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Session One: Contract Law 152PO1B 7.30am - 10.30am

"Quantifying damages for economic loss: Is this the hardest thing commercial litigators do?"

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Your instructions:

Your client has a cause of action sounding in damages for economic loss. Your client seeks advice on the likely quantum of damages that a court might award. A Court of Appeal decision on 16 September 2014, *Ramsay v BigTinCan Pty Ltd* [2014] NSWCA 324 http://www.caselaw.nsw.gov.au/action/PJUDG?jgmtid=174113 shows just how difficult a task this can be.

The facts:

The respondent, a company that had some track record in developing smartphone apps sought to raise $1.2 million to develop two apps. The appellant, one of its directors, in breach of his director's duties, dishonestly and fraudulently diverted the funding to a new entity intended to acquire the company's assets and development opportunities at a discount. What damages could the company recover from the director for breach of his duties?

The general principles for awarding damages are well-known.

General principles:

Causation of loss by the defendant
Putting the plaintiff in the same position as if he/she/it had not suffered the loss caused by the defendant

In *Target Holdings Ltd v Redferns* [1996] 1 AC 421 at 432 E-H, Lord Browne-Wilkinson said:

> "*At common law there are two principles fundamental to the award of damages. First, that the defendant's wrongful act must cause the damage complained of. Second, that the plaintiff is to be put 'in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation' ... [I]n my judgment those two principles are applicable as much in equity as at common law.*

> *Under both systems liability is fault-based: the defendant is only liable for the consequences of the legal wrong he has done to the plaintiff and make good the damage caused by such wrong. He is not responsible for damage not caused by his wrong or to pay by way of compensation more than the loss suffered from such wrong. The detailed rules of equity as to causation and the quantification of loss differ, at least ostensibly, from those applicable at common law. But the principles underlying both systems are the same.*"

The NSW Court of Appeal approved this passage in *O'Halloran v R T Thomas & Family Pty Ltd* (1988) 45 NSWLR 262 at 273 per Spigelman CJ; Priestley and Meagher JJA agreeing).

The defendant's wrongful act need not be THE cause of loss by the plaintiff. It needs only be A cause of the plaintiff's loss.

See *BigTinCan* at [62] per Macfarlan JA.

Damages/equitable compensation for loss of a chance/opportunity

Both at common law and in equity, damages can be awarded for loss of a chance or opportunity: *Spotless Group Ltd v Blanco Catering Pty Ltd* [2011] FCA 979; 212 IR 396 at [125]. As a result, the plaintiff in *BigTinCan* did not have to prove on the balance of probabilities that it would have raised additional capital if the dishonest director had not breached his director's duties. It only had to provide that it had lost an opportunity to raise additional capital: *BigTinCan* at [36] per Macfarlan JA; Gleeson JA at [123].

The Trial Judge:

The Trial Judge quantified the company's damages as the loss of opportunity to raise $1.2 million and put the loss at $300,000 - a 25% chance of raising the amount sought.

The Court of Appeal:

In the Court of Appeal, all three judges disagreed with this approach, for the reason that raising money would merely create a debt for the amount raised. Instead, all three judges agreed that one had to look at the profits the company might have earned had it not lost the opportunity to raise $1.2 million. There thus were two opportunities lost by the company: The opportunity to raise $1.2 million and the opportunity to use that money (had it been raised) to generate profits.

As Gleeson JA said at [123], "[*t]he critical issue is the quantification of the 'value' of that lost opportunity*". All three judges differed on the answer to that question.

Gleeson JA used financial projections prepared by the defaulting director for his new entity, rather than those prepared by the company. They estimated profits of $650,000 in 2011. Because of the significant contingencies faced by the company, his Honour applied a discount of 90% - producing damages of $65,000: [139]. On this view, the company only had a 10% chance of earning the forecast profits.

The company's own financial documents forecast profits before interest and tax at $1.8 million in 2011 and $5.4 million in 2012, totalling about $7.2 million. Macfarlan JA said that "*[t]he task of assessment ... is undoubtedly a highly subjective one*" which "*may involve a degree of speculation*": [82], [83]. "*Subjective*" means that one judge may assess damages very differently from another judge. His Honour said that Gleeson JA's assessment of the business opportunity at 10% of $650,000 was too low but did not himself state a percentage: [84].

Taking account of "*the very significant business contingencies*" faced by the company, his Honour agreed that the Trial Judge's figure of $300,000, although arrived at for the wrong reasons, was correct: [84]. His Honour did not express $300,000 as a percentage of potential lost profits but, had this been done, it could be seen that his assessment in fact represented only about 4% of the company's projected profits of about $7.2 million. But, using $650,000 as the maximum profits the company lost an opportunity to make (Gleeson JA's figure), $300,000 represented about 46% of potential lost profits.

The third judge, McColl JA, referred to the principle that, "*where a party's actions have made an accurate determination of damage or loss problematical, doubtful questions should be resolved against that party and the court should assess damages or compensation in a robust manner*": *Nicholls v Michael Wilson & Partners Ltd* [2012] NSWCA 383 at [287] per Sackville AJA, Meagher and Barrett JJ agreeing; see also *Houghton v Immer (No 155)* (1997) 44 NSWLR 46 at 59 per Handley JA, Mason P and Beazley JA agreeing. Gleeson JA agreed with this approach at [122].

Her Honour also took into account "*that seeking to evaluate the loss suffered by* [the company] *by reason of the appellants' conduct requires the use of hindsight and common sense": O'Halloran, supra,* 45 NSWLR at 273 per Spigelman CJ, Priestley and Meagher JJA agreeing.

Her Honour also referred to "*the necessarily impressionistic exercise involved in the assessment of damages*" and said that, as a result, she "*may not have reached the same figure*" as Macfarlan JA but nonetheless agreed that $300,000 represented "*a fair assessment*" of the company's loss: [4].

The result:

Four judges assessed the company's damages in this case:

- Two judges assessed the damages at $300,000, although one of them (the trial judge) used the wrong method to reach that figure. Based on the company's forecasts, this represented only about 4% of the potential lost profits. But, based on a much lower forecast (by the defaulting director), it represented about 46% of the lost profits.

- One judge might have reached a figure different to $300,000 had she herself assessed damages (it is not clear whether it would have been higher or lower) but was prepared to agree with $300,000.

- The fourth judge assessed damages at 10% of the forecast profits. But because a much lower forecast (by the defaulting director) was used, the damages were only $65,000. Had the fourth judge assessed damages as 10% of the company's forecast profits, the resulting amount would have been 10% of $7.2 million or $720,000. Thus, the judge who used the lowest percentage chance of the company making profits could have come up with the largest figure for its lost profits!

- In the result, by majority, the damages awarded were $300,000.

- An application by the defaulting director for special leave to appeal to the High Court of Australia will be heard on 13 March 2015: S268/2014. This may well not be the end of the story!

The take-away lessons:

- Advising a client on the likely quantum of damages for economic loss is extremely difficult because the process is impressionistic and highly subjective - which is another way of saying that different judges legitimately can reach very different results.

- The range of outcomes is affected both by the figure used for the maximum profits lost by the plaintiff and the percentage of those profits that the plaintiff would have earned.

- Because of this, it would be prudent to advise a client that it is not possible to give firm advice on the likely result.

- Instead, the client should be advised of the range of damages that could be awarded and the factors that might push the award toward the upper or lower extreme of the range.

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26 February 2015