

Assessment of damages for breach of contract

by Mark Brookes, Partner

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In *Tabcorp Holdings Ltd v Bowen Investments Pty Ltd* [2009] HCA 8, the High Court recently upheld an award for damages in the amount of \$1.38 million in favour of the lessor of premises. These premises were altered by a tenant without the lessor's prior written approval. The court preferred the cost of rectification, as opposed to the diminution in value, as the appropriate measure of damages for the loss sustained as a result of the tenant's breach.

Background facts

Tabcorp Holdings Ltd (**Tabcorp**) was the lessee of an office building in Melbourne owned by Bowen Investments Pty Ltd (**Bowen**). The lease contained a covenant that restricted Tabcorp from altering the premises without Bowen's prior written approval.

The foyer of the premises was significant to Bowen; it was completed only six months prior to Tabcorp taking possession of the premises and was of a high quality stone and timber construction. It was for this reason that Bowen was unwilling to provide Tabcorp with its approval, for the alteration of the foyer, as required by the covenant in the lease.

On visiting the premises however, a director of Bowen witnessed the demolition of the foyer. Bowen protested to Tabcorp to no avail. Tabcorp shortly thereafter completed the demolition of the original foyer and the construction of a new foyer in its place.

Whilst the lease remained on foot, Bowen instigated proceedings against Tabcorp seeking damages for breach of the covenant not to alter the premises.

Lower Court decisions

The trial judge found in favour of Bowen, and awarded damages in the amount of \$34,820, being the difference between the value of the property with the old and the new foyer.

In brief

- The High Court confirms a lessor's prima facie entitlement to rectification damages as the appropriate measure of loss, for breach of contract/lease.

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Bowen appealed the assessment of damages to the Full Court of the Federal Court, and the damages award was increased to \$1.38 million, which included \$580,000 for the cost of restoring the foyer to its original condition and \$800,000 for loss of rent while that restoration took place.

Tabcorp appealed the Full Court's decision to the High Court seeking restoration of the trial judge's assessment of damages.

High Court decision

The High Court dismissed Tabcorp's appeal, unanimously upholding the decision of the Full Court and Bowen's award of damages of \$1.38 million.

The High Court said that the non alteration clause was an express negative covenant:

"It serves a function of considerable practical utility in relation to the landlord's capacity to protect its legitimate interest in preserving the physical character of the premises leased."

Accordingly, the High Court confirmed that the common law rule is that where a party sustains loss by reason of a breach of contract, it is to be placed in the same position, with respect to damages, as if the contract had been performed.

In the present case it meant that as Bowen was contractually entitled to the preservation of the premises without alterations not consented to, the appropriate measure of damages is the loss sustained by Tabcorp's failure to comply with that obligation, that loss being the cost of restoring the premises to the condition it would have been in had the obligation not been breached.

The High Court confirmed that for the measure of damages to be assessed in accordance with the costs of rectification, the work to be completed to return the premises to its original condition must not only be necessary to produce conformity, but must also be reasonable in the circumstances. However, the court went on to say that the test of unreasonableness will only be satisfied in fairly exceptional circumstances.

It was said that 'where an innocent party is merely using a technical breach to secure an uncovenanted profit' is a suitable example of what might satisfy the unreasonableness test, thereby warranting damages being awarded on a diminution of value basis only.

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Tabcorp relied on the findings of the trial judge that Bowen constructed and leased the premises for commercial purposes to argue that they did not value the aesthetic qualities of the foyer, which was merely a 'leasing tool' and the old foyer was no more effective at procuring potential lessees than the new foyer. This argument was rejected by the High Court and it was held that in the circumstances it was not unreasonable for Bowen to seek rectification damages.

The High Court said that it was open for Tabcorp to argue that any award for damages should be reduced by a betterment discount. In theory, if Bowen were to use the damages obtained at judgement (together with interest earned) to return the foyer to its original condition after taking possession of the premises at the expiry of the lease, it would be better off than it would have been had the covenant not been breached. If Tabcorp had not breached the lease, Bowen would have taken possession of the foyer which would have been subjected to 15 to 20 years of wear and tear and would probably have required some refurbishment in any event. However, no such argument was raised by Tabcorp.

Conclusion

The decision in *Tabcorp Holdings Ltd v Bowen Investments Pty Ltd [2009] HCA 8* is significant as the High Court has confirmed that in circumstances where a lessor contracts to protect its position, as Bowen did, a breach may not be able to be rectified simply by the payment of damages to put the innocent party in the same *financial* position, with respect to the market value of the premises, that it would have been in, had the breach not occurred. Rather, the more appropriate (and significantly higher) measure of damages may be to return the lessor to its *actual* position under the contract, which would also include any loss of rent while the repairs are undertaken.

Upcoming presentation...

Clayton Payne, Associate will be presenting a complimentary in-house seminar entitled "**Back to the Future? - The Fair Work Act 2009**" on Thursday 16 July 2009.



Clayton will cover off on how the Rudd Government's reforms under the new "*Fair Work Act*" impact upon business and what is in store in relation to:

- awards;
- collective agreements;
- unfair dismissals; and
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