Williams Bros* and *Rodocanachi* incorrect, although the general principle expressed in the cases (that the sub-sale should *prima facie* be ignored) would still be correct.

(4) Analysis

49 There are a number of different explanations as to why sub-sales which leave the plaintiff better off are ignored in the cases of defects and non-delivery. As noted above, the position with regard to delayed delivery is anomalous.

50 One explanation, favoured by Dyson and Kramer, is that the court prioritises the plaintiff's choice by not resorting to the market. In other words, "[i]f the claimant chooses not to resort promptly (or at all) to the market, then the consequences of that choice – for better or for worse – will fall on the claimant".[109]

51 A second explanation, favoured by Bridge, is that it is better to have a clear and commercially certain rule which does not require the court to consider subsequent transactions or the like.[110] This is essentially a pragmatic argument: any distribution of benefit and burdens between plaintiff and defendant as a result of mitigatory principles is limited. A buyer may be occasionally undercompensated or

106 [2007] 2 AC 535, [2007] UKHL 12 at [13], *per* Lord Bingham (dissenting), and [30]–[32], *per* Lord Scott.

107 Harvey McGregor, "The Role of Mitigation in the Assessment of Damages" in *Contract Damages: Domestic and International Perspectives* (Djakhongir Saidov & Ralph Cunnington eds) (Oxford: Hart Publishing, 2008) at p 344.

108 Harvey McGregor (with contributions by Martin Spencer & Julian Picton), *McGregor on Damages* (London: Sweet & Maxwell, 19th Ed, 2016) at para 9-174.

109 Andrew Dyson & Adam Kramer, "There Is No 'Breach Date Rule': Mitigation, Difference in Value and Date of Assessment" (2014) 130 LQR 259 at 265.

110 Michael G Bridge, "Mitigation of Damages in Contract and the Meaning of Avoidable Loss" (1989) 105 LQR 398 at 408–409; Michael G Bridge, "Defective Goods and Sub-sales" [1998] JBL 259 at 259.

overcompensated but this does not matter because market certainty is more important. Waddams likewise argues that the rule is founded on convenience and crystallisation of the buyer's entitlement at an early stage.[111]

52 A third explanation, favoured by both Stevens and Winterton, is that the court makes awards which substitute for performance (or the right to performance) and that mitigation is "irrelevant".[112] We have already seen that mitigation is *not* irrelevant because it is presumed that the plaintiff will go on the market by the very measure used, but it could perhaps be argued that the court is concerned to substitute for performance *to an extent*, subject to the initial mitigatory presumption that the plaintiff will help herself by seeking a substitute performance.

53 It is suggested there is some truth to all of the explanations above. For the sake of convenience, and plaintiff autonomy, *prima facie*, sub-sales are not taken into account. There may also be a substitutive concern that the plaintiff's normative loss (in the sense of the loss of her interest in performance) should be compensated rather than the factual loss, given that the defendant's breach caused the loss in the first place.

54 However, it is also suggested that it would be fair to import the principle which McGregor suggested above. The real loss suffered by the plaintiff should be awarded where the defendant can show that the plaintiff has not in fact mitigated, nor is she subject to a claim by third parties. This is consonant with the law's more general desire to incentivise a plaintiff to mitigate, and also with interpersonal justice concerns that if a plaintiff does not need to mitigate, the defendant should not have to pay for losses which have not actually occurred. This is a fairer distribution of benefits and burdens between the parties.

D. Land and defects

55 Cost-of-cure awards for the restoration of land or buildings are often given as an example of an intrinsically substitutionary award.[113]

111 Stephen M Waddams, *The Law of Damages* (Toronto: Canada Law Book Co, 5th Ed, 2012) at paras 1.1480–1.1540 and 15.100.

112 Robert Stevens, "Damages and the Right to Performance: A Golden Victory or Not?" in *Exploring Contract Law* (Jason Neyers, Richard Bronagh & Stephen Pitel eds) (Oxford: Hart Publishing, 2009) at pp 181–182; David Winterton, *Money Awards in Contract Law* (Oxford: Hart Publishing, 2015) at pp 165–166.

113 Brian Coote, "Contract Damages, *Ruxley*, and the Performance Interest" (1997) 56 Camb LJ 537 at 556–558; Charlie Webb, "Performance and Compensation: An Analysis of Contract Damages and Contractual Obligation" (2006) 26 OxJLS 41 at 58; Stephen Smith, "Substitutionary Damages" in *Justifying Private Law Remedies* (Charles E F Rickett ed) (Oxford: Hart Publishing, 2008) at pp 100–113;

(*cont'd on the next page*)

Typically the diminution in value to the land is exceeded by the cost-of-cure, but the court nonetheless tends to award damages calculated according to the full cost-of-cure.[114] Cost-of-cure awards will be declined if they would be "unreasonable".[115]

56 Generally the court is not concerned with whether a plaintiff actually intends to spend her damages on obtaining a rectified performance.[116] This is because the court is concerned to allow plaintiffs autonomy and freedom in how they spend their damages. However, where rectification is impossible because the land to be rectified has been passed on to third parties, the mitigation problem in these cases is similar to that in *Slater v Hoyle*:[117] sometimes the owner of the land does not suffer an actual loss because he has passed on land for full price.

57 As for goods, the orthodoxy regarding sale of defective land is that a successful subsequent sale is not relevant and a plaintiff may still be entitled to rectification damages. Indeed, in *Director of War Service Homes v Harris*,[118] the Full Court of the Supreme Court of Queensland directly analogised the sale of defective land to the sale of defective goods and applied *Slater v Hoyle*.[119] In a recent Australian case, *Bannister & Hunter v Transition Resort Holdings (No 2)*,[120] the defendant developer successfully claimed rectification damages for substandard fill on the development site which would need to be replaced. There was no evidence as to whether the defective fill had reduced the value of the development. The defendants were entitled to claim rectification

David Winterton, "Money Awards Substituting for Performance" [2012] LMCLQ 446 at 451; Katy Barnett, "Great Expectations: A Dissection of Expectation Damages in Contract in England and Australia" (2016) JCL (forthcoming). *Cf* Robert Stevens, "Damages and the Right to Performance: A Golden Victory or Not?" in *Exploring Contract Law* (Jason Neyers, Richard Bronagh & Stephen Pitel eds) (Oxford: Hart Publishing, 2009) at pp 189–192.

114 *Eg*, *Bellgrove v Eldridge* (1954) 90 CLR 613; *Radford v De Froberville* [1977] 1 WLR 1262; *Dean v Ainley* [1987] 1 WLR 1729; *Chia Kok Leong v Prosperland Pte Ltd* [2005] 2 SLR(R) 484; *Tabcorp Holdings Ltd v Bowen Investments Pty Ltd* (2009) 236 CLR 272; [2009] HCA 8.

115 *Eg*, *Tito v Waddell (No 2)* [1977] Ch 106; *Ruxley Electronics and Constructions Ltd v Forsyth* [1996] 1 AC 344; *Yap Boon Keng Sonny v Pacific Prince International Pte Ltd* [2009] 1 SLR(R) 385.

116 See, *eg*, *Bellgrove v Eldridge* (1954) 90 CLR 613.

117 See also *Auspac Trade International Pty Ltd v Victorian Dairy Industry* (22 February 1994) (CA Vic) (unreported).

118 [1968] Qd R 275.

119 *Director of War Service Homes v Harris* [1968] Qd R 275 at 278–279, *per* Gibbs J.

120 [2013] NSWSC 1943.

damages notwithstanding the fact that the defendant had sold the development site and had no ongoing interest in it.[121]

58 In other cases, the court has refused to order rectification damages on the basis that the person who owned the land has since sold it. In *Cordon Investments Pty Ltd v Lesdor Pty Ltd*,[122] the New South Wales Court of Appeal held that the fact that the defendant no longer owned the housing development in question was a reason to decline to award rectification damages. The development was subject to a strata plan which meant that the common property in the premises (where many of the defects were present) was owned by an owners' corporation. In an echo of *Bence Graphics*, the question of whether the owners' corporation was likely to sue for the defects was held to be relevant. The Court of Appeal found that whether or not the defendant was likely to undertake the rectification works was something which went to the question of whether it was "necessary and reasonable" for rectification to be undertaken.[123] Because the defendants no longer owned the property, and because there was no evidence of an intention on the part of the owners' corporation to rectify, it was found to be unreasonable to award rectification damages. The court relied on a series of other cases which had held that whether rectification was possible went to the question of whether repairs were "necessary and reasonable".[124] As noted previously, this is something which overlaps with the consideration of whether rectification damages will actually be used to effect repair.

59 John Ren suggests that courts should distinguish between cases where an *actual* cost-of-cure is known[125] (that is, the loss has been mitigated) and cases where the cost-of-cure is hypothetical (that is, no mitigation has yet occurred).[126] Ren argues that the *prima facie* measure in all cases should be cost-of-cure, even where the object of the contract was to produce property for sale, because sellers of property want to sell properties without defects. This links to the point above about the presence or absence of claims against sellers. However, he argues that if a plaintiff has sold a defective building *without* having the defects rectified by the time of trial, the measure should simply be difference in

121 See also *De Cesare v Deluxe Motors Pty Ltd* (1996) 67 SASR 28; *Director of War Services Homes v Harris* [1968] Qd R 275 and *Scott Carver Pty Ltd v SAS Trustee Corp* [2005] NSWCA 462.

122 [2012] NSWCA 184.

123 *Cordon Investments Pty Ltd v Lesdor Pty Ltd* [2012] NSWCA 184 at [288]–[299], *per* Bathurst CJ (with whom MacFarlan and Meagher JJA agreed).

124 *Hyder Consulting (Australia) Pty Ltd v Wilh Wilhelmsen Agency Pty Ltd* [2001] NSWCA 313; *Westpoint Management Ltd v Chocolate Factory Apartments Ltd* [2007] NSWCA 253; *UI International Pty Ltd v Interworks Architects Pty Ltd* [2007] QCA 402.

125 See *Tito v Waddell (No 2)* [1977] Ch 106 at 133, *per* Megarry V-C.

126 John Ren, "Measure of Damages for Defective Building Work" (2014) 32 JCL 69.

value.[127] The hypothetical post-breach situation is no longer hypothetical, and the losses can be known. English case law tends more to this position.[128] Again, this brings us to a similar position as with the suggested solution to the goods cases: an assumption that the most substitutive amount should be awarded, subject to exceptions where the plaintiff actually does not need to mitigate and the factual losses are known. This is a fairer distributive solution between the parties.

VI. Conclusion

60 This article has sought to demonstrate that while substitutive concerns mould awards of contract damages to a significant degree, the doctrine of mitigation is in tension with those concerns. It has revealed that mitigation principles engage with localised questions of distributive justice in the sense of effecting a just allocation of benefits and burdens between plaintiff and defendant. Indeed, the analysis highlights that the doctrine of mitigation is *implicitly* built into some measurements for "direct loss" or "substitutive awards", with the effect of diluting the substitutive nature of the award. The article has shown that the concept of *avoidable loss* in mitigation reflects a policy of the law to encourage self-help – where the defendant cannot be forced to perform and will not do so, the plaintiff is best placed to avoid loss if she has access to substitute performance in the market, and the burden of finding a substitute hence falls upon her. *Avoided loss* is different to avoidable loss. The policy behind it is simply a mathematical *quid pro quo*: just as the defendant must pay if the plaintiff gets a worse performance by seeking a substitute performance, the defendant can benefit if the plaintiff gets a better performance by seeking a substitute performance. However, if the plaintiff gets an identical performance to that which was promised, the court simply awards the cost of the substitute. It has been shown that courts tend not to consider the ramifications if the plaintiff then passes on the costs of purchasing the substitute performance to third party purchasers, as in *Clark v Macourt*. It has been suggested that the result is insufficiently cognisant of the distributive ramifications of the decision. In some other cases, an award of damages leaves the plaintiff in a better position than she occupied in the beginning because of sub-sales to third parties. It has been suggested that while the initial award should be corrective and substitutive (that is, the third-party sale is irrelevant), the defendant ought to be able to point to situations where mitigation has not taken place and the plaintiff is not subject to a claim by third parties

127 John Ren, "Measure of Damages for Defective Building Work" (2014) 32 JCL 69 at 80–81.

128 See *Tito v Waddell (No 2)* [1977] Ch 106 at 132, *per* Megarry V-C. See also Adam Kramer, *The Law of Contract Damages* (Oxford: Hart Publishing, 2014) at pp 132–133.

and argue that a plaintiff should pay her actual loss as a matter of interpersonal justice.