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Author: Scott Elbert Dobbs

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Scott Elbert Dobbs
University of Wollongong

Dobbs, Scott Elbert, Common law recognition of opportunity costs: the classification dilemma and the religious legacy, Doctor of Philosophy thesis, School of Accounting and Finance, University of Wollongong, 2003. <http://ro.uow.edu.au/theses/1905>

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**Common Law Recognition of Opportunity Costs:
The Classification Dilemma and the Religious Legacy**

A thesis submitted in fulfilment of the requirements for the award of the degree of

Doctor of Philosophy

From

The University of Wollongong

By

Scott Elbert Dobbs

Bachelor of Commerce (Honours 1)

Bachelor of Law (Honours 2)

The School of Accounting and Finance 2003

Volume Two

CHAPTER SIX: THE FACTS OF EACH CASE

Introduction

The first section of this thesis examined the origin and formation of the common law and its historical infection with the church's hatred of usury. The worldviews of the common law and economics/finance were then contrasted to show that, in salient respects, deep philosophical tension resides between them. This section of the thesis examines the contemporaneous difficulties created by the ossification of the classification dilemma into the common law which face a litigant who attempts the recovery of opportunity costs. The hurdles which must be overcome in claiming compensation for opportunity cost are compounded by: the framework of the common law procedural mechanism which places burdens upon the parties who come to court seeking conflict resolution; the application of the rules of law which are taken from past cases and work within the legal rules paradigm which applies to damages awards; and the individual public policy perspective which influences the dispositive attitude which judges manifest toward cases which come before them. This chapter also examines the legal doctrines which have formed around the adversarial nature of the common law and which place responsibilities upon parties to litigation to supply tangible evidence and conceptual justification for the court's sanction against the defendant for losses inflicted, which include opportunity costs.

Any plaintiff attempting recovery of opportunity cost from a culpable defendant will be required to answer three questions which relate to the facts of each case:

- 1) Did the defendant *cause* the loss of the plaintiff?
- 2) Was the loss so remote that recovery is precluded?

- 3) Did the plaintiff take reasonable action to avoid the additional losses when it became manifest that the losses would accrue?

These questions relate directly to breach of contract, with additional considerations applying in tort cases. The additional considerations, especially those related to hypothetical circumstances, will be considered in this chapter.

The extent of recovery of losses in contract is governed by the rule in *Hadley v Baxendale*¹ (1854), where the court attempted to erode the powers of juries. “The decision in *Hadley v Baxendale* was part of a movement to convert questions of fact to be determined by a jury, into questions of law decided upon by the court and, in this particular case, to establish a doctrine of remoteness of damage.”² Since that time, the test of remoteness has been refined by the courts. Tort law has more recently undergone significant changes, progressing from the “but for” test,³ which had governed the limits of damages recovery in tort in the past, to the modern “common sense” test enunciated by the High Court in *March v Stramare*⁴ (1990). This must be kept in mind during the analysis below of the tort cases settled in the recent past. Occasionally, judges have stated that the issue of foreseeability, which sets the limit of recoverable damages in tort, also applies in contract as well.⁵

The courts treat events differently, depending upon whether the event has happened, is a past hypothetical event, or a future hypothetical event. Each of these types of event may be subject to a different regime by the courts, for the common law is ill-equipped to deal

¹ (1854) 9 Ex. 341; 156 E.R. 145.

² Cooke, P. J. and Oughton, D. W., 1989, *The Common Law of Obligations*, Butterworths, p. 245.

³ *March v Stramare (E. & M. H.) Pty. Ltd.* (1991) 171 C.L.R. 506; *Chappel v Hart* [1998] HCA 55 (2 September 1998) (High Court of Australia) These cases are covered in detail in the succeeding sections.

⁴ [1990-1991] 171 C.L.R. 506.

with future and hypothetical events, requiring tangible evidence to satisfy the legal burdens placed upon parties to litigation. Another consideration is whether a defendant caused a plaintiff to lose a valuable chance, which has also generated legal consideration of its own.

In order to permit a systematic examination of the conflicts which are inherent in the common law approach to damages awards, the common law rules which place legal obligations upon litigants to supply information and substantiation for the statements which are alleged against their adversary in court are segregated in the examination below. As the plaintiff is the party asking the court for relief, the initial burden to prove to the court's satisfaction that a relationship or duty exists between the plaintiff and defendant, the breach of which has caused some loss which can be quantified in money terms, and is not so intangible or removed from the central culpable action of the defendant that the court is swayed to deny the award of money in compensation for the loss. Each and every material aspect of the plaintiff's case is tested by the defendant, and if any salient point fails to meet the court's requisite standard of proof, the action might fail. There is a lack of linguistic precision and an absence of a cohesive theoretical construct in this process. In addition, the common law does not have an effective ability to resolve conflicts where probability enters into the resolution process. As a result, when cases arise where 'what would have been' is argued against 'what actually was', inconsistencies emerge which manifest the shortcomings imposed upon the common law through a lack of omniscience. This is especially true when considering hypothetical circumstances and future events, the majority of cases classifying these future-oriented claims for damages as 'special damages' requiring strict proof of their occurrence.

⁵ Treitel 1995, pp. 870-873 draws attention to the comments of the House of Lords in deprecating this

Damages are classed as ‘general’ or ‘special’, a distinction that affects the procedural difficulties in their respective recovery. General damages are *presumed* recoverable upon proof of the defendant’s culpable act and the resulting loss. Special damages, in contrast, must be *strictly proven*, and pleaded specifically, or they are precluded from recovery. Opportunity costs are normally classified as special damages, or consequential damages, which suffer from the additional evidentiary hurdle placed upon recovery by the courts, which explains much of the difficulty in actions seeking recovery of opportunity costs.

Damage: Direct or Consequential

Damages in the court’s view are either direct, i.e., general damages, or they are indirect, i.e., ‘consequential’ or ‘special damages’. There are procedural differences in claiming these different types of damages, and the classifications are not static.⁶ The pleading rules normally stipulate that general damages need not be pleaded with particularity, but special or consequential damages must be pleaded specifically.

‘General damages’, as I understand the term, are such as the law will presume to be the direct natural or probable consequence of the act complained of. ‘Special damages,’ on the other hand, are such as the law will not infer from the nature of the act. They do not follow in ordinary course. They are exceptional in their character, and, therefore, they must be claimed specially and proved strictly.⁷

Although no philosophical reason underlies a stringent differentiation between the two types, the subtle message underpinning this nominate dichotomy is that the plaintiff will bear a stricter burden of proof in claiming special damages. Tilbury has stated that “[i]n

phrasing in relation to contracts, yet it is used in Australia. This will be covered in the text below.

⁶ Jolowicz 1960, “The Changing Use of Special Damage and Its Effect on the Law”, [1960] CLJ 214.

⁷ *Stroms Bruks Aktie Bolag v John & Peter Hutchinson* [1905] A.C. 515 at 525 per Lord Macnaghten.

principle, it ought not to give rise to any significant differences in legal consequences”,⁸ but in practice the added burden of strictly proving the loss, and not being able to take advantage of a presumption of recovery, puts the plaintiff at a distinct tactical disadvantage. Instead of simply proving the breach of contract or tort, and the subsequent injury, the plaintiff must, in addition, strictly prove the additional loss. Opportunity costs fall within this area of special damage which, given that they then must be proven strictly, places the plaintiff at a disadvantage before the trial of the action begins. If the opportunity costs were considered as general damages, the plaintiff would be able to take advantage of their presumptive recovery upon proof of culpable action by the defendant, and subsequent injury.

As damages are increasingly classified conceptually distant from the direct damages resulting from the defendant's act, they are considered increasingly *remote*, undergoing a gradual metamorphosis from falling within the bounds of the first limb of *Hadley's* rule, i.e., general damages, to falling within the bounds of the second limb, or special damages⁹. At some point, however, the damages are clearly within either, or neither, of the limbs of the rule and will be recoverable under a limb of the rule, or not recoverable at all. The ramifications of the rule in *Hadley v Baxendale* is considered in detail at the end of this chapter. Regardless of the classification of the damage, the burden will fall upon the plaintiff to satisfy the court with proof of the loss claimed. This procedural burden will diverge into firstly satisfying the court regarding the causation of the damages, and secondly satisfying the court over the question of the quantum of damages.

⁸ Tilbury, M. 1990, *Civil Remedies*, vol. 1, Butterworths, p.37.

⁹ Recall from Chapter One that the two limbs of the rule in *Hadley v Baxendale* are the losses which are the "natural, usual course of things" resulting from a breach of the relevant type, and those losses which are in the contemplation of the parties when they made the contract that would result if the relevant breach occurred, are recoverable. All others are too remote to be recoverable.

If the plaintiff does not adequately address each of these questions in court, the plaintiff will have failed to discharge the burden of proof. Opportunity costs, which can be intangible in nature, place great difficulties upon plaintiffs in meeting both required conditions.

The Plaintiff's Burden of Proof

If the plaintiff does not discharge the onus of proving damage linked to culpable action, the plaintiff has not proved that a cause of action exists.¹⁰ In 1986, in *Gates v City Mutual Life Assurance Society Ltd.* the plaintiff proved that the defendant had committed a culpable misrepresentation, and that the plaintiff had also suffered a loss, but the court refused to compensate the plaintiff because the actual loss was not sufficiently linked to the actions of the defendant.¹¹ The plaintiff, therefore, will need to prove damage, or loss, *and* that it was *caused* by the defendant. The court might simply assume the causal link depending upon the proof of a breach of duty and an injury which is of the relevant type, but the cases are not consistent on this point. More often arising in cases where an injury is claimed which itself constitutes a loss of a chance of recovery in, say medical negligence cases, or lost commercial opportunity to make a profit, causal assumptions may be more justified in some types of cases than in others, where the difficulty of proving relevant aspects of the plaintiffs case is more acute. This is considered in a separate section below. Whether the loss claimed is related to past events, and therefore

¹⁰ *Norwest Refrigeration Services Pty. Ltd. and Bain Dawes (W.A.) Pty. Ltd; Geraldton Fisherman's Cooperative Ltd. and Norwest Refrigeration Services Pty. Ltd.* [1983-1984] 157 C.L.R. 149; *Gates v City Mutual Life Assurance Society Ltd.* (1986) 160 C.L.R. 1.

¹¹ (1986) 160 C.L.R. 1. The High Court refused compensation on the ground that the misrepresentation of the defendant, that insurance had been effectively secured which rendered the plaintiff indemnified for life if injured and unfit to carry on his trade, was not sufficiently linked to the plaintiff's loss on the footing that no insurance company during the relevant period offered a policy which was comparable to that which was putatively contained in the defendant's misrepresentation. The plaintiff, therefore, would have borne the loss of the subsequent injury in any event.

viewed as rigid, certain, and immutable, or whether it is a future loss which is considered flexible, always probability-related, and inherently impossible to prove with certainty, affects the way courts deal with each type of damage. “While the past appears dead, fixed and closed, the future is seen as living, plastic and open. The future appears governed by chance, but there is no chance about the past. A putative past event has either happened or not happened. Consequently, we may feel certain that it rained yesterday while only having in mind the probability of it raining tomorrow.”¹²

A plaintiff does not get the chance to run a case twice if evidence to prove both the cause of action and the damages is not adduced in the trial at first instance. Retrials are often allowed for error in law, but not for a plaintiff’s negligence in failing to produce the evidence needed to convince a court of losses claimed. In *Luna Park (NSW) Ltd. v Tramways Advertising Pty. Ltd.* (1938) the High Court of Australia ruled that although a breach of contract had been proved, the damage had not been proved and the plaintiff was disallowed from going to trial a second time with additional evidence to prove the damage. Latham C.J. noted that:

[t]he evidence which the defendant was content to put before the Court does not make it possible to reach any estimate of damage suffered. I can see no reason why the defendant should be allowed to fight the matter over again. If a party chooses to go to trial with incomplete evidence he must abide the consequences. The fact that his evidence might have been strengthened affords no reason for ordering a new trial. Thus the defendant must be content... with nominal damages.

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¹² Hamer, D. 1999, “Chance Would Be a Fine Thing: Proof of Causation and Quantum in an Unpredictable World”, [1999] 23 *M.U.L.R.* 557 at 562. This perspective was reiterated in *Ousley v The Queen* (unreported) M96/1996 (7 April 1997) High Court of Australia Transcripts, per Kirby J.

¹³ (1938) 61 C.L.R. 286; also *Nexus Minerals NL v Brutus Constructions Pty Ltd & Anor* [1997] FCA 926 where the Federal Court has recently strongly reiterated the position that “a right to claim damages arises on proof of the breach [or tort] itself, albeit only nominal damages if the claimant is unable to prove actual loss or damage suffered by reason of the breach [or tort].”

The burden of proof to be born by the plaintiff in civil litigation is “on the balance of probabilities”.¹⁴ A party in a civil action must convince the court that it was “more probable than not” that each salient element of the plaintiff’s case occurred in order to satisfy the burden placed upon them by the courts. This burden is not static and may shift back and forth. Where a plaintiff has raised an issue it must thereafter be answered by a defendant. In rebuttal to a claim by a plaintiff, a defendant then bears a burden of proof. Afterwards a plaintiff then has an opportunity to answer the defendant’s rebuttal. Courts must be convinced that each element in a civil action occurred on the balance of probability, and if a plaintiff fails, even slightly, s/he may fail altogether. The plaintiff must, on this standard, prove: that a relationship exists (a contractual relationship or a duty of care in tort); that the defendant breached this relationship, either by a breach of contract, or breach of duty of care; that the breach caused an injury to the plaintiff; the losses through the injury are not too remote to preclude recovery, and the nature or quantum of the loss, in money terms. Any of these elements which the plaintiff fails to prove to the requisite standard, with the possible exception of the quantum of damage, will be fatal to the plaintiff’s case. The fact that evidence is led which establishes a *possibility* that the defendant’s breach or tort ‘caused’ the loss is not enough.¹⁵

Chapter Five pointed out that the evidence which courts require essentially must be concrete or tangible in nature, and must withstand ardent criticism from an adversary seeking to destroy the legal credibility of any evidence adduced by a plaintiff. Although the plaintiff may easily show that the defendant committed some culpable act, the question of whether the defendant *caused* the loss to the plaintiff is more difficult to

¹⁴ This statement is now entrenched in statute in s. 140 (1) of the *Evidence Act* 1995 (Cth).

answer. The issue of causation is not certain in law, and has undergone recent restatement which may render discovery of any underlying principle more illusive. The literature on the subject, which is extensive, will be examined in the next section.

Proof of Causation

“In order to succeed, it [is] necessary for the plaintiffs to show that, in the relevant sense, the defendants’ breaches caused the loss that they claimed.”¹⁶ In other words, there must be a causal link between the act, breach, or omission of the defendant, and the loss suffered by the plaintiff in order for the court to consider that it would be unjust to fail to award compensation.¹⁷ This causal link must be one which is recognised *in law*. Causal links may be related to place, i.e., an event occurred, for instance, at the defendant’s place of work; related to time, for example a defendant’s action prevented an executive from executing a valuable contract by preventing timely attendance at a business meeting drawn for the purpose of the contract execution whereby a competitor was then awarded the contract because of the perceived lack of responsibility in the tardy attendance and, finally, related to choice, where a defendant chooses one course of action over another, resulting in injury and loss to a plaintiff.

The issue of causation in law is a *limiting* mechanism.¹⁸ “Proximate cause is the limitation which the courts have been compelled to place, as a practical necessity, upon

¹⁵ *Seltsan Pty. Ltd. v McGuinness; James Hardie & Coy Pty. Ltd. v McGuinness* [2000] NSWCA 29 (7 March 2000), Files 40456/97 and 40463/97. *St. George Club Ltd. v Hines* (1961-62) 35 A.L.J.R. 106; *Tubemakers v Fernandez* (1976) 50 A.L.J.R. 20.

¹⁶ *Alexander v Cambridge Credit Corporation Ltd.* (1987) 9 N.S.W.L.R. 310 at 319 per Mahoney JA.

¹⁷ Some of the losses, even though caused by a defendant’s culpable act, will never be recompensed. Honore states it, “It is only exceptionally that the law transfers to a defendant the whole risk of the loss, whatever its cause, that would not have occurred but for the defendant’s conduct. Honore, 1993, p. 3.

¹⁸ Treitel 1990, and Carter, Harland, and Lindgren 1990, also agree with this portrayal; also *Alexander v Cambridge Credit Corp. Ltd.* (1987) 9 N.S.W.L.R. 310 at 331 per Mahoney JA.

the actor's responsibility for the consequences of his conduct."¹⁹ Mechanisms of limitation are not restricted to simple causation, and "the legal principles of certainty, mitigation, and remoteness all [tend] in the direction of denying full compensation" to the plaintiff.²⁰ Although appeal to social pragmatism has always underpinned this limitation mechanism "as a practical necessity", philosophical justification is elusive.

The characterisation of actions may dictate whether or not courts sanction defendants for losses of plaintiffs. If, for example, where a plaintiff might sue to recover additional sums for a lost commercial investment where funds intended for investment in, say, an IPO, were withheld from the plaintiff by the defendant's default, the defendant could show that the plaintiff could simply have borrowed the extra funds to have made up the lost sum, then it was no longer the defendant's actions which *caused* the loss, for the loss can then be characterized as a failure of the plaintiff to properly mitigate. This does not only affect the issue of causation, but also relates to mitigation of damages, which is covered in a separate section below. In *March v Stramare (E. & M.H.) Pty. Ltd.*²¹ (1991) (*March*), the High Court of Australia confirmed its rejection of the 'but for' test (this damage would not have occurred 'but for' the defendant's act or omission), as the principle test of factual causation. In its place, it preferred the "common sense view of causation which it had expressed in its decision in *Fitzgerald v Penn*" (1954).²² Mason C.J. pointed out in *March* that the purposes of the law, in seeking the foundation of

¹⁹ Prosser, *Torts* p. 210, cited in Hart and Honore 1959, p. 99, note 2. It is difficult to segregate causation without intertwining notions of knowledge and responsibility into the discussion. Indeed, as Cardozo CJ of the New York Court of Appeals (as he then was) has said, "If no hazard was apparent to the eye of ordinary vigilance ... it did not take to itself the quality of a tort, though it happened to be wrong..." This shifting standard in the eyes of the courts provides fruitful areas of discussion which, unfortunately, cannot be pursued in this dissertation completely. *Palsgraf v. Long Island Railroad Company* 248 N.Y. 339; 59 A.L.R. 1253.

²⁰ Waddams 1992, "The Principles of Compensation", in Finn 1992, *Essays on Damages*, LBC, pp. 1-13 at p. 3.

²¹ (1991) 171 C.L.R. 506.

causation, dictated an alternative approach to that of the discipline of philosophy because the purpose of the results was different:

In philosophy and science, the concept of causation has been developed in the context of explaining phenomena by reference to the relationships between conditions and occurrences. In law, on the other hand, problems of causation arise in the context of ascertaining or apportioning legal responsibility for a given occurrence.²³

This has been confirmed by the High Court in a number of later cases, where the courts have upheld the ‘common sense’ approach.²⁴ The English House of Lords has also reiterated support for this view.²⁵ ‘Common sense’, though, is an indeterminate term which imports public policy issues which are considered in Chapter Eight.

Irrespective of the actual test used by the court to determine the causal source of an injury, the court will not forsake the contextual circumstances. “Questions of causation are not answered in a legal vacuum. Rather, they are answered in the legal framework in which they arise”.²⁶ Lord Hoffman put the idea of a legal framework into perspective:

In answering questions of causation for the purposes of holding someone responsible, both the law and common sense normally attach great significance to deliberate human acts and extraordinary natural events. A factory owner carelessly leaves a drum containing highly inflammable vapour in a place where it could easily be accidentally ignited. If a workman, thinking it is only an empty drum, throws in a cigarette butt and causes an explosion, one would have no difficulty in saying that the negligence of the owner caused the explosion,. On the other hand, if the workman, knowing exactly what the drum contains, lights a match and ignites it, one would have equally little difficulty in saying that he had caused the explosion and that the carelessness of the owner had merely provided him with an occasion for what he did. One would probably say the same if the drum was struck by lightning. In both cases one would say that although the vapour-filled drum was a necessary condition for the explosion to happen, it was not caused by the owner’s

²² (1954) 91 C.L.R. 268 at 276 also cited in the judgment of McHugh J. in *Chappel v Hart* [1998] HCA 55 (2 September 1998), p. 5.

²³ (1991) 171 C.L.R. 506 at 509.

²⁴ [1998] HCA 55.

²⁵ Lord Salmon and Lord Wilberforce in *Alphacell Ltd. v Woodward* [1972] A.C. 824 at 847; *Empress Car Company (Abertillery) Ltd. v National Rivers Authority* 5 February 1998, House of Lords at p. 5.

²⁶ *Chappel v Hart* [1998] HCA 55 per Gaudron J.

negligence. One might add by way of further explanation that the presence of an arsonist workman or lightning happening to strike at that time and place was a coincidence.²⁷

Although Lord Hoffman may have established the importance of context in matters of causation, he failed to define clearly the underlying principles of how the court will assign blame for a loss through the issue of causation. This was recognised by Kirby J. in *Chappel*:

[Both in common law courts and civil law courts] the courts have searched for principles to provide a “filter to eliminate those consequences of the defendant’s conduct for which he [or she] should not be held liable”. The search sets one on a path of reasoning which is inescapably “complex, difficult and controversial”. The outcome is a branch of the law which is “highly discretionary and unpredictable”. Needless to say, this causes dissatisfaction to litigants, anguish for their advisers, uncertainty for judges, agitation amongst commentators and friction between ... professionals and their legal counterparts.²⁸

Kirby J. then assessed the impact this approach might have on litigants:

As Dixon CJ, Fullager and Kitto JJ remarked in *Fitzgerald v Penn* “it is all ultimately a matter of common sense: and “[I]n truth the conception in question [i.e. causation] is not susceptible of reduction to a satisfactory formula”. Similarly, in *Alphacell Ltd. v Woodward*, Lord Salmon observed that causation is “essentially a practical question of fact which can best be answered by ordinary common sense rather than by abstract metaphysical theory.” Yet, a losing party has a right to know why it has lost and should not have its objections brushed aside with a reference to “commonsense”, at best an uncertain guide involving “subjective, unexpressed and undefined extra-legal values” varying from one decision-maker to another. Nevertheless, despite its obvious defects, the commonsense test has been embraced by this Court as a reminder that a “robust and pragmatic approach” to such questions is the one most congenial to the common law.²⁹

²⁷ *Empress Car Company (Abertillery) Ltd. v National Rivers Authority* (unreported) House of Lords 5 February 1998, at p. 6 per Lord Hoffman.

²⁸ [1998] HCA 55, p. 19.

²⁹ *Chappel* per Kirby J. at p.22

The issue of *causation* deals with the link between the defendant's action and the loss claimed. The issue of *remoteness*, or *proximity*³⁰, deals with the link between the losses and the burden placed upon the defendant by the court to give recompense for them. In effect "[q]uestions of proximity are concerned with whether the law should permit the plaintiff to recover from the defendant for the kind of damage which he has allegedly suffered"³¹. It must be stressed, therefore, that the scenario can arise where a reasonable person may conclude that the defendant 'caused' the plaintiff's loss, but the court will not enforce a pecuniary burden upon the defendant for the act or omission for which there is complaint because of the legal rules determining the recovery of certain types of damage, or upon notions of public policy. In law the question to be answered is not "what caused this injury?" but "did the fact that the defendant did so-and-so (where so-and-so constitutes a basis of liability, such as negligence or breach of contract) cause the injury?"³²

'Cause', therefore, does not necessarily mean that some initiating force was put into being by an act or omission which set in motion a chain of events where damage became inescapable. Concepts of risk, probability of the defendant being responsible, alternative causes, and hypothetical circumstances are finely balanced by the court, to seek the final goal in the court's eyes, which is to 'do justice' between the parties. The lingering spiritual duty of the ancient English monarch to administer justice to his subjects, as noted in Chapter Three, is still alive within the common law courts of the 21st century.

³⁰ The issue of proximity in this context deals with nearness and is used in other ways in conjunction with the issue of whether or not a defendant's action were the *proximate cause*, or the nearest cause. This term is used more widely in the USA jurisdictions.

³¹ DiLallo 1990, "The Measure of Damages in Contract", in BLEC 1990, *Damages in Contract and Tort*, pp. 239-260 at 243-4.

³² Honore 1999, p. 2.

Area of Risk Test

It was mentioned above that sometimes courts make a presumption of causation. The court may do so if an injury occurs to a plaintiff within an area of risk created by a defendant. Thus, in *McGhee v National Coal Board*³³ (1973), the defendant was held liable to a plaintiff who suffered loss from severe dermatitis which the court found was caused by the negligence of the defendant in not providing washing facilities for the plaintiff who worked in the defendant's brick kilns. As the court found that the defendant had materially increased the risk of dermatitis occurring, the plaintiff was able to recover damages for the injury.

But the question remains whether a pursuer must necessarily fail if, after he has shown a breach of duty, involving an increase of risk of disease, he cannot positively prove that this increase of risk caused or materially contributed to the disease while his employers cannot positively prove the contrary. In this intermediate case there is an appearance of logic in the view that the pursuer, on whom the onus lies, should fail ... The question is whether we should be satisfied ... with this logical approach. In my opinion, there are further considerations of importance. First, it is a sound principle that where a person has, by breach of a duty of care, created a risk, and injury occurs within the area of that risk, the loss should be borne by him unless he shows that it had some other cause.³⁴

This case also stands as support for the proposition above that the evidentiary onus shifts back and forth between plaintiff and defendant during the court process. If in the case above the defendant were to introduce evidence which showed the employee worked during the evening hours for another employer with duties handling toxic chemicals known to create a high risk of dermatitis, this may be enough for the defendant to escape liability. If, in rebuttal, the plaintiff employee were to show that the chemical plant where he worked at night issued protective clothing, filtered personal breathing apparatus and other safety equipment which alleviated the risk of contracting dermatitis, the onus might

³³ [1973] 1 W.L.R. 1.

then shift back to the defendant to prove somehow the issued apparatus was deficient or perhaps that another cause was operative. The onus which shifts in these circumstances is not the *legal* onus, but the *evidentiary* onus.³⁵ The court will weigh each piece of evidence produced in court to ascertain the legal credibility to be assigned to it, and a matrix of both evidence and argument will comprise each party's respective case. When the parties finally rest, the plaintiff has either discharged the legal onus of evidentially proving the elements of the case to the requisite standard, or the case fails altogether.

The court's willingness to assume the causal nexus may also be explained by reference to a social policy exercised by the court in sympathy with the plaintiff where there is an inherent difficulty in overcoming the burden of proof in disease cases in general, or perhaps by a tacit understanding by the bench that knowledge is incomplete, coupled with an intuition of the defendant's guilt. These considerations, which are extra-legal and, *ex-hypothesi*, are precluded from open consideration in court judgments, were noted by Kirby J. in *Chappel*, who recognised the intrusion of "extra-legal and unexpressed values" related to the causation issue. Although to Kirby J. there is a clear problem with the legal approach to the issue of causation, His Honour could still not offer a clear and unequivocal solution to the quandary where he found "a large element of intuition in deciding such questions which may be insusceptible to detailed and analytical justification [and] not susceptible of reduction to a satisfactory formula."³⁶

³⁴ *McGhee v National Coal Board* [1973] 1 W.L.R. 1 at 6 per Lord Wilberforce.

³⁵ This point was carefully pointed out in the Transcripts of *Naxakis v Western and General Hospital and Anor.* by Kirby J. in conversation with Mr. Moshinski for the appellant. Transcripts of Proceedings 16 November 1998, <http://www.austlii.edu.au/au/other/hca/transcripts/1998/M43/1.html> morning. It is also in the principal judgment at (1999) 162 A.L.R. 540 at 561, also Gaudron J. at 547; Hamer, D. 1999, p. 34 of 74.

³⁶ *Chappel v Hart* [1998] HCA 55, p. 22; Honore, 1974, "Causation and Remoteness of Damage", in MacCormack and Birks (eds.) 1986, *The Legal Mind*, Oxford University Press, p. 1-43;

It is also possible to characterise cases similar to *Chappel* as a loss of a chance to avoid the injury, which is covered in a separate section below. Cases like *McGhee* (see above) must also consider whether a concurrent cause was active which contributed to the injury of the plaintiff, further complicating the court's task. If justice is the overriding goal of the court in the disposition of any case, increased medical knowledge regarding multiple possible causes of a disease or other injurious medical conditions may not be helpful to courts in disposing of cases. Considerations of multiple causes of a condition, and subsequent losses, show that courts, in the name of justice, are attempting to determine whether the plaintiff's loss should be recovered from the defendant, or whether in law there was a new, supervening, or alternative explanation for the plaintiff's detrimental change in position.

Novus Actus

If there is some intervening act or cause that breaks the link between the plaintiff and the acts or omissions of the defendant, then the court may rule that the intervening act of some other circumstance, or *novus actus interveniens*, is such as to excuse the defendant from the burden of recompense to the plaintiff, as the 'chain of causation' is broken.³⁷ Thus, courts recognize the intricate web of circumstances which may surround the loss or injury to a party, and seek to avoid placing sanction for the plaintiff's whole loss upon a defendant where circumstances have arisen which are not within the defendant's influence and, therefore, an injustice may arise in holding the defendant entirely responsible. This concept may be portrayed as follows. A man is injured by the negligence of a driver; he is taken to the hospital by ambulance and on the way to the hospital the ambulance is struck by a concrete slab negligently being moved by crane

above the street, killing the injured man. Is the original defendant driver responsible for the circumstances which in fact killed the injured man? The court would assess the secondary event as a new act which intervened into the circumstances of the original action. It is questionable, however, that the original tortfeasor would be excused completely. Contemporary courts would have no trouble in readily recognizing that concurrent and successive causes can exist.

If the negligence or breach of duty of one person is the cause of injury to another, the wrongdoer cannot in all circumstances escape liability by proving that, though he was to blame, yet for the negligence of a third person the injured man would not have suffered the damage of which he complains. There is abundant authority for the proposition that the mere fact that a subsequent act of negligence has been the immediate cause of disaster does not exonerate the original offender.³⁸

The original tortfeasor in the scenario above would be able to escape additional damages clearly shown to have been caused by the negligence of the crane operator. The original victim, or in this case the victim's family, would be able to recover as far as money can compensate, for the whole loss incurred from their departed loved one. The main argument would likely focus on the case between the negligent driver and the negligent crane operator regarding how much each would be required to pay.

Intervening events are not restricted to tort cases of this nature. Courts require both victims of tortious conduct and victims of breach of contract to avoid any losses which are possible to avoid by taking reasonable action. If a victim fails to take reasonable and prudent action to stop continuing losses after the initial damage has been inflicted, it is seen as a *novus actus*. The court views those avoidable losses as having been *caused* by the plaintiff's failure to take action, and not the defendant's culpable act. In these

³⁷ *Chapman v Hearse* (1961) 106 C.L.R. 112.

³⁸ Lord du Parc in *Grant v Sun Shipping Co. Ltd.* [1948] A.C. 549 at 563; also cited and quoted by Mason C.J. in *March v Stramare (E. & M. H.) Pty. Ltd.* [1990-91] 171 C.L.R. 506 at 513.

circumstances the defendant is excused from incurring any liability in contract breach, although s/he may be directly responsible for those losses if, upon examination, it can be shown that the plaintiff could have avoided those ongoing losses. In contract this is known as the plaintiff's duty to mitigate his/her loss.

Mitigation of Damages

Within the general heading of an intervening act, there is a 'duty' imposed upon the victim of breach of contract or tort which, in effect, places a burden upon the victim to attempt to avoid any losses which can be avoided in the circumstances. An injured party must attempt, for example, to avoid losses incurred in a rising market by replacing goods where delivery is refused by a stubborn seller in breach of contract. A seller must try to sell with expedition in a falling market goods which have been wrongfully refused in breach of contract by a purchaser. A purchaser of a defective product may be precluded from recovery of damages past the point where the court determines that it would have been reasonable for the defective product to be replaced instead of continually repaired.³⁹ In short, the right to damages for breach of contract is not absolute, and is qualified by a rule "which imposes on the plaintiff the duty of taking all reasonable steps to mitigate the loss consequent on the breach, and debars him from claiming any part of the damage which is due to his neglect to take such steps."⁴⁰

This burden of mitigation is seen as a species of loss which was not in fact caused by the actions of a defendant, and an injured party who could have otherwise avoided loss is not entitled to just sit and do nothing and let losses accumulate, charging them to the

³⁹ *Burns v M.A.N. Automotive (Australia) Pty. Ltd.* (1986) 161 C.L.R. 653.

defendant.⁴¹ To rule otherwise is to sanction the actions of a lazy plaintiff who lets losses increase without any action being taken and then attributes the losses to the defendant. The courts have developed the attitude that any losses which a reasonable plaintiff could have avoided were caused not by the actions of the defendant, but by the apathy or lethargy of the plaintiff.

This has direct impact on the recovery of avoidable opportunity costs. If the court ascertains that the plaintiff had any resources which could have been directed at avoiding losses for, say, an investment which was planned for funds wrongfully withheld by the defendant, then the plaintiff may be denied the recovery of opportunity losses. The loss is categorised as having been caused by the plaintiff's failure to mitigate rather than by any action on the part of the defendant. It may be, in such circumstances, that the court will seek to determine whether the injured party could have avoided the losses by purchasing alternative products, borrowing funds to secure the alternative investment, or in some practical reasonable way making provision to alleviate the opportunity cost by using an alternative resource, rather than simply letting the losses accumulate.

In *Seguna and Seguna v Roads and Traffic Authority of New South Wales*⁴² (1995), the plaintiffs failed to recover a claimed opportunity cost because they failed to show that they had taken any concrete steps to actually make the investment which they claimed made up part of the loss they bore from the defendant's actions which caused a drop in

⁴⁰ *British Westinghouse Electric and Manufacturing Co. v Underground Electric Railway Co. of London Ltd.* [1912] A.C. 673 at 689 per Viscount Haldane.

⁴¹ Bridge 1989, draws attention to the inconsistencies which arise in certain English and Australian cases where plaintiffs who suffered losses from breach of contract were denied damages for a proven loss because the court decided it would have been prudent for them to have recontracted with the defendant on new terms which would have avoided a portion of the losses claimed. See "Mitigation of Damages in Contract and the Meaning of Avoidable Losses", [1989] 105 L.Q.R. 398.

⁴² [1995] NSWLEC 147, at p. 8.

property value. If the plaintiffs had taken concrete steps to make the planned investment with borrowed funds, but had found themselves unable to do so from the lowered property value, which left them with diminished borrowing capacity, the court may have held the losses recoverable. The recoverable loss in these circumstances would have been the difference between the investment costs incurred as a result of the additional borrowing, and those costs which would have been incurred had the defendant not been guilty of a culpable act or omission. This is not intrinsically antithetical to the economic approach, for innovation, as noted in Chapter Five, is highly prized in the economic worldview and application of a reasonable and innovative approach to loss avoidance will certainly fall within the reasonability test applied by the court.

‘Mitigation’, consequently, is one major obstacle in claiming the opportunity costs arising from late payment by a defendant. Regardless of whether the withheld funds are debts or damages, if the injured party has the ability to borrow to invest or in some other way evade losses otherwise caused by the defendant, the courts may be singularly unsympathetic to any claims that the funds withheld by the defendant were the effective cause to losses suffered, other than direct losses.

Whether a party has acted ‘reasonably’ in avoiding losses is considered as a matter of fact,⁴³ with the ‘duty’ to mitigate⁴⁴ comprising the rule of law. The injured party will not be held to know the future with spectacular foresight or to manage remaining funds with ingenious financial knowledge, but will be held to the standard of the reasonable person

⁴³ *Payzu Ltd. v Saunders* [1919] 2 K.B. 581 (Court of Appeal).

⁴⁴ Bridge calls attention to the fact that it may be technically improper to even speak of the “duty” to mitigate, for, he says, that a duty is always reflected in a right recognized by the counterparty [1989, at 399]. This may be subject to some criticism, as the characterisation of a right, which contains a privilege of demand, versus a rule of law, which will always be available to the defendant, and both of which give the defendant the ability to escape pecuniary penalty, seems an empty distinction.

in the plaintiff's position. According to Bridge: "[t]he plaintiff must take steps consistent with the demands of reasonable and prudent action, ... not a difficult and hazardous course of action, nor to act in such a way as to impair his commercial reputation".⁴⁵

The standard which the court imposes upon a plaintiff will consider each case on its own factual circumstances. A purchaser of a truck with a defective engine, which was in breach of the seller's warranty, was debarred from claiming damages related to time, effort, and expense past that point where the courts held it prudent for him to purchase another truck or make alternative arrangements.⁴⁶ Where a purchaser refused late delivery, and instead repudiated a contract, the court held the losses attributable to the failed delivery irrecoverable on the grounds that the market value of the goods (a ship) had increased by the deadline for delivery, and it was reasonable for the buyers to have taken the ship on a fresh bargain and, therefore, avoided the loss.⁴⁷

These cases portray a tacit assumption that it is poor social policy for courts to sanction the actions of a plaintiff who simply 'does nothing' to avoid losses. Interpreted through the issue of causation, any avoidable losses are not *caused* by the defendant's act or omission, but are *caused* by the plaintiff not acting in a prudent and reasonable manner. The impact of this interpretation upon the recovery of opportunity costs is significant, but does not seem applicable where an injured party is precluded from pursuing a course of action, despite the reasonableness of the action when considered apart from other circumstances. One such scenario might be constructed where a company, under a restrictive covenant from a previous bond issue to maintain a debt/equity ratio at a certain

⁴⁵ Bridge 1989, 400.

⁴⁶ *Burns v M.A.N. Automotive (Aust) Pty. Ltd.* (1986) 161 C.L.R. 653.

level, would find itself in breach of its previous covenant if additional borrowing were pursued to make up funds wrongfully withheld from it. The result could be a forced liquidation or additional penalties imposed far in excess of the losses caused by the defaulting party. In this instance, it is submitted that despite the interpretation of mitigation as a rule of law the court will consider to what extent mitigation should have taken place as “a question of fact” in the circumstances of each case.⁴⁸ In the example above it seems prudent to assert that a company who would violate terms of a restrictive covenant in, say, the contract and trust deed relating to a debenture issue, where a leverage ratio would be exceeded with additional borrowing, resulting in a ‘trigger event’ which would expose the company to a winding up, would be under no duty at all to borrow additional funds and risk winding up where a defendant has withheld funds causing damages to flow on.

In addition, where a plaintiff has other resources which could be used to make up losses inflicted by a defendant, it does not instantly appear how the loss is actually avoided. The loss is certainly shifted within the financial paradigm of the plaintiff, but it is not alleviated in any sense at all. The opportunity cost of a resource is incurred regardless of origin of the resource. A plaintiff, therefore, incurs an opportunity cost when funds are redeployed from another investment or account to offset a loss caused by the defendant’s late payment. The loss is incurred and the logic of the defendant’s exoneration where a plaintiff fails to borrow or redeploy resources is not cogent. This point was addressed by

⁴⁷ *Sotiros Shipping Inc. and Aeco Maritime SA v Sameiet Solholt (The Solholt)* [1983] 1 Lloyd’s Rep 605; also cited Carter and Harland 1998, *Cases and Materials on Contract Law in Australia*, 3rd ed., p. 799.

⁴⁸ *Payzu Ltd. v Saunders* [1919] 2 K.B. 581.

the High Court of Australia in *Hungerfords v Walker*,⁴⁹ which is considered in detail in Chapter Nine.

Causation, Hypothetical Events and Probability

In one sense, all calculations of damages by courts are hypothetical. The first rule of damages is *restitutio in integrum*, or the restoration of a plaintiff to the position s/he would have been in had the wrong, i.e., breach of contract⁵⁰ or tort⁵¹ not occurred. The courts are thereby faced with the search for *what would have been*, and then subsequently measuring that finding against what the court finds actually happened.⁵² If one defines opportunity cost in general terms as “what would have been if the defendant had not committed a culpable act” then the hypothetical nature of opportunity cost immediately confronts the observer, and the question is subsequently removed from the plaintiff’s *assertion* of what would have been, to a question of the plaintiff’s *proof* of what would have been, and discussion returns to the evidential burden, the subject of this chapter.

If the court is convinced that it was “more probable than not”⁵³ that a culpable past event was *caused* by the defendant’s tort or breach of contract, i.e. theoretically over 50%, then the plaintiff recovers complete damages,⁵⁴ subject to the rules of remoteness and mitigation of damages. This is the all-or-nothing rule in civil litigation. To define a plaintiff’s loss as a chance that an event will occur, such as the chance to win a contest, be included in a prize draw, or escape an otherwise detrimental event, complicates the

⁴⁹ (1989) 171 C.L.R. 125.

⁵⁰ *Robinson v Harman* (1848) 1 Ex 850 at 855; 154 E.R. 363 at 365; *Wenham v Ella* (1972) 127 C.L.R. 454; *Commonwealth v Amann Aviation* (1992) 174 C.L.R. 64.

⁵¹ *Livingston v Rawyards Coal Co.* (1880) 5 App Cas 25.

⁵² The *restitutio in integrum* rule is examined more carefully in Chapter Seven.

⁵³ *Livingstone v Halvorsen* (1978) 22 A.L.R. 213; 53 A.L.J.R. 50; also see Luntz and Hambly 1992, pp. 259-60; s. 140 *Evidence Act* 1995 (Cth).

logic which has been formerly applied in cases determined on the balance of probabilities.⁵⁵ It has come to be recognized that a chance that an event will occur which is beneficial to the plaintiff is a right which has value.⁵⁶ Sometimes this is termed ‘loss of a chance’. Closely connected are the cases where there is a ‘loss of opportunity’. Loss of opportunity, although it is certainly an opportunity cost, it is not to be confused with opportunity cost in general. All losses of a commercial opportunity can be considered opportunity costs, but not all opportunity costs are losses of a commercial opportunity.⁵⁷

Under the “balance of probability” test, cases where the plaintiff lost a chance which itself had less than 50% probability of a successful outcome would be treated as having nothing of value, incurring no loss, and thus failing to prove a cause of action. Starting in 1911, though, the common law began to attribute value where the loss was a chance to gain a benefit. In *Chaplin v Hicks* (1911) the House of Lords recognised that a loss of a chance to win in a contest, or to gain a valuable right, was a chance for which some people would pay money and was valuable in itself. This has led to courts addressing a number of related issues including the valuation of chances where there are lost commercial opportunities,⁵⁸ where the chance is a chance to recover from an injury misdiagnosed by a physician,⁵⁹ or the chance is the chance to recover damages in

⁵⁴ Hamer, D. 1999, p. 3.

⁵⁵ The terminology in the courts is unfortunate, for courts in the past have not used “probability” in a mathematical sense, making discourse on this subject difficult between economics and the common law.

⁵⁶ The value of a chance can be explained through option theory. An option upon a benefit gained through a contingent event is the basis for option theory, but the courts have not analysed common law disputes in this way. This will be discussed further in Chapter Ten.

⁵⁷ This depends, of course, on whether one defines “commercial” in the wide sense as any profitable undertaking, whether personal, business related or otherwise.

⁵⁸ *Sellars v Adelaide Petroleum N.L. and Others; Poseidon Ltd. v Adelaide Petroleum N.L. and Others* (1994) 179 C.L.R. 332, (1994) A.T.P.R. 41-301; *Nexus Minerals v Brutus Constructions Pty. Ltd. & Anor.* (unreported) [1997] FCA 926

⁵⁹ *Naxakis v Western and General Hospital and Anor.* [1999] 73 A.L.J.R.782; *Hotson v Fitzgerald* [1985] 1 W.L.R. 1036; *Hotson v East Berkshire Area Health Authority* [1987] 2 All E.R. 908.

litigation, which was prevented by the professional negligence of firms of solicitors.⁶⁰ These issues are hypothetical, for the court must assess what the position of the plaintiff *would have been* if the defendant had not committed the act, for which s/he is being held responsible by the plaintiff. The losses claimed by the plaintiff normally divide into pre-trial losses, and post-trial losses. The future-oriented post trial losses, and hypothetical pre-trial losses are normally assessed differently than the pre-trial losses which actually occurred. The hypothetical past, and future losses incorporate probabilistic thinking and raise a number of controversial issues.

Pre-trial and Post-trial Loss Assessment

“The past has already happened and is, in principle, knowable. The future, on the other hand, is a matter of chance, and is a far less certain object of knowledge”.⁶¹ The past events occurring prior to trial are either proven to the requisite standard or they are not. If the court is satisfied that their occurrence was “more probable than not” then they are treated as certainly having occurred. If it is considered “more probable than not” that the losses were caused by the defendant, the defendant is treated as having caused the whole loss. When losses include future elements, the common law fails to elucidate a consistent framework of principle which is both workable and applicable in wider curial application.

The cases reveal that the courts resort to a proportional assessment of the future damages. If it is concluded that a plaintiff will need, say, an operation in the future which costs, in

⁶⁰ *Johnson v Perez; Creed v Perez* [1988-1989] 166 C.L.R. 351.

⁶¹ Hamer, D. 1999, p. 2. There is, as Hamer points out, an asymmetry in the knowledge of time between the knowable past and the unknowable future. This asymmetry is too often overlooked and presumed rather than addressed openly in case judgments.

today's terms, \$30,000, but only on a 40% probability, then it is likely that only 40% of the entire amount will be awarded.

The role of the court in making an assessment of damages which depends upon its view as to what will be and what would have been is to be contrasted with its ordinary function in civil actions of determining what was. In determining what did happen in the past a court decides on the balance of probabilities. Anything that is more probable than not it treats as certain. But in assessing damages which depend upon its view as to what will happen in the future or would have happened in the future if something had not happened in the past, the court must make an estimate as to what are the chances that a particular thing will or would have happened and reflect those chances, whether they are more or less than even, in the amount of damages which it awards.⁶²

In *Malec v J.C. Hutton*⁶³ (1990) the plaintiff, Malec, contracted a disease, brucellosis, while employed at the defendant's meatworks. A neurotic condition known to be caused by the disease supervened between the time of injury and the trial. The High Court of Australia concluded that there was a chance that the plaintiff would have contracted the neurotic condition anyway, and reduced the amount it awarded accordingly. The court equated hypothetical situations of the past with unknowable future events, differentiating the historical 'fact' from both future speculation and hypothetical past:

The fact that a plaintiff did not work is a matter of history, and facts of that kind are ascertained for the purposes of civil litigation on the balance of probabilities: if the court attains the required degree of satisfaction as to the occurrence of an historical fact, that fact is accepted as having occurred. By contrast, earning capacity can be assessed only upon the hypothesis that the plaintiff had not been tortiously injured: what would he have been able to earn if he had not been tortiously injured? To answer that question, the court must speculate to some extent. As the hypothesis is false – for the plaintiff has been injured – the ascertainment of earning capacity involves an evaluation of possibilities, not establishing a fact as a matter of history. Hypothetical situations of the past are analogous to future possibilities: in one case the court must form an estimate of the likelihood that the hypothetical situation would have occurred, in the other the court must form an estimate of the likelihood that the possibility will occur.⁶⁴

⁶² *Mallet v McMonagle* [1970] A.C. 166 at 176 per Lord Diplock; *Malec v J.C. Hutton Pty. Ltd.* [1990] 169 C.L.R. 638 at 640 per Brennan and Dawson JJ.

⁶³ *Malec v J.C. Hutton Pty. Ltd.* [1990] 169 C.L.R. 638.

Previously, the House of Lords, in *McGhee v National Coal Board*⁶⁵ (1973) had deprecated the strict assignment of probability to events of the past, and commented on the use of percentage risk assignments in the placement of blame for an event:

It is known that some factors materially increase the risk and others materially decrease it. Some no doubt are peripheral. Suppose, however, it were otherwise and it could be proved that men engaged in a particular industrial process would be exposed to a 52 per cent. risk of contracting dermatitis even when proper washing facilities were provided. Suppose it could also be proved that that risk would be increased to say, 90 percent, when such facilities were not provided. It would follow that ... the employer who negligently failed to provide the proper facilities would escape from any liability to an employee who contracted dermatitis notwithstanding that the employers had increased the risk from 52 per cent. to 90 per cent. The negligence would not be a cause of the dermatitis because even with proper washing facilities, i.e. without the negligence, it would still have been more likely than not that the employee would have contracted the disease – the risk of injury then being 52 per cent. If, however, you substitute 48 per cent. for 52 per cent. the employer could not escape liability, not even if he had increased the risk to say, only 60 per cent. Clearly such results would not make sense; nor would they, in my view, accord with the common law.⁶⁶

Legal reticence by English courts to embrace probabilities has not been followed in Australia. In contrast to the English judicial position, Australian courts will attempt to assign a value to events within its perception of what likelihood should be assigned to the hypothetical event:

If the law is to take account of future or hypothetical events in assessing damages, it can only do so in terms of the degree of probability of those events occurring. The probability may be very high - 99.9 per cent - or very low - 0.1 per cent. But unless the chance is so low as to be regarded as speculative - say less than 1 per cent - or so high as to be practically certain - say over 99 per cent - the court will take that chance into account in assessing the damages. Where proof is necessarily unattainable, it would be unfair to treat as certain a prediction which has a 51 per cent probability of occurring, but to ignore altogether a prediction which has a 49 per cent probability of occurring.⁶⁷

⁶⁴ [1990] 169 C.L.R. 638 at 640.

⁶⁵ [1973] 1 W.L.R. 1.

⁶⁶ [1973] 1 W.L.R. 1 at 12.

The mathematical approach to the probability of an event occurrence was not favoured by Brennan and Dawson JJ. in *Malec*, for “[d]amages founded on hypothetical evaluations defy precise calculations”.⁶⁸ This statement is both a reminder of the stark contrast in the approaches of economics and law, but also a recognition that the purposes contained within the court process are inherently sociological, and based on the notion that justice must be administered between parties essentially at war. The more inherently mathematical position of Deane, Gaudron, and McHugh JJ. in *Malec*, on the whole, appears more theoretically defensible, although the position of Brennan and Dawson JJ. may be more practical from the court’s perspective. Their approach, based on the traditional use of estimates of ‘likelihood’ may make use of an intuitive sense of where justice is found in a particular case. This approach also preserves a higher level of discretion for future courts to limit past cases to their facts and give more options to courts in the future to settle cases without additional unwanted precedential fetters.

This approach, although pragmatic, does not provide a defence to the criticism that the common law is simply not equipped to deal with such mathematically-based difficulties. Bridge pointed out that “the common law ... characteristically buries important points of principle in remedial detail. This may be seen as a conscious shirking by the legal system of hard questions that would compel a rigorous and perhaps rigid rationalisation of the institution ...”⁶⁹ This criticism may be too harsh. If some defensible probability is given for a future event, it seems likely that the court will assign some value to the expected loss, even if the assessment of the amount of damages may be nearly impossible.⁷⁰ There

⁶⁷ *Malec v J.C. Hutton Pty. Ltd.* (1990) 169 C.L.R. 638 per Deane, Gaudron, and McHugh JJ., citing *Mallet v McMonagle* [1970] A.C. 166 at 174.

⁶⁸ *Malec v J.C. Hutton Pty. Ltd.* (1990) 169 C.L.R. 638 at 641 per Brennan and Dawson JJ.

⁶⁹ Bridge 1989, 407.

⁷⁰ *Howe v Teefy* (1927) 27 S.R. (NSW) 301 at 306.

is a limit to the ability of the court to entertain such allegations regarding damages,⁷¹ but the limit may be flexible.

Where the courts are called to assess damages in “loss of commercial opportunity” cases, it may be more crucially important to differentiate between tort cases, and those founded in breach of contract. A third alternative, cases of lost commercial opportunities founded on statutory causes of action, such as s. 52 of the *Trade Practices Act* 1974 (Cth), have been stated to be assessed with the same criteria as tort cases⁷² and, therefore, have not been differentiated for that reason. Action founded under a breach of other legislation, for example ss. 12BB-12DM of the *Australian Securities and Investment Commission Act* 2001 (Cth) [ASIC], only typically gives rise to recovery of the “loss or damage” incurred by any person⁷³ and, therefore, is not analytically helpful.

The courts may be willing to award damages for the loss of a chance to gain a profit from future opportunities assessed according to the likelihood of contract renewal, despite the fact that the defendant is under no obligation to renew the contract. In *The Commonwealth v Amann Aviation*⁷⁴(1992), Amann had won the tender for aerial surveillance of the northern coastal areas of Australia from the Federal Government. After purchasing several aircraft, and commencing the refit of specialised equipment for the surveillance work, Amann was unable to deploy the contracted number of aircraft by the contract deadline. This technically constituted a breach of the contract entitling the Commonwealth to repudiate the contract. The contract specified that in this event procedural notice had to be given prior to repudiation. The Commonwealth did not

⁷¹ *Seguna and Seguna v RTA of New South Wales* [1995] NSWLEC 147.

⁷² *Gates v City Mutual Life Assurance Society Ltd.* (1986) 160 C.L.R. 1.

⁷³ Section 12GF(1) *ASIC* 2001 (Cth)

follow the procedure, but instead repudiated the contract with Amann, who accepted the repudiation and sued for its losses under the contract. The claim included a large component for the opportunity of renewing the contract with the Commonwealth, where Amann would have enjoyed an advantageous position in tendering for renewal had the contract been performed. The court concluded that the likelihood of Amann being successful in the circumstances was not negligible, and ruled that they could recover for the lost chance of renewal. In awarding damages in excess of \$5 million, the court discounted the award because of the chance that the Commonwealth might have rightfully repudiated the contract in the future. As performance of the contract and the subsequent chance to perform had been precluded by the wrongful repudiation, the court held that the burden of proof should fall upon the Commonwealth to prove that the chance had no value. The Commonwealth could not do this, for the repudiation had rendered the assessment of the chance for renewal impossible. "It is the breach of contract itself which makes it impossible even to undertake an assessment..."⁷⁵ The court chose to let the risk that the renewal would not eventuate fall upon the party charged with wrongdoing.

In *Sellars v Adelaide Petroleum N.L.*⁷⁶ (1994) the original plaintiffs Adelaide, had negotiated, but not executed, a contract with Pagini Resources, which would enable a capital reconstruction which was needed for expansion and exploration purposes. Adelaide were persuaded through the representations of Sellars, an executive of Poseidon Limited, to contract on better terms with Poseidon instead of Pagini. After the contract with Poseidon was executed, the Board of Directors of Poseidon repudiated the contract,

⁷⁴ (1992) 174 C.L.R. 64.

⁷⁵ *McRae v Commonwealth Disposal Commission* (1951) 84 C.L.R. 377 at 414, cited with approval by Brennan J. in *Commonwealth v Amann Aviation* (1992) 174 C.L.R. 64.

alleging that Sellars had acted in excess of authority, offering instead a contract of much lesser advantage to Adelaide. Adelaide accepted a repudiation, and sought to reinstate the negotiations with Pagini. Pagini offered Adelaide another contract, but on less advantageous terms than previously. Adelaide contracted with Pagini and sued Sellars and Poseidon for the losses incurred for the lost opportunity to execute a more advantageous contract with Pagini, the result of the misrepresentations of Sellars under s. 52 of the *Trade Practices Act* 1974 (Cth), asking damages under s. 82 *Trade Practices Act* 1974 (Cth), the section controlling the damages awarded under s. 52. The High Court had to decide the question:

Is it necessary for the applicant to prove on the balance of probabilities that a benefit would have been derived from the opportunity had it not been lost, and if so, the extent of that benefit? Or is it sufficient for the applicant to show, not on the balance of probabilities, but by reference to the degree of possibilities and probabilities, that there were some prospects of deriving a benefit from the opportunity had it not been lost and, if so, then to ascertain the value of the opportunity or benefit by reference to such possibilities and probabilities?⁷⁷

The court ruled that the plaintiffs could recover, and unequivocally recognized the loss of chance doctrine. In this case it was the lost chance of a profitable commercial opportunity. Applying *Malec*, the court ruled that the logic in *Malec* should not be confined to its facts:

Neither in logic nor in the nature of things is there any reason for confining the approach taken in *Malec* concerning the proof of future possibilities and past hypothetical situations to the assessment of damages for personal injuries. The reasons which commended the adoption of that approach in assessments of that kind apply with equal force to the assessment of damages for loss of a commercial opportunity, as the judgments in *Amann* acknowledge.⁷⁸

⁷⁶ (1994) 179 C.L.R. 332

⁷⁷ *Sellars v Adelaide Petroleum N.L.* (1994) 179 C.L.R. 332 at 339 per Mason CJ, Dawson, Toohey, and Gaudron JJ.

⁷⁸ (1994) 179 C.L.R. 332 at 350.

Judgments such as *Malec*, *Adelaide Petroleum*, and *Chappell* indicate that courts do not wish to fetter their decision-making powers, and assess the cases coming before them with intuition as much as legal reasoning. The concept of ‘justice’ may be more integrally tied to the way the facts of each case are characterised than with a precedential principle which can be more generally applied. Litigants may feel that subjectivity has been introduced, which breeds uncertainty in the application of the law.⁷⁹

Remoteness and Proximity

The concept of remoteness concerns itself with what *kinds* of damage the court will hold the defendant liable in an action. Damage of the most catastrophic and unusual nature may ensue from breach, but on practical grounds the law takes the view that a line must be drawn somewhere and that certain kinds or types of loss, though admittedly caused as a direct result of the defendant’s conduct, shall not qualify for compensation.⁸⁰

The issue of remoteness arises where the defendant denies liability for damage, even though it may have resulted undeniably from his/her actions. Knowledge, actual and imputed, the likelihood of the event occurring, and the circumstances around the event are all considered. In addition, in contract, the parties are free to make provision in respect of a contemplated loss which the court will also consider. The terms of the contract, therefore, become central in such a dispute.

⁷⁹ *Chappel v Hart* [1998] HCA 55; 156 A.L.R. 517.

⁸⁰ Furmiston, M. P. 1991, *Cheshire, Fifoot, and Furmiston’s Law of Contract*, 12th edition, Butterworths, p. 596.

The modern law, in contract, starts with the judgment of Baron Alderson in the 1854 case of *Hadley v Baxendale*.⁸¹ Alderson B. gave the ‘rule’, divided into two ‘limbs’ or parts (sometimes called two rules), upon which damages must be claimed, excluding any other damages as *too remote*. This is a reflection of the underlying social policy that it is unwise to put an unlimited burden of loss upon a defendant in circumstances where losses cannot be reasonably *foreseen*.⁸² Foreseeability, therefore, and its inescapable counterpart, knowledge, are used as benchmarks in determining whether the court will award damages for certain types of losses which it regards as too remote as to create an injustice to award a pecuniary burden for losses incurred by the plaintiff or third parties, but nevertheless which can be theoretically traced to the actions or omissions of the defendant. Baron Alderson stated in the famous *ratio* of the court in *Hadley v Baxendale*:

Now we think the proper rule in such a case as the present is this: - Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e. according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated.⁸³

⁸¹ (1854) 9 Exch. 341; 156 E.R. 145.

⁸² *Overseas Tankships (UK) Ltd. v Morts Dock & Engineering Co. Ltd. (The Wagon Mound) (No. 1)* (1961) A.C. 388. In the United States, where this issue has been considered by the courts, the leading case is still the 1931 case of *Ultramares v Touche* where Cardozo J. noted that if [unlimited] liability were to exist for negligence, then it would “expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class”. Although this dictum may be criticised as a slippery slope fallacy, it portrays the essential fears of the courts in delimiting the scope of recovery completely. See 255 N.Y. 170 at 179. *Bryan v Maloney* (unreported) F.C. 95/011; *Perre v Apand Pty. Ltd.* (unreported) [1999] HCA 36.

⁸³ (1854) 9 Exch 341; 156 E.R. 145 at 151.

Hadley v Baxendale has been the starting point of the assessment of damages in English and Australian Courts from 1854 to the present day. Damages recoverable under the two limbs of the rule illustrated in that case are said to be 1) damages arising from the “usual course of things” and 2) damages which are contemplated in specific knowledge given between the parties. The quantification issue, to the courts, is a logically secondary consideration which must be scrutinised after the court has ascertained the factual limit to which it will hold the defendant accountable. The court takes a pragmatic perspective when starting upon this exercise. Lord Wright argued that:

[t]he law cannot take account of everything that follows a wrongful act; it regards some subsequent matters as outside the scope of its selection, because “it were infinite for the law to judge the cause of causes,” or consequences of consequences. ... In the varied web of affairs, the law must abstract some consequences as relevant, not perhaps on grounds of pure logic but simply for practical reasons.⁸⁴

Remoteness, therefore, is the limit, beyond which the court will not hold the defendant liable for losses incurred, regardless of whether or not they are conceptually attributed to the defendant’s actions. The relationship of the parties prior to the culpable act will dictate the generic limits of damages which the court will assign to a party to be borne *ex post facto* from a culpable action. Remoteness:

is directed to the relationship between the parties insofar as it is relevant to the allegedly negligent act of one person and the resulting injury sustained by another. It involves the notion of nearness or closeness and embraces physical proximity (in the case of space and time) between the person or property of the defendant, circumstantial proximity such as overriding relationships of employer and employee or of a professional man and his client and causal proximity in the sense of the closeness or directness of the relationship between the particular act or cause of action and the injury sustained... The identity and relative importance of the considerations relevant to an issue of proximity will obviously vary in different classes of case and the question whether the relationship is ‘so’ close ‘that’ the common law should recognise a duty of care in a new area of

⁸⁴ *Liesbosch Dredger v Edison S.S. (Owners)* [1933] A.C. 449 at 460 per Lord Wright.

class of case is, as Lord Atkin foresaw, likely to be ‘difficult’ of resolution in that it may involve value judgments on matters of policy and degree.⁸⁵

Whether in tort or contract, the court will look to establish limitations, therefore, upon the award which will be given to the plaintiff. Both in contract, and in tort, the court will seek the limit beyond which it will not hold the defendant responsible. This goes to the issue of causation and, in tort at least, a theory of unity has been advanced, which “demonstrate[s] that the ostensibly separate inquiries into duty of care, breach of duty, and remoteness of damage (including causation) are aspects of a single inquiry into reasonable conduct.”⁸⁶

Contrasting contract with tort, there is also the additional consideration that the contractors can provide for breach, in essence making their own law within the bounds of the contract. The ability of contractors to provide for breach does not extinguish the court’s use of reasonableness and the ‘reasonable man’ test in determining for what, if anything, the defendant will be held responsible through either his/her breach or neglect of duty.

The crucial question is whether, on the information available to the defendant when the contract was made, he should, or the reasonable man in his position would, have realised that such loss was sufficiently likely to result from the breach of contract to make it proper to hold that the loss flowed naturally from the breach or that loss of that kind should have been within his contemplation.⁸⁷

In *Liesbosch Dredger v S.S. Edison (Owners)* (1933), the court was called on to determine if the losses incurred by a group of marine engineers with respect to the

⁸⁵ *Jaensch v Coffey* (1984) 155 C.L.R. 549 at 584-5.

⁸⁶ Ipp, D.A. Hon. Justice 1992 “Problems and Progress in Remoteness of Damage” in Finn, P.D., *Essays on Damages*, LBC, pp. 14-41, at p. 19.

⁸⁷ [1969] A.C. 350 at 385; *Jaensch v Coffey* (1984) 155 C.L.R. 549 at 585.

reinstatement of a dredge lost by the gross negligence of the operation of a steamship, was too remote. The defendants sought to avoid liability on the grounds of remoteness for consequential losses from the plaintiffs' loss of the ability to perform a contract, where the defendants' steam ship had negligently sank the plaintiff's dredge. Both the Registrar in Admiralty, and the court at first instance had ruled they were not too remote. The Court of Appeal reversed the lower court decision, and held that the recovery was to be limited to the value of the vessel lost at the time of the event. The marine engineers appealed to the House of Lords who agreed, holding the other losses, relating to the frustrated contract, to be too remote. The House of Lords avoided the conceptual criticism of the lack of attention to the contract losses by further holding that the loss was to be the value of the vessel lost *as a going concern* at the time of loss. Although the court held that some of the damages allowed at first instance were to be excluded, it remitted the case back to the Registrar in Admiralty for assessment of damages, and held that the value should have been allowed according to the rule announced above. "The rule, however, obviously requires some care in its application; the figure of damage is to represent the capitalized value of the vessel as a profit-earning machine, not in the abstract but in view of the actual circumstances."⁸⁸ This enabled the court to avoid confronting the difficult issue where the past cases had conceptually dictated that the loss was too remote for recovery, but where in any commercial sense the failure to award compensation for the loss of the profits from the dredge performing the contractual obligations would have been acutely unjust.

⁸⁸ *Liesbosch Dredger v S.S. Edison* [1933] A.C. 449 at 464. Cooke and Oughton 1989 have deprecated the decision in *Leisbosch*, pointing out that it may be more distinguished than followed for what the authors deem a manifestly inadequate award of damages, and question whether it forms part of Australian law. See pp. 131-138

Thus the courts have decided that damages awards should be limited, and that there is no authority for an unlimited liability with respect to contract, excluding consideration with respect to specific terms. Parties are free to express what damages are to be paid when a breach occurs.⁸⁹

In subsequent cases, the limits of the “usual course of things” has been explored. In tort, from 1921, as a consequence of the judgment handed down in *Re Polemis*,⁹⁰ the language used in assessing the remoteness of the damage from which to assess the award was said to be the “direct and natural consequence of the act.”⁹¹ This is very similar to the language used in *Hadley*. In 1961 the Privy Council overturned *Re Polemis* citing the change in the social environment as justification :

For it does not seem consonant with current ideas of justice and morality that for an act of negligence, however slight or menial, which results in some trivial foreseeable damage the actor should be liable for all consequences however unforeseeable and however grave, so long as they can be said to be ‘direct’. It is a principle of civil liability, subject only to qualifications which have no present relevance, that a man must be considered to be responsible for the probable consequences of his act.⁹²

The wider application, therefore, of the principles of ‘civil liability’ by Viscount Simonds above in the *Wagon Mound* can readily be seen to be available to the courts in contract, not just limited to tort law,⁹³ to set the limits beyond which the defendant will

⁸⁹ *Chaplin v Hicks* [1911] 2 K.B. 786 at 790-91 per Vaughan Williams L.J. The ability of contractors to provide for a breach is subject to the court’s scrutiny of penalty clauses which, if ruled *in terrorem* will be unenforceable. This is examined in Chapter Eight.

⁹⁰ *Re Polemis and Furness, Withy & Co. Ltd.* [1921] 3 KB 560.

⁹¹ [1921] 3 KB 560 at 577.

⁹² *Overseas Tankship (U.K.) Ltd. v Morts Dock and Engineering Co. Ltd. (The Wagon Mound) (No. 1)* [1961] A.C. 388.

⁹³ There are wider grounds upon which to criticize the court’s ruling in the *Wagon Mound* cases. A single event caused the loss of a complete dock and works, and also a ship moored alongside the docks. It defies common analysis of causation, fault, and recovery to hold the two cases of damages claims, which resulted from a single event, consistent with any form of social logic where the owners of the dock failed to recover, but the owners of the ship recovered substantial sums. Legal counsel burdened with the obligation to explain this anomaly to a client, as the loser, is certainly not to be envied.

not be held responsible without other considerations. Viscount Simonds did not elaborate upon what he meant with respect to the “probable consequences” exactly, but these issues are explored in other tort cases. In contract, *Hadley v Baxendale*⁹⁴ has remained influential as the starting point in determining the remoteness of damages claimed for breach of contract despite the wide variety of cases determined from the time it was handed down in 1854.

A Closer Look at *Hadley*’s Limbs

What is relevant with respect to the limbs of *Hadley v Baxendale* for this section is the qualitative character of the two limbs. The first limb, damages are recoverable if they are the “natural, usual course of things arising from a breach” of the relevant kind, assumes an actual knowledge on the part of all parties to the contract of this type. The court assumes that the parties to the contract are knowledgeable enough to know what losses arise naturally or in the usual course of their own affairs such that it may be said that a defendant party of full age and capacity acting at arm’s length cannot escape the impact upon him/herself of a breach, without other mitigating circumstances to which the court can turn to alleviate part of the damage or injury caused through the breach attributed to the defendant.

The first limb, therefore, is as much an assumption with respect to the industry, trade, or circumstances of the parties and the contract, as it is a statement of law. It does not mean that the court will not recognise that any loss beyond the parameter of the first limb of the rule is not a loss which the court will compensate. It is, however, a line which the court will draw, beyond which it will not *presumptively* hold the defendant responsible

⁹⁴ (1854) 9 Exch 341; 156 E.R. 145.

after breach and loss are proven. The language used in contract and tort to portray the necessary knowledge and, as a result, the requisite foreseeability, changes as the case may be, but there is at least some argument to be made that they should both be reconciled philosophically into one single strand.⁹⁵

The courts have been unwilling to make this change. The main reason seems to be that with contract the parties are importing a certain ability to make their own law.⁹⁶ The terms of the contracts can dictate the parameters upon which the court may limit its award. With tort, however, the usual tort being negligence, the parties involved don't have the privilege of making provision ahead of time for the consequences of the act causing loss.⁹⁷ In contract, this ability to provide for the losses resulting from breach results in a rather more restrictive interpretation of the limits of the losses for which remuneration is awarded.

The second limb of *Hadley's* rule is that damages are recoverable if they are within the contemplation of the parties as liable to result from a breach of the relevant kind when they made the contract. This appears to deal with both imputed *and* actual knowledge. The second limb would also appear to exclude, by default, any characteristics which are able to be included in the first limb. Thus, the court in *Hadley* established the principle that if the party to a contract is actually given notice of a special circumstance, as was the (then) instant case, the party who possessed the knowledge prior to the execution of the contract should have communicated the special circumstances to the party contracting opposite in order to claim and invoke the sanction of the State with respect to losses

⁹⁵ Goff, LJ and Jones, G. 1993, *The Law of Restitution*, 4th edition, London, Sweet and Maxwell; McMeel, G. 2000, *The Modern Law of Restitution*, London, Blackstone press; lpp 1992, 14-21.

⁹⁶ *M.B.P. (S.A.) Pty. Ltd. v Gogic* [1990-1991] 171 C.L.R. 657.

incurred which fall into the second limb. This perspective is supported by the comments by Asquith L.J. in *Victoria Laundry (Windsor) Ltd. v. Newman Industries Ltd.* (1949):

[K]nowledge possessed is of two kinds; one imputed, the other actual. Everyone, as a reasonable person, is taken to know the “ordinary course of things” and consequently what loss is liable to result from a breach of contract in that ordinary course. This is the subject matter of the “first rule” in *Hadley v Baxendale*. But to this knowledge, which a contract-breaker is assumed to possess whether he actually possesses it or not, there may have to be added in a particular case knowledge which he actually possess, of special circumstances outside the “ordinary course of things”, of such a kind that a breach in those special circumstances would be liable to cause more loss. Such a case attracts the operation of the “second rule” so as to make additional loss also recoverable.⁹⁸

An important assumption, often overlooked with respect to the limbs of this famous rule, is the assumption imported through the doctrine of *stare decisis* that the first limb implies a *static environment* with respect to the damages which should be recovered. It is a precedent, set by the judiciary, regarding the level of knowledge imputed to the general class of contractors of the class in consideration. Factors regarding the trade involved, or perhaps the commercial environment, and the court-imposed standard for *that* reasonable contractor will be scrutinised by the court to ascertain the level beyond which the court will no longer sanction the defendant and order recovery of losses incurred by the plaintiff. The prohibition of further recovery will be enforced unless the plaintiff produces evidence to satisfy the court that the defendant had requisite *additional* knowledge to make it just that the defendant should bear the loss, thus falling under the *second limb* of the rule. The courts, though, often operate quite removed from changing social circumstances. Decades after economists have renounced earlier economic doctrines, or reformed them in line with social circumstances, judges and lawyers might

⁹⁷ *Koufos v C. Czarnikow Ltd.* [1969] 1 A.C. 350 at 386-7 per Lord Reid.

⁹⁸ [1949] 2 K.B. 528 at 539-40.

still be calling them ‘new’ or ‘modern’.⁹⁹ The precedent of a former decision dictating which factual contractual characteristics fall into either the first or second limb will give assistance, or hindrance to a litigant, but will effectively render the analysis legally static. Thus, the implication that a judicial stasis is imported into the rule of *Hadley*, is unavoidable.¹⁰⁰

There is at least one consideration, however, that militates against the assertion of judicial stasis. The courts rule within the confines of the case at bar, in particular the evidence presented in each case which affects the level of expectation which might be imputed to the contractors. It is open to the plaintiff to lead evidence that shows the level of knowledge in the environment of the contracting parties. The courts may, therefore, impute a different, more or less stringent level of knowledge depending on the evidence of the instant case as long as in the judgment ratio of the case no prior legal principle is overly strained in the damages awarded. If, in the judgment of a lower court, damages are awarded such that an error of law can be alleged by either the defendant or the plaintiff, it may give rise to appeal. If a principle is broken by a judgment in the High Court of Australia, then the law is simply changed within the jurisdiction.

Adding to this “muddle”¹⁰¹ the courts have had to deal with the imprecision of the language of the rule as originally stated. The ‘first limb’ of the rule in *Hadley v Baxendale* contains the words “natural”, and “usual” course of “things”,¹⁰² all of which are words which cannot be strictly defined. The courts have had to deal with this

⁹⁹ Atiyah, 1979, p. 666.

¹⁰⁰ This point will be mentioned again in Chapter Nine.

¹⁰¹ Simpson, A. W. B. 1988, *Legal Theory and Legal History*, London, Hambledon Press, p. 381. Simpson’s criticism of the common law will be more fully examined in Chapter Eight which analyses public policy in the courts.

¹⁰² 9 EX 345 at 355; [1854] 156 E.R. 145 at 151.

imprecision in later cases, struggling to perfect a subsequent rule which conforms to its common law master and yet overcomes trenchant criticism from litigants for violation of ‘certainty’ in the law:

In order to make the contract breaker liable under either rule it is not necessary that he should actually have asked himself what loss is liable to result from a breach. As has often been pointed out, parties at the time of contracting contemplate not the breach of the contract, but its performance. It suffices that, if he had considered the question, he would, as a reasonable man, have concluded that the loss in question was liable to result. Nor, finally, to make a particular loss recoverable, need it be proved that upon a given state of knowledge the defendant could, as a reasonable man, foresee that a breach must necessarily result in that loss. It is enough if he could foresee it was likely to result. It is indeed enough... if the loss (or some factor without which it would not have occurred) is a “serious possibility” or a “real danger”. For short, we have used the word “liable” to result. Possibly the colloquialism “on the cards” indicates the shade of meaning with approach to accuracy.¹⁰³

At the very heart of the continuing confusion, however, is the imputation of a presumption of knowledge on one hand (first limb) and the imputation of actual knowledge on the other hand (second limb). The first limb encompasses an area where, leaving apart other mitigating circumstances, the *defendant* cannot escape the extraction of the plaintiff’s loss by the court by claiming no prior knowledge. The second limb encompasses an area where the *plaintiff* cannot escape the loss without proving that actual, implied or constructive notice is given to the defendant such that the plaintiff is justified in calling for the sanction of the courts. The first limb implies a search by the court to the wider social construction around the contract. The second limb looks at the terms of the contract and behaviour of the contractors in determining the ‘contemplation’ of the parties involved with respect to special circumstances. The environment and normal practice portrayed by such evidence as the class of actors of which the parties are part, rises to importance in the first limb, and the specific terms of the contract, prior

¹⁰³ *Victoria Laundry (Windsor) Ltd. v Newman Industries Ltd.* [1949] 2 K.B. 528 per Asquith J. at 540.

dealings, and the imputed, constructive, and actual notices given will rise in importance in the second limb.

Summary

This chapter has covered in detail the issues of causation, remoteness of damage, and mitigation regarding the burden placed upon the plaintiff to prove that a defendant should be burdened with a claimed loss. These issues are examined in their relationship to opportunity cost recovery. The interaction of all the issues in a single trial battle makes it difficult to specifically delineate the weight which might be given to any single consideration. The weight which the court gives to any or all of them will be specifically determined by the evidence provided in each case. The evidence, of course, will determine the facts of each case which the court will accept as the true account of events. The next chapter will examine rules of a different nature. These are ‘rules of law’ which in relevant respects have different qualities which affect recovery of damages, and specifically opportunity cost as damages.

The sections above clearly show that despite a clearly defensible theoretical position that opportunity cost inflicted by a recalcitrant defendant is a real loss, it is not instantly recoverable by a plaintiff despite its actual occurrence. The methodology of law dictates that each and every aspect of the plaintiff's case be proven to a requisite standard. If the plaintiff cannot gather acceptable satisfactory evidence to meet the standards set by the court to invoke State sanction against a defendant, the action will fail and the plaintiff simply will have no remedy. The burden, therefore, falls upon a plaintiff to schematically communicate to the court the facts of the case, using a specie of proxy, i.e. documentary and testimonial evidence, that an *unavoidable* opportunity cost has been *caused* by the

defendant, the loss is not too *remote*, and that the loss is not so *hypothetically intangible* that it is irrecoverable. Meeting these criteria, a plaintiff will find support from the court system in the recovery of opportunity costs. This is subject to rules other than those above. There is a genre of rules which come from the law itself, which limit or otherwise dictate the parameters of damages awards.

CHAPTER SEVEN: LEGAL RULES IN DECIDING DAMAGES

Introduction

The previous chapter examined the problems arising in the common law courts when dealing with the burden of providing satisfactory evidence which prove the facts of each case. Causation, remoteness of damages, and mitigation were examined, all of which relate to the amount and nature of evidence put before the courts by the parties to litigation. The rules considered in the previous chapter are rules of law in every sense, and the division between evidence and law for purposes of analysis may not be a philosophically accurate approach in delineating the contradictions attached to recovery of opportunity costs. Nevertheless, the classification of the rules used in courts must have semiotic content in order for discussion to proceed, requiring a defensible systemic cardinal organization. This organisation and content is found within the evidence versus law paradigm. As the previous chapter examined the ‘rules of evidence’, this chapter analyses conflicts in the treatment of damages awards which arise from the application of ‘rules of law’ by the courts.

The examination will begin with comments about rules in general and the rules versus standards debate. A section will follow which will focus on the rule that damages are considered to be restitutionary. The chapter will then examine the problems which result from converting all damages awards to a money metric, the past refusal of courts to recognise the nature of damages awards as economic loss and interest as damages, and the once-for-all-time payment of damages rule. The chapter concludes that precedent-

based rules of law were seminal in propagating curial resistance to economic theory. Although, as the next chapter will show, changing social expectation has influenced the reception of economic principles in common law courts, past judges, consistent with the requirement to provide written reasons, have appealed to rules to justify resistance to the recognition of the relevance of applicable economic theory in common law courts, obfuscating the underlying bias emanating from covert public policy perspectives.

The rules which the common law uses in the disposition of cases, reflecting the principle of *stare decisis*, are taken from past cases. This was made clear in Chapters Three and Five. Whether past cases generate rules considered narrow and rigid, or else attempt to promote a standard which contains flexibility is a debate which is not settled. Dworkin,¹ Hart,² Raz,³ Carrio,⁴ Christie,⁵ and Boukema⁶ have all written upon this subject and the material on this subject is complex, subjective, and problematic. Schlag raises a number of interesting observations in this debate, such as the fact that rules and principles are used to judge rules and principles, and that

disputes that pit a rule against a standard are extremely common in legal discourse. Indeed, the battles of legal adversaries (whether they be judges, lawyers, or legal academics) are often joined so that one side is arguing for a rule while the other is promoting a standard. And this is true regardless of whether the disputes are petty squabbles heard in traffic court or cutting edge controversies that grace the pages of elite law reviews.⁷

This thesis does not enter deeply into the rules/principles (or “standards” as Schlag uses) debate. When considering opportunity cost, the courts themselves have relied upon both

¹ Dworkin, R. 1977, *Taking Rights Seriously*, London, Duckworth, chapters 2 and 3.

² Hart, H.L.A. 1994, *The Concept of Law*, Bullock and Raz (eds.), 2nd ed., Oxford, Clarendon Press.

³ Raz, J. 1972, “Legal Principles and the Limits of Law”, 81 *Yale Law Journal* (1972) 823.

⁴ Carrio, G. 1971, *Legal Principles and legal Positivism*, O’Connell translation, Buenos Aires.

⁵ Christie, P. 1968, “The Model of Principles”, 1968 *Duke Law Journal* 649.

⁶ Boukema, H.J.M. 1980, *Judging: Towards a Rational Judicial Process*, W.E.J. Tjeenk Willink Holland.

⁷ Schlag, P. 1985, “Rules and Standards”, 33 *UCLA Law Review*, (1985) 379 at 380.

rules and standards. Thus, the latent ambiguity of the debate hinders meaningful progression. Exactly what constitutes a ‘rule’ of law, especially if one takes the view that a ‘rule’ is different from a ‘principle’, is a vague proposition, and one difficult to bring to conclusion. Historically great legal scholars have found themselves on opposite sides of legal argument regarding the “rules v principles” debate.⁸ Bentham thought that the common law to be full of “pedantic caprice”,⁹ and not rules at all, at least not rules to which he gave approval. Simpson argues that the “common law” is essentially a contradiction of terms, and promotes a characterisation of what courts do in common law jurisdictions as “a body of traditional ideas received within a caste of experts”.¹⁰ It is not the purpose of this thesis to provide an answer to the questions which would arise regarding this aspect of legal rules.¹¹ Courts themselves have acknowledged the existence and perpetuation of rules.¹²

It may be more accurate to portray all legal rules on a continuum rather than in categories. The division in time past has been nominated between the evidentiary issues, given to juries to decide, and ‘legal’ issues, those issues given to the bench to decide. Even this dichotomy is singularly unsatisfactory for a thorough examination of this subject. Even if we tried to outline all the principles and rules in force presently,

⁸ Oliver Wendell Holmes and Benjamin Cardozo found themselves in this dispute over the issue of a railway crossing in *Baltimore & Ohio R.R. v Goodman*, 275 U.S. 66 (1927), and *Pokora v Wabash Ry.*, 292 U.S. 98 (1934) cited in Schlag, P. 1985, pp. 379-430, at 379 ff.

⁹ Bentham, J. 1822, “Common Law”, in Burns, J. H. and Hart, H. L. A. 1977, *A Comment on the Commentaries and A Fragment on Government*, University of London, Athlone Press, II.3 at p. 170.

¹⁰ Simpson, 1987b, p. 362.

¹¹ Indeed, as Simpson, 1987b, pp. 360 ff. points out, there is a strong argument both from historical writers of the classical period in England, typified by Jeremy Bentham, and contemporary writers that the common law really does not exist at all, let alone whether there was a systemic reasoning within rules which were susceptible to knowledge and codification.

¹² Starting at the early cases on interest or opportunity cost recovery, there are references throughout to “the rule of the common law”. See *De Havilland v Bowerbank* (1807) 1 Camp. 50; 170 E.R. 872; *Hadley v Baxendale* (1854) 9 Ex. 341; 156 E.R. 145; *The Liesbosch, Dredger v S.S. Edison* (1933) A.C. 449.

relegating each one to a systematic classification, it would be pointless. According to Dworkin:

If ... we tried actually to list all the principles in force, we would fail. They are controversial, their weight is all important, they are numberless, and they shift and change so fast that the start of our list would be obsolete before we reached the middle. Even if we succeeded, we would not have a key for law because there would be nothing left for our key to unlock.¹³

This work will concentrate only upon the rules which are centrally relevant to the discussion of opportunity cost recovery, comprising the central dominant rules of the common law.

Applicable Rules Governing Damages Awards

The difference between the categories of 'rules' for the purpose of this research centres on the dichotomy between evidence and law. This was characterised in Chapter Six as burdens which the parties to litigation bear upon themselves, and the burden which the bench bears upon itself to properly apply in the case. An example is where the relevant rule of law dictates, say, that a plaintiff must prove his/her loss on the balance of probabilities, and the rule of evidence is whether or not the plaintiff has actually proven the loss *in this case*. The first is applied through another rule (*stare decisis*), and the second is gleaned from the documentation and testimony submitted to the court by the plaintiff. Another example may be the rule that a criminal should not be able to profit from his/her own wrongdoing.¹⁴ The rule of evidence in a case being litigated may be reframed into a question that whether a principal heir, who recklessly ran down her wealthy grandfather with a motor vehicle was a criminal and, therefore, precluded from

¹³ Dworkin, R. 1977, *Taking Rights Seriously*, London, Duckworth Books, p. 44; Davis, J.L.R., 1992, "Interest as Compensation" in Finn, P.D. 1992, *Essays on Damages*, Law Book Company, pp. 129-152.

¹⁴ *Riggs v Palmer* (1889) 115 NY 506, 22 NE 188.

recovery of the estate through the execution of the will of the grandfather. The factual evidence which would be weighed, for instance, might centre around whether the intention of the heir was such as to commit a crime or not. Thus, the rules of evidence are formed around the facts of each case. The evidence pertaining to these facts are introduced into the courts from the plaintiff and defendant. In contrast, the rules of law are taken in principle from past cases¹⁵ and applied to present facts, and the application of these rules, although argued by counsel, is governed by the bench. The evidential hurdles lying in the path of the plaintiff which are to be surmounted if recovery is to take place were covered in the previous chapter.

This chapter will focus upon the relevant rules of law, which are promulgated through the courts themselves and which are relevant to the issue of opportunity cost recovery. When courts use imperfect discovery techniques to ascertain facts in novel situations and then balance competing interests in applying ‘rules of law’ to the facts which are determined, legal contradictions begin to arise. It will be argued that certain contradictions involving principles directly related to recovery of opportunity costs have been maintained illogically through the application of the legal rules, despite the fact that the High Court of Australia has recognised and partially resolved significant aspects of the contradictions in the case of *Hungerfords v Walker*,¹⁶ the subject of Chapter Nine.

¹⁵ In general, statutory rules are ignored in this dissertation.

¹⁶ (1989) 171 C.L.R. 125.

Restitutio in Integrum

The doctrine of *restitutio in integrum* is the aim of damages awards.¹⁷ Translated rather loosely it means a “restoration of the whole”. It illustrates that the purpose of the award of damages is to restore the plaintiff, as far as money can do, to the position in which the plaintiff would have been, had the defendant not committed the act or omission, whether in contract or tort, which caused the loss to the plaintiff.¹⁸ It is so well entrenched that in *Hungerfords v Walker* (1989) the High Court said that it is “the fundamental principle that a plaintiff is entitled to *restitutio in integrum*”.¹⁹ Fifty years earlier, in *Liesbosch, Dredger v. S.S. Edison*²⁰ (1933), Lord Wright affirmed “the dominate rule of law is the principle of *restitutio in integrum*.” This rule is to dominate all other applicable rules in damages awards, for “the dominant rule of law is the principle of *restitutio in integrum*, and subsidiary rules can only be justified if they give effect to that rule.”²¹

Assuming the plaintiff has proven that a loss has been incurred, and the loss is attributed to the act or omission of the defendant, the central questions subsequently arising to be determined through the principle of *restitutio in integrum* are ‘What loss?’, and ‘What compensation or restoration is to take place?’ Thus the concept of restitution deals at heart with the *quantification* issue. As the concept of remoteness addresses the issue as to the *kind* of damage to be restored, restitution addresses the issue regarding what the *measure* of damage will be. In *Haines v Bendall*²² (1991) the High Court referred to the

¹⁷ *Owners of the Dredger Leisbosch v Owners of the Steamship Edison* [1933] A.C. 449; *Burns v M.A.N. Automotive (Australia) Pty. Ltd.* (1986) 161 C.L.R. 653; *Wenham v Ella* (1972) 127 C.L.R. 454; *Butler v Egg & Egg Pulp Marketing Board* (1966) 144 C.L.R. 185.

¹⁸ *Robinson v Harmon* [1848] 1 Ex. 850; 154 E.R. 363, *Livingstone v The Rawyards Coal Company* (1880) 5 App Cas 25.

¹⁹ (1989) 171 C.L.R. 125 .

²⁰ [1933] A.C. 449 at 463.

²¹ *ibid.*

²² (1991) 172 C.L.R. 60.

issues of *true* compensation, and *fair legal measure* of compensation²³ which has the deceptively simple connotation that the court seeks *perfect* compensation for the plaintiff where the acts of the defendant have caused loss. This would also be implied by the social expectation of accuracy, which informs the content of case awards, which is covered in Chapter Eight. This is questionable at best and the underlying tension between the court seeking a complete inquiry “into the precise circumstances that would have attended the plaintiff if the wrong had not been done, and on the other hand, a search for rules that are clear, predictable, workable, fair between one claimant and another in similar circumstances, and reasonably inexpensive [in] application”,²⁴ illustrates that the common law is in a state of flux and seeks a balance between competing social expectations of efficiency and accuracy through implementation of rules of law.

It is, therefore, fair to the courts to say that approximate compensation is all for which a plaintiff can hope. Indeed “rules as to damages can in the nature of things only be approximately just.”²⁵ Dr. Lushington, in *The Columbus*, (1849) observed how:

the party receiving the injury is entitled to an indemnity for the same. But although this is the general principle of law, all courts have found it necessary to adopt certain rules for the application of it; and it is utterly impossible, in all the various cases that may arise, that the remedy which the law may give should always be to the precise amount of the loss or injury sustained. In many cases it will, of necessity, exceed, in others fall short of the precise amount.²⁶

This may not be a satisfactory explanation for the shortcomings of the common law, and it might be more defensible to attribute shortcomings and excesses to limitations such as mitigation or remoteness, and/or to issues of evidential proof, rather than to proclaim

²³ (1991) 172 C.L.R. 60 at 66.

²⁴ Waddams, S. M. 1992, “The Principles of Compensation” in Finn, P.D. (ed) *Essays on Damages*, Law Book Company, p. 1.

²⁵ *Rodoconachi v Milburn* (1886) 18 Q.B.D. 67 at 78 per Lindley J., cited in Waddams 1992, p. 1.

²⁶ *The Columbus* (1849) 166 E.R. 922 and 923.

simply that it is ‘impossible’ to recompense precisely. The better view is that in the proof of injury the Court is a hind-sighted third party and cannot roll back time to view the events with precision. This results in a lack of omniscience.²⁷ The manifest difficulty in ascertaining the truth of the actual loss and the resulting limits of justice in some cases means that the courts simply cannot make a perfect award. This shifts the burden for perfect damages awards back to the parties involved in the litigation who must introduce enough acceptable evidence for the court to make clear and satisfactory inference regarding the actual losses. According to this premise, it can be said that the award will be, in its compensatory exactitude, directly related to the breadth of the acceptable evidence which is presented to the court and upon which it bases judgment, subject of course, to other mitigating rules of law or policies of the court.

Courts struggle to fit new facts into the very rules which they use for judgment. The application of rules taken from past decisions may mask covertly political decisions or changes in underlying social perspectives. Further, the choice of rules to apply may give judges a wide range of potential outcomes on a given set of facts. One rule may predominate²⁸ or a balance may need to be struck. Rules may not be absolutely logical, but the court will seek to address an issue by searching for an applicable rule.²⁹

²⁷ Blazey-Ayoub, P.J. Conomos, J. W. and Doris, J. I. 1996, *Concise Evidence Law*, Federation Press, p. 2; *McGhee v National Coal Board* [1972] 3 All E.R. 1008 at 1012 per Lord Wilberforce, who indirectly lamented this point and the impossibility of providing proof of the source of causation of injuries in some instances.

²⁸ Cardozo, B. J. 1921, *The Nature of the Judicial Process*, 1970 edition, Yale University Press, p. 41; Cross, R. and Harris, J. W. 1991, *Precedent in English Law*, 4th edition, Oxford, Clarendon Press, p. 4.

²⁹ *Hadley v Baxendale* [1854] 156 E.R. 145, *Robinson v Harmon* [1848] 1 Ex 150; 154 E.R. 363, *Livingstone v Rawyards Coal Co.* (1880) 5 App Cas 25. In each of these seminal 19th century cases, the court searched for, and “found”, an applicable rule upon which to dispose of the case.

Waddams³⁰ takes the view that it is the seeking of applicable rules that prevents compensation from being more perfect. He points out that “rough and ready” justice is all that a plaintiff can expect. This assertion may be well-taken in borderline cases where the evidence is such that the inquiry would be so catastrophically tedious that the court cannot possibly allot time to pursue issues, but appears to take a utilitarian/pragmatic approach which in principle might not be defensible. In addition, it may breed uncertainty in the application of the law, contrary to underlying social expectations, examined in Chapter Eight. It is conceded, however, that this criticism may be somewhat idealistic, given the difficulties which face modern courts in areas of increasingly technical evidence. For Waddams, the costs of tedious inquiry far outweigh the injustice in what he infers may be isolated cases. His priority is, therefore, weighted toward efficiency in the court process at the cost of tedious pursuit to achieve accuracy in damages awards. “[T]hough perfect restitution is [the] ultimate aim and end [of the law of damages], yet it is not the sole consideration: a working system of law must always pay attention to the cost of the process to the parties, to the court, and to the community at large.”³¹

The compensatory principle dictates that a plaintiff who has suffered from the act or omission of a defendant at least has a *prima facie* right of restoration of that position. The process of ascertaining what restoration is to take place forms the heart of the common law process of awarding damages. It is not difficult to state that a plaintiff is entitled to restoration to a previous position, it is another thing to consistently restore plaintiffs to previous positions in a just and rational manner. To put it another way, the court may

³⁰ Waddams, S. M. 1992, “The Principles of Compensation” in Finn, P.D. (ed), 1992, *Essays on Damages*, Law Book Company, pp. 1-13.

³¹ Waddams 1992, p. 13.

look at the restoration in different ways, and apply widespread discretion, with the answers to legal questions which are handed down by judges in case judgments seldom manifestly pleasing all parties involved in the litigation.

There is support for the proposition that there is imported into every case an underlying tension, when a rule of law which is essentially a legal hereditary order of governance providing simultaneously both a virtuous goal and a benchmark for judgment, is applied to facts, unique within themselves, where the court *must* decide for one party or another with imperfect evidence.³² In other words, a *general* rule is applied to *unique* facts. The problem is more acute when it is remembered that an assessment of ‘value’ routinely involves a high degree of subjectivity. The potential for individual preferences to enter into the judgment is enormous. There are not many areas of law more prominent in this regard than the area of damages. Legal contradictions and inconsistent rulings can easily be found in the cases. As already noted, in *Liesbosch Dredger v S.S. Edison*³³ (1933), the court took the view that the compensation to the plaintiff owners of a dredge, lost through the defendant’s negligence, should be that of the value of the lost dredge to its owners in the particular circumstances as a going concern. Other considerations regarding the contractual situation of the owners in the employment of the dredge and the subsequent lost profit were considered unrecoverable. In contrast, the court went to great pains to ascertain the lost profits of a plaintiff in a breach of copyright action, even down to the accounting method used to account for overheads to ascertain the surplus capacity of one of the firms in *LED Builders v Eagle Homes*³⁴ (1999). In the former case the court was not interested in the contractual situation of the plaintiff as it was considered too

³² Simpson 1987b, p. 360.

³³ *Owners of the Dredger Liesbosch v Owners of Steamship Edison* [1933] A.C. 449.

³⁴ *LED Builders Pty. Ltd. v Eagle Homes Pty Ltd.* (unreported) [1999] FCA 584.

remote in relation to the damages claimed, but in the latter case the court was interested in the contractual situation of the defendant, because it considered that it was not too remote in relation to the damages claimed. The Court refused to award the market value of the coal improperly taken from the plaintiff's land in *Livingstone v Rawyards Coal Co.*³⁵ (1880), yet it awarded the difference in market value of sugar which was delivered late in a falling market in *Koufos v C. Czarnikow Ltd.*³⁶ (1969). It awarded a loss of a chance to succeed in a beauty contest in *Chaplin v Hicks*³⁷ (1911), but refused to award for the loss of a chance to recover properly where a hospital was charged with the liability where a physician misdiagnosed an injury in *Hotson v East Berkshire Area Health Authority*³⁸ (1987).

In other cases the court has assessed the value of shares at the date they should have been transferred, despite the fact they had declined in value from that date to the date of the award;³⁹ held a gun-maker responsible for substantial damages when he repudiated a purchase of a motor vehicle, even though the dealer was able to return it to the supplier without loss,⁴⁰ yet refused the actual costs of additional housing in a hotel for a short period, undoubtedly caused by the actions of a solicitor who failed to properly investigate a title to a house.⁴¹ All of these cases have been decided according to the court's understanding of what would 'properly' compensate the plaintiffs in the actions, where

³⁵ *Livingstone v Rawyards Coal Co.* (1880) 5 App Cas 25.

³⁶ *Koufos v C. Czarnikow Ltd.* [1969] 1 A. C. 350 House of Lords.

³⁷ *Chaplin v Hicks* [1911] 2 K.B. 786.

³⁸ *Hotson v East Berkshire Area Health Authority* [1987] 2 All E.R. 908. It may be true that some of the contradictions in damages awards can be explained by the division between past, past hypothetical, and future losses assessment which dictates at present how the courts in Australia view probability. This is a recent development which only superficially mitigates this area of conflict in the legal rules. Some additional weight should be given to the factual circumstances where the parties to the litigation are to blame for inconsistencies where evidence of losses claimed was not sufficient to convince the court to rule in their favour, despite in hind sight that they were justified in asking for compensation.

³⁹ *Solloway v McLaughlin* [1938] A.C. 247.

⁴⁰ *W.L. Thompson Ltd. v Robinson (Gunmakers) Ltd.* [1955] Ch 177; [1955] 1 All E.R. 154.

⁴¹ *Pilkington v Wood* [1953] 2 All E.R. 810.

rules of past cases were applied. These cases demonstrate that courts will choose a rule, not necessarily because the rule has relevance to the facts of a case, but because it has relevance according to the *purpose* of the present curial inquiry. These factors will assist the court in choosing the applicable rules to apply, and how strictly or widely to interpret them. The discretionary element in choosing the rule upon which to dispose of a case can, subsequently, seem contradictory. How the bench characterises the facts presented will set the parameters of the argument regarding the legal rules to apply. Judges have a vast array of rules from which to choose, resulting in wide discretion in the disposition of an instant case. Judges can follow a precedent, distinguish it, apply or partially apply it, or overrule it. Some rather disparate factual situations have been held to have principles which are similar.⁴²

‘Proper compensation’, therefore, may be influenced by factors other than the compensatory principle. Other considerations will undoubtedly enter in, and through the legal matrix the courts must somehow ‘do justice’ to the parties in conflict. “The essential quality which legitimates the courts in these roles is: that they strive to do justice in the case.”⁴³ The ancestral duty of the old English Kings to administer justice which was handed to the courts, still lingers within the system of English law practiced in Australia.

The underlying conflict between the common law rule of *restitutio in integrum* and the reality of the inadequacy of many damages awards is still not resolved. It would seem that the court philosophically compromises by holding, prior to any appraisal of facts in a

⁴²In *D.P.P. v Morgan* [1970] 3 All E.R. 1053 the House of Lords relied on a case of a husband’s desertion to justify the conclusion that intention must be proven in a rape case. It may be the better view to give recognition to the efforts of well-paid counsel than to curial logic.

given case, that some losses are too remote, while still holding that the rule of *restitutio in integrum* is the goal of the awards of damages. The rule in *Hadley*, which stipulates the limits of recoverable damages in contract, prior to any factual evaluation in a given case, is a prime example of the result of transmuting an area formerly reserved for the consideration of the jury as trier of fact, and relegating it to a rule of law in an attempt to rationalise the common law into principles. Cooke and Oughton,⁴⁴ Atiyah,⁴⁵ and Allen and Hiscock⁴⁶ all trace the “common law of contracts” to the *law of contract* through the 19th century transformation period into 20th century commercial application. The underlying tension arising from the use of broadly-applied rules to dispose of uniquely-ascertained fact situations in litigation has never been fully resolved by the courts, and it seems apparent that contradictions between case judgments will continue. The cases are individually constructed from the unique facts which comprise the cause of action. How the parties (and their respective counsels) characterise the losses claimed may dictate how the court approaches the disposition of the case and the award of damages.

Opportunity cost is clearly an economic concept, but it is not clearly characterised as an economic loss. Past courts did not view the additional component being sought by the plaintiff in compensation for the time the defendant has withheld payment as part of ongoing injury from deprivation of a capital sum. Whether or not the interest component normally awarded comprises an integral part of an ongoing chain of injury inflicted by a defendant is open to debate. The courts have held a restrictive posture on this issue.

⁴³ Blazey-Ayoub, Conomos, and Doris 1996, p. 1.

⁴⁴ Cooke and Oughton 1989, Chapter 4 and p. 245.

⁴⁵ Atiyah 1979, Chapters 17-21.

⁴⁶ Allen and Hiscock 1992, *The Law of Contract in Australia*, 2nd edition, CCH, Appendix 1.

Interest on Damages or Interest as Damages

Whether the court views extra sums claimed for time delay in late payment as part of the original damage, or whether it awards the extra sum as an extemporaneous consideration separate from the original damage done by the defendant may be seminal in its theoretical justification in law. Past courts adopted rules which precluded interest, apart from statutory interest, (mentioned in Chapter Four as a compromise between the previous common law incorporation of the religious objection to its award, and growing commercial practice which demanded its inclusion into damages awards) on sums of money awarded in damages to a plaintiff. The courts awarded, as a result of legislation, interest *on* the damages, without recognition that the interest itself represented an integral damage suffered by the plaintiff. This legal distinction is difficult to justify, for the plaintiff suffers the loss whether or not it is characterized as a continuing integral part of the damages, or given as an added compensation on damages. Past courts, even in the very recent past, have been unwilling to even deal with this point. *Norwest Refrigeration Services Pty. Ltd. v Bain Dawes (W.A.) Pty. Ltd.*⁴⁷ (1984) provides a particularly clear expression of the contradiction pertaining to the treatment of interest in damage claims:

[the plaintiff] claims that the interest [on the overdue sum] is an integral part of the damages themselves. It is not merely a case of seeking interest on a sum assessed as the damages flowing from a tort. In our opinion, however it be put, the argument cannot succeed. At common law, no court could award interest in a case such as this, whether by way of interest on damages or as damages.⁴⁸

The damage done to plaintiffs by unscrupulous defendants who withheld funds due was certainly foreseeable, and undoubtedly recognisable as a common problem in modern terms at least from 1893 when the House of Lords handed down the judgment in *London*

⁴⁷ *Norwest Refrigeration Services Pty. Ltd. v Bain Dawes (W.A.) Pty. Ltd.* (1984) 157 C.L.R. 149

⁴⁸ *Norwest Refrigeration Services Pty. Ltd. v Bain Dawes (W.A.) Pty. Ltd.* (1984) 157 C.L.R. 149 at 162; *Hungerfords v Walker* (1989) 171 C.L.R. 125 at 139.

*Chatham & Dover Railway Co. v South Eastern Railway Co.*⁴⁹ All the Law Lords in this seminal case expressed dissatisfaction with the state of the law, and yet refused to define a clear and workable rule which would circumvent the philosophical tension erected in the classification dilemma. This narrow approach reflects the parochial nature of the common law's inability to be innovative and the propensity to sift all actions through the historic forms of action. This may be seen nearly a century after the decision in the *London and Chatham* case was handed down in *President of India v Lips Maritime Corporation*⁵⁰ (1988) where Lord Brandon of Oakbrook said "there is no such thing as a cause of action in damages for late payment of damages. The only remedy which the law affords for delay in paying damages is the discretionary award of interest pursuant to statute."⁵¹ It may be possible to portray this statement as a rule against making a rule.

In view of the changes in English society, the predominant commercial nature and large scale growth of business, and the momentous advances in economic knowledge during the 20th century, the position taken by the court above is difficult to justify. The sum withheld by a defendant inflicts an economic loss upon the plaintiff, and as long as the sum is withheld, the economic loss continues. The recovery of the losses incurred by a plaintiff from the pure time value of a sum withheld does not magically begin on the day of the defendant's default, and the artificial divergence which the court imposed upon the classification is another piece of evidence which analogically fits the description of a lingering legal influence from prior ecclesiastical rule. From an economic perspective a plaintiff suffers loss as soon as s/he parts with the money. The courts refused to embrace this concept. A wider effect was that this lingering melancholy supported cases where

⁴⁹ [1893] A.C. 429. Cases in the mid 1700's were shown in Chapter Four to have incorporated consideration of this problem and to have dealt with it in a far less rigid manner.

⁵⁰ (1988) A.C. 395.

pure economic loss was precluded from recovery in other areas. Until recently, the courts historically eschewed awards where a defendant's detrimental action did not involve physical harm but which inflicted purely economic loss upon a plaintiff.⁵² Starting in 1964,⁵³ however, the English courts widened the scope of economic loss recovery to include actions for negligent misstatement. Encroachment upon the historic antipathy to the recognisance that an inflicted money loss was a real loss slowly altered how courts characterised economic loss, subsequently decrementally affecting the difference between the legal classification of interest on damages awards, and the economic classification of opportunity losses. This translated into a subtle but growing awareness that there may be little difference between interest *on* damages and interest *as* damages.

The difficulty for the courts in deciding this issue stems from the historic considerations examined in Chapters Three and Five. The restrictive common law forms of action did not allow recovery of damages for purely economic losses in the absence of a duty on the part of the defendant toward the plaintiff. Causes of action in tort were categorised by the courts according to the classification of plaintiff's interest. If the plaintiff incurred an injury to an interest which was proprietary, such as to the actual person or tangible property of the plaintiff, the damages were subsequently recoverable.⁵⁴ In contrast, if the plaintiff's damaged interest was purely economic in nature,⁵⁵ such as a loss arising from a contract which could not be profitably completed because of the defendant's

⁵¹ (1988) A.C. 395 at 425.

⁵² The cases examined in this section do not have elements of deceit or fraud in them. Cases which contained elements of fraud or deceit were treated differently from those where the tort did not involve malice or criminally culpable elements, and are not considered.

⁵³ *Hedley Byrne & Co. Ltd. v Heller & Partners Ltd.* [1964] A.C. 465; [1963] 2 All E.R. 575.

⁵⁴ Gibbs J., in *Caltex Oil (Australia) Pty. Ltd. v the Dredge "Willemstad"*, opined from the early cases that a possessory title to a ship may have been enough to found a cause of action. See online edition at http://www.austlii.edu.au/au/cases/cth/high_ct/136C.L.R.529.html paragraph 22. As stated in Chapter six, the classification of the facts of each case will influence the choice of rules to dispose of the case.

negligence, this type of interest was not recoverable.⁵⁶ This should not be surprising, since the classification dilemma examined in Chapter Four succinctly stated the same principle with respect to recovery of opportunity cost and the difference in the posture of recovery that the courts exhibited between the lost use of land (*mesne* profits), and the lost use of money (usury). The classification dilemma argued that the courts allowed recovery of the economic damage done to a plaintiff when it was associated with land, i.e. physical property, but did not allow recovery of the economic damage when the economic damage (expressed as the opportunity cost) arose from another economic damage (expressed as an overdue capital sum). The fact that the courts maintained the same dichotomy when purely economic losses were incurred highlights the attempts by judges to maintain consistency in the common law. This attitude toward consistency informs the policy of certainty and predictability which is examined in Chapter Eight.

The rule against recovery of pure economic loss was recognised to have begun later than the classification dilemma, starting in the 1875 case of *Cattle v Stockton Waterworks Co.*,⁵⁷ where a contractor, working on a pipe, failed to recover for loss of contractual profits when the defendants negligently caused the area where he was working to be flooded, causing extra time and expense in the performance of his contract with another party. This case stood for the proposition that pure economic loss, in the absence of some culpably inflicted physical damage, was irrecoverable. The cases prior to 1964 are not uniform in the refusal to award purely economic loss, though, for some courts interpreted

⁵⁵ The contractual interest in this section is not to be confused with the plaintiff and defendant being in a contractual relationship.

⁵⁶ *Chargeurs Reunis Compagnie Francaise de Navigation a Vapeur v English and American Shipping Co.* (1921) 9 L1 LR 464; *Caltex Oil (Australia) Pty. Ltd. v The Dredge Willemstad* (1976) 136 C.L.R. 529.

⁵⁷ (1875) LR 10 QB 453 at 457 per Blackburn J.; *Caltex Oil (Australia) Pty. Ltd. v The Dredge "Willemstad"* (1976) 136 C.L.R. 529 at 546 per Gibbs J.; *Spartan Steel & Alloys Ltd. v Martin & Co. (Contractors) Ltd.* [1973] Q.B. 27 at 35 per Denning LJ., at 48 per Lawson LJ.

the issue as one relating to the remoteness of the damage,⁵⁸ and others as an issue of whether the loss resulted from a breach of duty on the part of the tortfeasor.⁵⁹ It seems clear that in the absence of any contractual relationship between the parties, the recoverable losses had to relate to a cause of action which needed a duty of care upon which to prove breach and subsequent loss, for litigants in contractual relationship were bound by the rule in *Hadley v Baxendale* (1854), examined in Chapter Six. Litigants seeking recovery of economic losses for an injury, economic or otherwise, could only succeed if they could fit the claim into one of the established forms of action, or else prove a breach of duty of care and negligence on the part of the defendant towards them. If the duty of care otherwise needed to found the action in tort could not be proved, the action failed.⁶⁰ Litigants found it difficult to establish this duty when the courts held a rigid rule that if there was no injury to the actual property or person of the plaintiff, the action was not recognised in common law.⁶¹ The case law further divided into two lines of authority, one which awarded economic losses despite the conspicuous absence of a strict attachment to person or property, and one which adhered to the strict interpretation of the restriction. This dichotomy in case authority persisted notwithstanding the far reaching social changes and the growth of contractual relationships in society since the 19th century.

⁵⁸ *The Marpessa* (1891) P. 403.

⁵⁹ *Caltex Oil (Australia) Pty. Ltd. v The Dredge "Willemstad"* (1976) 136 C.L.R. 529 at 545 per Gibbs J.

⁶⁰ *Chargeurs Reunis Compagnie Francaise De Navigation A Vapeur and Others v English & American Shipping Company* [1921] 9 Ll. LR 464 per Bankes LJ.

⁶¹ *La Societe Anonyme De Remorquage A Helic v Bennets* [1911] 1 KB 243 at 248 per Hamilton J.; *Simpson v Thompson* [1877] 3 App Cas 279 at 289 per Penzance LJ. It is true that if another cause of action could be found, it might provide the plaintiff with a remedy. Such was the case in *Attorney-General for NSW v Perpetual Trustee Co. Ltd.* (1955) 92 C.L.R. 113, where the House of Lords recognised that if the action had been founded *per quod sevitium amisit* [ancient common law action based in master-servant relationships] it would have succeeded.

The 1964 case of *Hedley Byrne v Heller and Partners*,⁶² where a firm recovered purely financial damages incurred from reliance upon statements made in a special purpose financial assessment by the defendants, was restrictively interpreted when it was first handed down.⁶³ In 1966, the Queen's Bench refused to award economic losses to auctioneers whose sale yards were closed due to the negligent release of virus from a cattle disease research institute near the sale yards. Widgery J pointed out that:

[t]he world of commerce would come to a halt and ordinary life would become intolerable if the law imposed a duty on all persons at all times to refrain from any conduct which might foreseeably cause detriment to another, but where an absence of reasonable care may foreseeably cause direct injury to the person or property of another, a duty to take such care exists. ... The duty of care [arises] only because a lack of care might cause direct injury to the person or property of someone, and the duty was owed only to those whose person or property was foreseeably at risk. ... What [*Hedley Byrne v Heller*] does not decide is that an ability to foresee indirect or economic loss to another as a result of one's conduct automatically imposes a duty to take care to avoid that loss.⁶⁴

The curial distinction between proprietary losses and economic losses maintained a persistent resistance toward plaintiffs who claimed economic losses where physical damage was lacking.⁶⁵ In contrast, where some physical damage was caused by the defendant's actions, the plaintiffs recovered all of the costs related to the physical damage and, in addition, all the consequential economic losses which were sufficiently associated with the material injury.⁶⁶ The courts' position was clearly inconsistent.

⁶² [1964] A.C. 465.

⁶³ *S.C.M. (United Kingdom) Ltd. v W. J. Whittall & son Ltd.* (1971) 1 Q. B. 337; *Electrochrome Ltd. v Welsh Plastics Ltd.* (1968) 2 All E.R. 205.

⁶⁴ *Weller & Co. v Foot and Mouth Disease Research Institute* (1966) 1 Q.B. 569 at 585-7 per Widgery J.

⁶⁵ *Electrochrome Ltd. v Welsh Plastics Ltd.* (1968) 2 All E.R. 205; *Dynamco Ltd. v Holland and Hannen and Cubitts (Scotland) Ltd.* (1971) SLT 150; *John C. Dalziel (Airdrie) Ltd. v Burgh of Airdrie* (1966) SLT (Sh Ct) 39; *Caltex Oil (Australia) Pty. Ltd. v The Dredge "Willemstad"* (1976) 136 C.L.R. 529 at 550.

⁶⁶ *British Celanese Ltd. v A. H. Hunt (Capacitors) Ltd. v W. J. Whittall & Son Ltd.* (1971) 1 Q. B. 337; *Spartan Steel & Alloys Ltd. v Martin & Co. (Contractors) Ltd.* (1973) 1 Q. B. 27.

The criticism of the inconsistency of the court's distinction and prohibition of recovery of pure economic loss gained momentum during the same period the courts were attempting to restrict the application of *Hedley Byrne*. The dicta of Lord Denning M.R. in *Spartan Steel & Alloys v Martin & Co.*⁶⁷ (1973) questioned the usefulness of historic doctrine of the courts, and instead advocated a reliance upon the creation and maintenance of a curial policy:

The more I think about these cases, the more difficult I find it to put each into its proper pigeon-hole. Sometimes I say: 'There was no duty.' In others I say: 'The damage was too remote.' So much so that I think the time has come to discard those tests which have proved so elusive. It seems to me better to consider the particular relationship in hand, and see whether or not, as a matter of policy, economic loss should be recoverable, or not.⁶⁸

Although Lord Denning M.R. questioned the illogical defense of the distinction which the courts had raised between proprietary and economic interests, His Honour still refused to award the additional economic losses incurred by a steel mill where contractors had negligently cut the power source to the mill. This compelled the mill owners to pour hot metal out of the caldrons immediately lest the metal cool inside and cause great damage. The material damages were awarded, along with the loss of profit associated with the downgraded quality of the metal in the aborted first pour, but the resulting loss of profits from potential additional pours in normal operation were held irrecoverable, despite being foreseeable.

[I]f claims for economic loss were permitted for this particular hazard, there would be no end of claims. Some might be genuine, but many might be inflated, or even false. A machine might not have been in use anyway, but it would be easy to put it down to the cut in supply. It would be well-nigh impossible to check the claims. If there was economic loss on one day, did the claimant do his best to mitigate it by working harder next day? And so forth. Rather than expose claimants to such temptation and defendants to such hard labour - on comparatively small claims - it is

⁶⁷ Edmund-Davies LJ (in dissent) *Spartan Steel & Alloys v Martin & Co. (Contractors) Ltd.* (1973) 1 Q.B. 27.

⁶⁸ *Spartan Steel & Alloys Ltd. v Martin & Co. (Contractors) Ltd.* (1973) 1 Q. B. 27 at 37.

better to disallow economic loss altogether, at any rate when it stands alone, independent of any physical damage.⁶⁹

Lord Denning's fears were unjustified. The High Court of Australia refused to follow this logic in 1976 in *Caltex Oil (Australia) Pty. Ltd. v The Dredge "Willemstad"*⁷⁰ where a refinery claimed the economic losses arising from the negligent operation of a dredge which resulted in the cutting of an underwater pipeline supplying its refinery with material. The court awarded the economic losses of the severed pipeline to the plaintiff based on apparent notions of proximity and the knowledge which the defendant possessed which imposes sufficient duty to avoid the damage which would inflict the very loss claimed. Mason and Stephen JJ, in separate judgments, noted the dissenting judgment of Edmund-Davies LJ in *Spartan Steel* where His Honour deprecated the judicial distinction between proprietary and contractual interests and called for a resolution of the matter.⁷¹

The tension which was promulgated by the courts in the cases above shows a striking similarity to the tension erected between awards of opportunity costs associated with property and money sums, examined in Chapter Four. Where defendants interfered with property, economic losses were awarded as part of those damages. Where defendants interfered with economic interests, and material injury to the plaintiffs property or person was lacking in the plaintiff's case, no economic losses were awarded.

⁶⁹ (1973) 1 Q. B. 27 at 38 per Lord Denning M. R.

⁷⁰ (1976) 136 C.L.R. 529.

⁷¹ Edmund-Davies LJ uncontrovertibly expressed dissatisfaction with the prohibitory rule which, he thought presented "a problem regarding which differing judicial and academic views have been expressed and which it high time should be finally solved." (1973) 2 Q.B. 27 at 37.

It is probably to be expected that the courts would have taken this restrictive stance towards litigants seeking recovery of economic losses only. If economic losses were to have been awarded prior to the *Caltex Oil* case above, the basis upon which to deny opportunity costs to plaintiffs for overdue sums would have been severely eroded more quickly. Since the courts did not comprehensively address the classification dilemma until 1989 in *Hungerfords v Walker*, it would have been surprising to see an earlier dissolution of the refusal to award pure economic losses without physical injury. The double standard would not have escaped notice of counsel in subsequent cases and the bench would have been fully informed of the anomaly in any related case. For the courts to have classified interest awards in the damages as simply more damage would have been to completely undermine the artificial distinction which supported this prohibition against pure economic loss recovery in the common law. If the common law distinction between recoverable damages associated with physical damage to property or person had been resolved earlier than the 1970's in Australia, it is reasonable to assert that the classification dilemma promulgated by Lord Tenterden in 1829 and resolved in *Hungerfords v Walker* in 1989 would also have been resolved sooner. What is curious is that after *Caltex Oil*, in 1976, it was still 13 years before a case arose which had the necessary factual circumstances which enabled the High Court of Australia to complete the transferral from the *previous* curial platform, restriction of recovery of economic loss, to the *current* curial platform, recovery upon proof of breach of duty, and proof of economic loss.⁷²

Damages of a purely economic nature, inflicted at the hands of a defendant, obviously inflict an economic loss. For the precedent to have long continued within the Australian

⁷² Subject, of course, to the other mitigating circumstances and rules of law.

court system, where an economic loss was inflicted, and an interest component recovered by the plaintiff for the time value of the economic loss inflicted, yet an interest component solely denied for the recovery of the time value of an economic loss because the defendant inflicted an economic loss by refusing to pay a sum due, would have been intolerable. Obviously, if the courts had previously viewed interest as part of the ongoing damages attached to a capital sum, as opposed to a component awarded which was related to but still essentially divorced from the capital sum, it would have rendered this area of the law moribund and obsolete. The result of this dichotomy is that the courts carried an illogical distinction within the prohibition of pure economic loss recovery, for if interest which is related to a capital sum is not economic loss, it is difficult to theoretically justify its award. If the underlying basis of damages be restitutionary, then how can an additional sum in the form of an interest component be awarded in any circumstance if no loss can be theoretically attached to that element of the damages award? The recognition that there is a loss attached to the delay in payment of a principle sum just as certainly as there is a loss attached to the purely financial impact of a defendant's negligence, however uncertain in its theoretical classification, shows that this area of law urgently needed a reconciliatory intervention from the judicial hierarchy.

In curial terms, from the time of the *Caltex Oil* case, the continuing prohibition stated above lasted for only the shortest time, a mere blink of the eye, before it was resolved by the High Court through the *Hungerfords* case. *Caltex Oil* opened the doorway to judicial recognition, and it was further flung open by the rule in *Hungerfords*. There are two posited reasons why the denial survived for the intervening period between the *Caltex Oil* case in 1976, and *Hungerfords* in 1989. Firstly, courts normally cannot simply rule on any subject they please. A case must come before the court with the necessary factual circumstances which allows the court, in effect, to 'legislate' upon this area of law.

Secondly, an intervening, judicially liberating event in 1986, the Australia Act 1986 and its associated United Kingdom legislation preventing appeals to the UK courts, enabled the High Court of Australia to be able to intellectually consider legal issues apart from previously constricting English common law precedent.

There are other rules which the common law maintains which also inhibit the court's freedom to tailor justice to meet individual circumstances presented by litigants. Notably, the time value of money has always presented problems for the courts, which are bound by the rule to pay damages in a one-time payment to plaintiffs and that litigation be settled once-and-for-all between parties.

Once-For-All-Time Rule of Payment of Damages

Some rules applying to damages awards are so entrenched in the common law, that the courts have taken them for granted.⁷³ These include the rule of *restitutio in integrum* covered above and the rule that the plaintiff must prove the loss claimed. In addition, the courts have stated:

- ◆ the payment of damages to a party to litigation must be assessed and awarded in a lump sum, that is, they must be “recovered once and forever”.⁷⁴ The court has no power, other than a once-for-all-time award, to award periodical payments to a plaintiff; and
- ◆ the court has no interest in how the plaintiff actually spends the award given.

⁷³ *Johnson and Others v Perez; Creed v Perez* (1988-1989) 166 C.L.R. 351 at 412 *et seq.*; *Todorovic v Waller* (1981) 150 C.L.R. 402 at 412 per Gibbs CJ, and Wilson J.; Luntz and Hambly 1992, pp. 345-6.

⁷⁴ As Gibbs C.J. and Wilson, J. note in the text of the case the lump sum rule in common law is mitigated in some jurisdictions by statute, the most prominent of which is normally in motor vehicle accident awards.

The defendant cannot ask the court to oversee the manner in which an award is spent after judgment, the plaintiff also cannot come again to the court to ask for additional damages because, in hindsight, the damages awarded by court in final judgment proved to be inadequate. The once-for-all-time rule is to promote a finality of litigation. The rule requires the court to assess all the injury of which the plaintiff complains, and bring the ‘value’ of the past injury to the present, and likewise discounting the future aspect of the injury, to arrive at a present value payment for all the injury caused by the defendant.

As in finance, the discount and interest rates applied are crucial in determining the outcome of the figure assigned to damages. A small change in the rate applied to cash flows over a significant period will have quite significant effects upon the present value of any sum awarded. The court applies an interest rate to the past aspect of the damage in an apparent recognition of the “abstention” theory of interest,⁷⁵ although, as examined in the previous section and in Chapter Five, the methods used by courts seeking to resolve disputes where the damages claimed included future and past elements have been largely inconsistent with the economic approach. Translating the time value of future and past sums to a present value has presented the courts with challenges in different ways and under different classifications.

Nominalism, Inflation, and Acceptance of Economic Theory

Many past cases have been settled on the ‘nominalistic’ theory of money, although Luntz asserts that the reported cases show increasingly fewer instances where this has been

⁷⁵ *M.B.P. (S.A.) Pty. Ltd. v Gogic* (1991) 171 C.L.R. 657 at 666; Von Bohm-Bawerk 1914, Vol. 1, Chapter Three.

done.⁷⁶ Nominalism is the view that one unit of currency at a point in time equates with the same unit of same currency at all later times. In short, the actual purchasing power of the currency in real terms is ignored. The difference between the rates of interest imputed by the court on an award, and the actual loss attributable to a bona fide opportunity cost, manifests injustice to plaintiffs to the extent that the difference represents an underpayment, and an injustice to the defendant to the extent that the difference represents an overpayment of damages to the plaintiff in real purchasing terms.

The nominalistic view of money clashes, in view of inflation, with the notion of restoration of a position under the doctrine of *restitutio in integrum*. It cannot be said that a plaintiff's position would be restored if a nominal view of money dictated that a dollar of currency was always equal to a dollar of the same currency regardless of the time frame. This concept is repugnant to the entire framework of commercial enterprise and investment theory. Since at least World War I, inflation has been an integral part of economic consideration⁷⁷. In addition, financial theory recognizes the time value of money as a legitimate principle in itself, which the courts have historically been reluctant to openly embrace.⁷⁸ In 1970, Lord Reid in *Taylor v O'Connor*⁷⁹ recognised that a conflict existed, supported by the propagation of nominalism in the courts, and said:

I am well aware that there is a school of thought which holds that the law should refuse to have any regard to inflation but that calculations should be based on stable prices, steady or slowly

⁷⁶ *Bonython v The Commonwealth* (1948) 75 C.L.R. 589 at 621 affirmed [1951] A.C. 201; also cited in Luntz 1990, pp. 295-6. Mann 1992, however, raises an argument which refutes the assertion and alleges that courts have held a nominalistic view since the formation of the common law, and more particularly in the 20th century, when inflation became a central economic consideration. This is explored below. Mann, F. A. 1992, *The Legal Aspect of Money*, 5th edition, Oxford, Clarendon Press, chapters 4 and 10.

⁷⁷ Twigger 1999, shows that between 1881 and 1899 the highest inflation in England was 1.5% p.a. and over the whole period the total inflation was -5.5% in aggregate. This must have had an influence on the economic considerations of appeals court judges during the period. In contrast, inflation starting at the beginning of World War I, i.e., 1915, was 12.5%, and the aggregate inflation over the next 4 years was nearly 98%. See *Inflation: The Value of the Pound 1750-1998*, Research Paper 99/20, 23 February 1999, House of Commons Library, Table 1.

⁷⁸ This aspect is examined in Chapter five.

increasing rates of remuneration and low rates of interest. That must, I think, be based either on an expectation of an early return to a period of stability or on a nostalgic reluctance to recognise change. It appears to me that some people fear that inflation will get worse, some think that it will go on much as at present, some hope that it will be slowed down, but comparatively few believe that a return to the old financial stability is likely in the foreseeable future. To take any account of future inflation will no doubt cause complications and make estimates even more uncertain. No doubt we should not assume the worst but it would, I think, be quite unrealistic to refuse to take it into account at all.⁸⁰

Lord Reid's willingness to accept that inflation was a part of the reality of social circumstances which should be incorporated into the damages amounts was not widespread amongst the judiciary. The judicial resistance to acceptance of inflation portrays how little some judges have kept abreast of the changes in economic knowledge. In *Lim Poh Choo v Camden and Islington Area Health Authority* (1980),⁸¹ Lord Scarman objected to the consideration of future inflation in damages awards and gave three suggested reasons:

- 1) it is pure speculation whether inflation will increase, stay the same, or disappear in the future;
- 2) inflation should be dealt with by an investment policy; and
- 3) the recipient of a lump sum should be in "the same position as others, who have to rely on capital for their support to face the future".⁸²

In *Todorovic v Waller; Jetson v Hankin* (1981) Gibbs CJ and Wilson J. thought that Lord Scarman had "much force" in his first reason. Their Honours went on to say:

It is true that present indications suggest that inflation will continue into the foreseeable future, but for how long and at what rate it will continue is not more than conjecture, and the rate at which it will increase during any particular year a decade or so hence cannot even be conjectured.

⁷⁹ [1971] A.C. 115

⁸⁰ [1971] A.C. 115 at pp. 129-130; Luntz 1990, p. 296.

⁸¹ [1980] A.C. 174.

Evidence directed to these questions would be purely speculative, and would prolong and complicate trials for no advantage. Moreover, even if the rate of inflation could be predicted safely it is not of itself relevant. No principle of compensation entitles a plaintiff to be protected generally from the effects of inflation. The only relevance of inflation is that it will be likely to increase the earnings that might have been made had the plaintiff not been injured, and the cost of the goods and services that his injuries have made necessary for his future care: cf. *Cookson v Knowles*⁸³. Wages and costs will, of course, rise with inflation, but not necessarily at the same rate, and this introduces another element of speculation into the topic. Of course, it is rightly said that the courts take into account matters equally speculative when they have regard to the contingencies of life. [...] Such evidence as to future contingencies, like evidence as to what the inflation rate will be a decade or so in the future, is no more than unverifiable surmise and inadmissible.⁸⁴

By criticising inflationary calculations because they do not admit certainty the court predisposed itself to dismissing an integral part of financial decision theory and to contradict the views of accountants, financial analysts and actuaries. Thus, the history of the judicial recognition of inflation does not lend itself to the view that the court readily recognises the relevance of economic theory to its determinations.

It would appear that the remarks of Gibbs CJ and Wilson J directly contradict the principle of *restitutio in integrum*. If the plaintiff's position is to be restored to the antecedent position existing at the time that the wrong was committed, it is manifestly incongruent with the restitutionary principle that a lump sum currency award set without regard to the future inflation rate could possibly restore to a plaintiff the earning power s/he had prior to the defendant's conduct. The nominal view of money with respect to non-pecuniary losses, therefore is unlikely to ensure that damages awarded will

⁸² [1980] A.C. 174 at 193.

⁸³ [1979] A.C. at 574,576. The reference and footnote are in the original.

⁸⁴ *Todorovic v Waller; Jetson v Hankin* [1981] 150 C.L.R. 402 at 419 per Gibbs CJ and Wilson J.

compensate for a loss incurred. Instead, the quantitative view of money would more aptly satisfy the restitutionary purpose.⁸⁵

The complication of inflation in setting truly restitutionary damages awards has been more widely covered in the United States of America. The courts in that jurisdiction have recognized a variety of ways to deal with the issue of inflation. In general, the courts there have generally dealt with the speculative issues arising from consideration of inflation with less conservatism than the High Court of Australia showed in *Todorovic*. The courts in the USA attribute a risk-averse posture to plaintiffs when setting the discount and interest rates.⁸⁶ In Australia, the courts also assume risk-averse investment characteristics, but this raises the question which of the two parties, plaintiff or defendant, should bear the risk of the future. This question runs throughout the inflation debate in damages awards, but the High Court, in *Pennant Hills Restaurant v Barrell Insurances Pty. Ltd.*⁸⁷ (1981), sidestepped this criticism to a degree by selecting a discount rate sufficiently low that the risk was largely transferred to the defendant. Prior to *Pennant Hills* the courts awarded damages with discount rates on future aspects of the losses which did not realistically take into account the economic theory behind investment real return rates depressed by significant inflation.

The cases in the decade leading up to the landmark case of *Hungerfords v Walker* in 1989, show that the High Court of Australia was increasingly aware of the economic theory of inflation and investment growth, and the resulting disparity between that theory

⁸⁵ Luntz, H. 2002, *Assessment of Damages for Personal Injury and Death*, 4th edition, LexisNexis Butterworths supports this view, at pp. 391-392.

⁸⁶ *Chesapeake and Ohio Railway v Kelly* 241 U.S. 485, 490-1 (1916) cited Malone 1979, p. 511.

⁸⁷ (1981) 145 C.L.R. 625; this case and the public policy behind the court's decision is covered in Chapter Eight.

and court damages awards.⁸⁸ This was all the more remarkable considering the attributes of the common law were shown in Chapter Five to possess characteristics which inhibit the pace of change in principle. The High Court itself, seven years prior to issuing a “blanket rate” in *Pennant Hills*, had criticised the Supreme Court of New South Wales for prescribing an interest rate to be followed by trial judges.⁸⁹

In the context of inflationary considerations, Malone⁹⁰ defines three underlying considerations which affect the way courts deal with damages awards: predictability, efficiency, and accuracy. Malone does *not* consider the court’s inherent attitude of conservatism, nor the source of the ability to employ individual public policy perspectives by the judiciary in the courts. The impact of these underlying social expectations will be examined in the next chapter, which will focus on the social policies employed by the courts in determining damage awards.

⁸⁸ *Sharman v Evans* (1977) 138 C.L.R. 563 at 588; *Hawkins v Lindley* (1974) 4 A.L.R. 697, at 699; *Todorovic v Waller* (1981) 150 C.L.R. 402; *Pennant Hills Restaurant v Barrell Insurances Pty. Ltd.* (1981) 145 C.L.R. 625. In 1979, King CJ of the South Australian Supreme Court stated that “judicial notice can be taken of “general economic trends, the effects of inflation, prevailing rates of interest and returns on investment”. *Rendell v Paul* (1979) 22 S.A.S.R. 459 at 465-6, also cited with approval in *Woods v Multi-Sport Holdings Pty Ltd* [2002] HCA 9 (7 March, 2002) (unreported) McHugh, Kirby, Hayne and Callinan JJ. A notable exception to judicial resistance to economic theory is manifest in the dissenting judgment of Stephen J. in *Todorovic* where the text reads as clearly and logically can be said in defence of a reconciliation between what the plaintiff has lost and the real effects of pitiful damages awards modified by indefensible interest and discount rates. The judgment is so strong in its logic and manifest legitimacy that the House of Lords, in the 1999 case of *Wells v Wells* ([1999] 1 A.C. 345 at 364 *et seq.*) said that the approach to a lump sum payment has never been explained better than the text of the judgment of Stephen J. See Luntz and Hambly 2002, pp. 570-577.

⁸⁹ *Hawkins v Lindsley* (1974) 4 A.L.R. 697. It may be that the judicial attribution of credibility to economic theory progressed concurrently in the USA, Canada, and Australia, for within one decade of *Hawkins*, Luntz points out, both the Supreme Courts of Canada, and the USA held similar views to the criticism expressed in *Hawkins v Lindsley*. Luntz 2002, p. 406.

⁹⁰ Malone, T. E. 1979, “Considering Inflation in Calculating Lost Future Earnings”, *Washburn Law Journal*, vol. 18, (1979) pp. 499-511 at 500. Making this assumption reflects the courts taking a position which can be construed to be the most favourable to the plaintiff, and may also reflect, in addition to a judicial conservatism, a paternalistic attitude toward the victim of wrongdoing.

Summary

Damages are considered a money compensation for a loss incurred. This is plainly evident from the rule that damages are restitutionary. A plaintiff is entitled, as examined above, to be restored as far as money can do, to the place or position which was occupied prior to the wrongful act of the defendant. Whether in tort or contract, a plaintiff who suffers loss from the culpable acts of the defendant is entitled under the restitutionary rule to have those losses completely restored. The examination revealed, in contrast to this statement, that the common law interjects hurdles which prevent the complete restoration from taking place. These further hurdles have all related to difficulties confronting the courts who cannot have perfect knowledge. Courts do not have perfect knowledge of the events leading to the loss, courts do not have perfect knowledge regarding the hypothetical position the plaintiff would occupy at the time of trial, and courts do not have perfect knowledge regarding the future circumstances which will affect the position plaintiffs will occupy in the future.

It may be fairly said that a multiplicity of problems arise contrary to the rule of *restitutio in integrum* from another rule, that of the once-for-all-time payment rule. Perhaps the difficulties arising from the analysis in this chapter can be properly, if not conveniently, characterised as the problem of geochronological removal of common law adjudicators from the factual events giving rise to litigation. This may be accurate, although it does not address other conflicts which arise in the examination of common law damages awards. Other difficulties arise where, in recognition of the human limitations of judges, individual perspectives are brought into the methods employed by judges when approaching common law damages awards. Accordingly, the next chapter will examine the central principles, labelled as ‘social policies’, or ‘public policies’, which influence

judges when approaching difficult questions relating to damages awards. Specifically addressing inflation, the next chapter will show that judicial resistance to the recognition of opportunity costs awards was part of the larger framework of resistance inherent in the conflicts of methodology between law and economics, examined in Chapter Five. These conflicts have been perpetuated through the use of *stare decisis*, or precedent, and the considerations of efficiency, accuracy, and predictability in the common law.

CHAPTER EIGHT: THE INFLUENCE OF PUBLIC POLICY ON DAMAGES AND LEGAL RECEPTION OF ECONOMIC THEORY

Introduction

Courts address legal disputes by turning attention to the facts which are considered true in each instance. By ascertaining the facts in this manner, a rule, or a series of rules, is then invoked to fit the present facts into established forms and causes of action. The rules are drawn from past cases with facts arguably similar to a present case, and applied through the doctrine of *stare decisis*. Throughout the litigious process there is an underlying assumption that the process is necessary for the common good of society. The concept of a ‘common good’ provided early judges with a legitimising tool which they could use to justify decisions based on an intuitive sense of where justice could be found in a particular case. This use of the concept of the common good provides the basis for public policy to inform the work of the courts.

Historically, as established in Chapter Three, the church was an integral part of English government. According to Holdsworth,¹ from the medieval period:

[c]hurch and State were regarded... as a single society which had many common objects ... bound to give one another assistance in carrying out those common objects. [I]f the church is thus regarded as an integral part of the state, if the church’s law is as much the king’s law as the law of the state, a fortiori Christianity must be regarded as part of the law of England.

¹ Holdsworth, 1923, vol. 8, p. 403.

The King's Bench, in 1663, expressly claimed to have inherited the church's role as "*custos morum*", or "the guardian of morals."² The morals, of course, were Christian morals, and to offend the church was to commit an offence (see Chapter Two). Despite the concessions made to the Unitarians in England in 1813, and the subsequent repeal of "so much of the Blasphemy Act 1698, as related to the doctrine of the Trinity",³ Lord Eldon refused, in 1817, to allow execution of a trust which was settled to propagate teaching against the doctrine of the Trinity, holding that the impugning of the doctrine of the Trinity was still "an offence indictable by the common law". Although rejected in 1842, this early reflection of willingness on the part of the judiciary to enforce as 'common law' an overtly religious doctrine illustrates clearly the influence of the church on the English common law, which was examined in Chapters Two and Three, and was salient in the ossification of the classification dilemma into the common law, which was examined in Chapter Four. The law which the church sought to implement was 'God's Law,' as interpreted by the church and its clerical members.⁴ Thus, where a case presented issues found to be in contravention of the law of God, it was labelled as "against the common good".⁵

Prior to the Medieval Inquisition, discussed in Chapter Two, the clergy had been resistant to the violent attitude of the surrounding communities in the treatment of heretics. Slowly, over nearly two centuries, the church finally adopted a worldview incorporating

² Black, H. C. 1990, *Black's Law Dictionary*, 6th edition, West Publishing p 387.

³ Holdsworth, 1923, vol. 8, p. 411.

⁴ On this view Lord Tenterden would have been enforcing "God's Law" in *Page v Newman* in 1829.

⁵ *Sanderson v Warner* (1623) Palm. 291; 81 E.R. 1087. Knight, 1922, cites several cases which, he asserts, shows the origins of public policy in case judgments. Along with Winfield, 1929, he makes a defence for the position that public policy started with consideration of the common good based on the translation of "*encounter common ley*" as "against the common good". This phrase seems more aptly translated "against the common law". In *Sanderson v Warner*, one prominent phrase in the legal French is "*usury est encoûter le common ley, & ley de Dieu*" which should be translated as "usury is against the common law

the hostile attitude into ecclesiastical standards of community oversight. In the same way, the courts were resistant to the commercial practices which began in the late 18th century and gathered momentum in the first decades of the 19th century. In contrast to the methods employed by the church to resist the encroachment of social attitudes in the period prior to the Medieval Inquisition, the defence by the court against the assault of the norms of a changing commercial society came in the form of the judgment of Lord Tenterden in *Page v Newman* in 1829. The intervening centuries between the time of the Medieval Inquisition and 19th century England had framed a more sophisticated legal enforcement structure, and the surrounding social architecture was far more advanced than in the previous period with a developed central government, a defined geopolitical entity, a national identity, and a well-developed domestic and international trade network.

The conflict between commercial practice and the court's enforcement policies was already evident when that case was handed down, for Mason and Carter commented upon the 'deep torpor' which struck the commercial community in the aftermath of the judgment.⁶ Lord Tenterden turned to an extra-legal standard, in effect an appeal to an expectation of efficiency, which informed his judgment in that case.⁷ After World War II, the cases reveal that society had fully accepted the commercial ethic and there was no longer any logical reason for the perpetuation of historic proscription regarding curial recognition of commercial practices which had proved so costly to the commercial realm.

and the law of God." See Knight, W. M. S. 1922, "Public Policy in English Law", 38 L.Q.R. 207, and Winfield, P.H., 1929, "Public Policy in the English Common Law", 42 *Harv L. Rev* 76.

⁶ Mason and Carter 1995, p. 694.

⁷ *Page v Newman* (1829) 9 B & C 378 at 381; 109 E.R. 140 at 141. Lord Tenterden's statement in rejecting the alternative to the prohibition of granting interest on overdue sums of money "That would be productive of great inconvenience." shows that His Honour was out of touch with the commercial practices, already firmly entrenched into English society by 1829. In addition, His Honour's judgment manifests one of the

The courts' resort to extra-legal social expectations, in effect curial social policies, can be labelled a defensive tactic employed where the alternative reliance upon strict legal reasoning would not have produced a desired result.

It took approximately 160 years between *Page v Newman* (1829) and the High Court case of *Hungerfords v Walker* (1989) for the courts to recognise the changed social expectations surrounding commercial practice which demanded that the opportunity costs of overdue sums be recovered, an amazingly similar amount of time to the church's adoption of the social standards in the period prior to the Medieval Inquisition. The capitulation of the court in *Hungerfords* is strikingly comparable to the recognition and capitulation of the clergy to the surrounding social expectation regarding the punishment of heretics which influenced the Medieval Inquisition. Reference to social expectations, or social policies⁸, is not absent, though, in the intervening period between the Medieval Inquisition in the 12th century to Lord Tenterden in the 19th century.

Winfield takes the position that Bracton,⁹ in the 13th century, contained quite a number of allusions to public policy, and that a paradox existed where "public policy pervade[d] the common law and nobody [was] aware of its existence."¹⁰ He alludes that the reason public policy came to be embedded into the common law mind was because the common law functioned "when as yet there was not much statute law and practically no case law at all to summon to the judge's assistance."¹¹ This implies that early judges made

very social principles which are examined in this chapter which the courts of the 20th century employed in resisting another form of opportunity cost, inflation.

⁸ In the context of this chapter, the terms "public policy", "social policy" and "social expectations" are used interchangeably to improve readability.

⁹ Henry of Bratton, (1210-1268) *On the Laws and Customs of England* cited as Bracton.

¹⁰ Winfield 1929, p. 77.

¹¹ *ibid.*

decisions from a personal perspective on what was good for the community in which the court was sitting, not from an established body of recognised law.

Littleton, in the 15th century, described public policy in terms of “inconvenience” or “against reason”, which are difficult to define in legal terms.¹² Later developments in the 17th century, such as the concept that a contract for an illegal purpose is void as *malum prohibitum* and therefore unenforceable, appealed to public policy for support and took for granted that policy was a legitimate tool for judges to use. In each of these instances, judges argued that some aspect of the common good would be sacrificed unless the judgment were handed down with the given features. This was not always the case, and in *Egerton v Brownlow*,¹³ in 1853, a special session of the Law Lords and King’s justices nearly put an end to the use of any notions of public policy. In that case Lord Truro argued that public policy:¹⁴

is that principle of the law which holds that no subject can lawfully do that which has a tendency to be injurious to the public, or against the public good, which may be termed, as it sometimes has been, the policy of the law, or public policy in relation to the administration of the law.

Lord St. Leonard, in the same case, avoided any definitive exposition of what constituted public policy, instead assuming its existence and use, and approved of prior instances, most notably Lord Nottingham in *Duke of Norfolk's Case* (1685):

Lord Nottingham ... went further than ever had been gone before, and he did it on grounds of public policy. He was asked, “Where will you stop?” and he said: “I will stop wherever I find a visible inconvenience.” Succeeding judges have gone on; ... and that clearly shows how sound the

¹² “And the law, which is the perfection of reason, cannot suffer anything that is inconvenient”. Section 97b, Coke, E. 1628, *Coke upon Littleton*, 1823 reprint, New York, Gryphon Books.

¹³ (1853) 4 H.L. Cas. 1. Pollock C.B. in this case equated the phrase “against the common good” to “repugnant to the State,” upon which it is easy to conclude that even those judges who in times past relied or referred to public policy and the common good, probably did not have a very concise idea of exactly what these terms meant.

¹⁴ *Egerton v Brownlow* [1843-1860] All E.R. Rep. 970 at 988.

principle of Lord Nottingham was, and how wisely it has been extended. But the judges have had no difficulty in stopping: and why did they stop? Because they found inconvenience.¹⁵

The description of public policy in the court masks the lack of clear legal principle regarding what subject matter is being considered. In *Egerton v Brownlow*, the contentious term in a will giving an estate for life with certain other remainders to a person if that person were to attain the title of Earl was held to be void as against public policy, for the tendency was to corrupt the otherwise noble functions of the peerage. No legal principle was broken in the drafting of the will. The gap was filled by the House of Lords by reference to the mischief it would cause and, for this reason, was void as against public policy. Knight revealed that:

[t]he doctrine, concealed under the widest generalization, operates, in fact, because of some gap in that law, though only where the dominant general consideration is the good of the community – the supreme law – with, it may be, some special consideration for the rights or interests of individuals other than those immediately concerned in the matter the subject of suit. It is the Judge, too, who discovers the gap, and, to fill it, enunciates, develops, and applies this doctrine.¹⁶

Winfield describes public policy as based in the ecclesiastically influenced natural law which has lingered within the common law since its inception. This, he describes, was “the law of reason” taken from the exhortations in St. German's *Doctor and Student* first published in 1523. Thus, in Littleton's *Tenures* “he gives as the ground of the particular rule which he is stating that adoption of any contrary principle would be ‘inconvenient’ or ‘against reason’.” Winfield asserts that the expressions of Littleton were turned into a crude doctrine of public policy by Coke, who emphasised the maxim *nihil quod est*

¹⁵ *Howard v Duke of Norfolk* (1685), 14 Lords Journal, 49 H.L. cited in *Egerton v Brownlow* [1843-1860] All E.R. Rep. 970 at 1015.

¹⁶ Knight 1922, p. 208.

inconveniens est licitum,¹⁷ indicating preference for the public good over the private good.

From the end of the 19th century and through to the end of the 20th century, the complexity of reported judgments steadily increased and public policy began to be described in more articulate, yet more obfuscated ways. Judges unconsciously imposed individual notions of public policy which introduced predilections in case judgments which can now be seen in hind sight.

‘Public policy’, as used in this chapter, is an undefined overriding consideration that society will be detrimentally affected if an act is allowed which, subsequently, introduces a bias into judicial decisions. Just how society will be detrimentally affected is largely assumed, rather than justified, and criticism that much of the public policy manifested in the reported judgments cannot be logically defended is not easy to rebut. Conversely, from the sitting judge’s perspective, avoidance of public policy issues is sometimes quite difficult. Assumptions are imported into the bench’s perspective regarding what is good for society and how society will be harmed, for instance, if the courts become less efficient, or produce manifestly inaccurate damages awards, or behave in a way which is plainly uncertain or unpredictable. Public policy in the courts is, subsequently, certainly a fluid and changing standard, incapable of precise definition. Examples of early cases decided on policy grounds can be found, such as Lord Mansfield’s statement that “[n]o court will lend its aid to a man who founds his cause of action upon an immoral or an

¹⁷ "Nothing that is inconvenient is lawful" Black 1990, 1046. This phrase was taken by Pollock C.B. in *Egerton v Brownlow* to be authority for the doctrine of public policy. [1853] 4 H.L. 1, 140 at 145, cited in Winfield 1929, p. 83, supported by Black’s definition, who attributes its frequent use to Lord Coke.

illegal act”.¹⁸ This same principle was said to find expression in Lord Eldon's statement that equity will not intervene to recognise the title of a party guilty of an illegality: “Let the estate lie, where it falls,”¹⁹ and appears to be the source of the equitable maxim “He who comes to equity must come with clean hands”.²⁰ These are examples where policy can be clearly seen, but the principles examined in this chapter are not so starkly unmasked. The exercise of policies of predictability, efficiency, and accuracy in case law judgments have not always been straightforward.

Courts do not always openly acknowledge the influence of public policy in the common law decision process.²¹ The use of public policy in the courts provides a basis for criticism that the settlement of cases uses extra-legal criteria, criteria which may have roots in the communal conscience of the society in which courts reside. The participatory decision model employed in the early Germanic courts mentioned in Chapter Two used this communal conscience in dealing with crimes and civil wrongs. Whether the use of an intuitive community sense of justice by modern judges can still be defended is open to argument, but the recognition that judges approach some cases with preconceived notions based in individual notions of social beliefs, policies, and mores seems beyond dispute.

Thus, it is inevitable that in any research on the recovery of opportunity cost in litigation that public policy issues will arise. This chapter examines how public policy

¹⁸ *Holman v Johnson* (1775) 1 Cowp 341 at 343; McInnes, M. 1997, “Advancement, Illegality and Restitution”; 1997 APLJ LEXIS 3.

¹⁹ *Muckleston v Brown* (1801) 6 Ves 52 at 69.

²⁰ *I.C.I. Australia Operations Pty. Ltd. v Trade Practices Commission* (1992) 38 F.C.R. 248; 110 A.L.R. 47; *F.A.I. Insurances Pty. Ltd. v Pioneer Concrete Services Ltd.* (1987) 15 N.S.W.L.R. 552 at 555-7 per Young J. Also see *Sterling Winthrop Pty. Ltd. v Boots Company (Australia) Pty. Ltd.* [1995] 33 I.P.R. 302 per Tamberlin J. who linked the maxim to public interest considerations in trade practices violations under statute.

²¹ *Leask v Commonwealth* (1996) 187 C.L.R. 579 per Toohey J. at 1013. Vermeesch, R. B., and Lindgren, K. E., 2001, *Business Law of Australia*, Sydney, Butterworths, p. 52.

considerations have hindered judicial acceptance of economic principles and divides consideration of public policy principles into three categories which have woven threads of overt influence into curial reflection on inflation, discount rates, and interest rates, all of which are seminally important when considering the opportunity costs of a sum of money owed by a defendant to a plaintiff. This is especially so if the sum is comprised of compensation for long-term future expected losses. The principles of efficiency, accuracy, and predictability, the subject of this chapter, have been especially influential in court decisions.

The principle of efficiency, whereby the courts are expected to deliver judgment in a cost-effective and expedient manner, has received increased attention from legal writers in the 20th century attempting to equate the ‘common good’ with social wealth, using individual wealth as a proxy, arguing that the common law tacitly or openly uses efficiency as a guideline to generate rules of law. Opponents have argued that justice is not congruent in all circumstances with efficiency, and that other values must enter in to the common law judgments. Epstein²² argues caution against the excessive use of policy, defined in terms of changes in either the social behaviour or technological patterns of communities²³ where courts exercise jurisdiction, as justification for the alteration of legal rules. He takes the position that good rules can be maintained and bad rules abandoned through other means, but to over-rely on social changes as justification for altering previously workable legal rules is to assault the static notion of the common law, value innovation over stability and increase uncertainty. Certainty, though, has not been historically a mark of early cases, for even competent judges found it difficult to

²² Epstein, R. A., 1980, “The Static Conception of the Common Law”, *The Journal of Legal Studies* vol. IX, no. 2, March 1980, pp. 253-275.

²³ Epstein 1980, p. 254.

promulgate certainty in decision making due to a lack of swift and accurate communication and the lack of accurate case reports.

Early Court Reports

The court reports prior to the 19th century were incomplete, constituting little more than case summaries. The lack of clarity and completeness in early reports not only hinders historical research, but it also hindered coherency in the English common law generally. Without the ability to ascertain the logical processes upon which early courts derived rules, it becomes difficult to organise and substantiate a systematic view of the early doctrines of the common law. In *Hadley v Baxendale* (1854), the court chose to pronounce a “rule of the common law” which it did not fully justify, or at least the case reports of the decision do not contain sufficient information to fully establish the court's justifications. Some discussion was reported regarding the limitations on recovery of damages, disclosing the appeal of Alderson B. to ‘expediency’ as motivation for the court’s decision, reflecting an appeal to an overriding, undefined application of a public policy perspective.²⁴ Deficiencies in the reporting of early cases render a search for internal coherence in this area of the common law difficult or impossible.

Although the common law had been an institution recognised since at least the late 13th century, coherency in the English common law is a relatively new feature. It wasn’t until about 1790 that the first ‘text’ on contract was published by John Joseph Powell. At the same time the English judiciary may have relied upon European continental courts and writers for ideas which they could incorporate into their judgments. Atiyah suggests that

²⁴ [1854] 9 Ex. 341 at 354.

the Court in *Hadley* borrowed from the continental writer Pothier's *Law of Obligations*,²⁵ first published in 1732 in French. Gordley asserts there was no theory in contract law until the nineteenth century²⁶ and Washington plainly implies that the common law principles were developed for hundreds of years before the courts worked out how to deal with contracts in a systematic fashion.²⁷ In light of this, it should come as no surprise that the damage award limitations set by the courts in modern contract law may not have a sound theoretical foundation. As late as 1840, the legal education in England was, according to Holdsworth, in a "disgraceful state",²⁸ adding disorder to reform attempts, which had started in 1832. Although tort law has a traceable lineage going back to the earliest writs with respect to land in the 12th century, it too was subject to the thrust to instill principles which gripped the common law from about the turn of the 19th century. Thus, the development of a coherent legal doctrine of damages in tort has undergone fundamental changes concurrent with those in contract.

The covert use of public policy in the courts, mostly hidden by inadequate case reporting, has masked the underlying reality for many centuries that judges have made law, and made it quite prolifically, while still adhering to an official doctrine that they do not make law at all. This chapter will show how judge-made law, distinguished from precedent in its narrow sense of simply following analogically similar previous decisions, has affected the common law in Australia by erecting obstacles against critical scrutiny and evaluation of certain economic principles. Of particular concern to this thesis is the

²⁵ Atiyah, 1979, p. 432.

²⁶ Gordley, J., 1991, *The Philosophical Origins of Modern Contract Doctrine*, Oxford, Clarendon Press, p. 231.

²⁷ Washington, G. T., 1975, "Innovation in Nineteenth Century Contract Law" [1975] 91 *Law Quarterly Review* 247 at 250-1.

²⁸ Holdsworth, 1923, vol. 15, p. 231. Holdsworth points out that starting in 1833, lectures were held for law students, and in 1836 examination criteria was set, but that this examination criteria only became mandatory after statutory support was given in 1843.

courts' attitude toward the consideration of time. Since opportunity cost in economics normally imports an assumption of the effluxion of time, i.e., time value, the economic phenomena which are affected by time have also suffered from the same curial resistance, hindering critical evaluation and acceptance of these economic models in the courts.

This chapter focuses upon court decisions affecting consideration of inflation,²⁹ whereby the real value of money declines over time, and argues that the same considerations apply to the courts' consideration of opportunity costs in a wider sense. Indeed, it may be argued that inflation is an opportunity cost in its purest sense, for it is a cost attached to the time money is held without an increase in its nominate value to maintain purchasing power parity with that of a prior period. Through the examination of case judgments showing how the issue of inflation is considered by the courts, impediments to recovery of opportunity cost which relate to public policy principles are then brought to light. The three major recurrent principles examined in the case literature which concern issues of time and the three factors named above (inflation, discount rates, and interest rates) manifest past judicial resistance, where judges have clearly made law which ostracized consideration of economic principles. Although judges have made law for centuries, prior to the 1980's in Australia judicial opinion still supported the declaratory role of the bench.

²⁹ The logical corollaries to inflation, i.e., interest rates and discount rates are also covered in this chapter by cogent inference rather than by focussed examination. It is taken as obvious that where inflation impacts a damages award and the curial tool to offset inflation is an interest rate on past losses, then of course interest rates must be included by necessary inference. The same argument applies to discount rates on future aspects of losses.

Policy and the Declarative Role of the Bench

Examination of public policy draws into question the declaratory role of the bench and the criticism that judges make law according to a preconceived individual social perspective. “There was a time when it was thought almost indecent to suggest that judges make law – they only declare it.”³⁰ Hale, in the 17th century, stated that courts cannot “make a law properly so-called, for that only the King and Parliament can do”.³¹ In 1892, Lord Esher had utterly denied that judges make law. “There is in fact no such thing as judge-made law, for the judges do not make the law though they frequently have to apply existing law to circumstances as to which it has not previously been authoritatively laid down that such law is applicable.”³²

This portrayal of the declaratory role of the bench masks the law-making role of judges which has been more overtly recognised in recent times.³³ No casual modern observer to legal history could possibly view cases such as *Donoghue v Stevenson*³⁴ or *Overseas Tankships v Mort Dock & Engineering Co. Ltd. (The Wagon Mound) (No.1)*³⁵ and not be impressed with the level of judicial law-making. Despite Lord Esher's denial above, as early as 1875 Mellish LJ had taunted his colleagues by declaring that: “The whole of the rules of equity and nine-tenths of the common law have in fact been made by judges.”³⁶ Indeed, it may be questionable whether there would be any modern passionate adherents

³⁰ Lord Reid 1976, “The Judge as Law Maker”, *Journal of Society of Public Teachers of Law*, p. 22.

³¹ Hale, M. 1713, *History of the Common Law of England*, online edition available at: <http://socserv2.socsci.mcmaster.ca/~econ/ugcm/3ll3/hale/common> chapter IV at point 3.

³² *Willis v Baddeley* [1892] 2 Q.B. 324 at 326; Cross, R. and Harris, W. 1991, *Precedent in English Law*, 4th edition, Oxford, Clarendon Press, p. 28.

³³ Cf. Lord Reid (1976); McHugh, M. Hon Justice “The Law-making Function of the Judicial Process”, 62 *A.L.J.* 15 concluded in 62 *A.L.J.* 116 ; Devlin 1976, “Judges and Lawmakers” (1976) 39 *M. L. R.* 1; Mason, A. Chief Justice Sir “Changing Law in a Changing Society” [1993] 67 *A.L.J.* 568.

³⁴ [1932] A.C. 562.

³⁵ [1961] A.C. 388.

³⁶ *Allen v Jackson* (1875) 1 Ch. D. 399 at 405 per Mellish LJ.

to the declaratory theory of the bench when it is said by the [former] Chief Justice of the High Court of Australia that

[j]ust as legislative reforms are now fashioned to meet Australian needs, so Australian courts are developing and refining general principles of judge-made law in their own way ... In recent years the High Court has brought about significant developments in legal principle, so much so that it can now be said that there is an emerging Australian common law.³⁷

Remarks such as these question whether or not the declaratory theory of the bench can still be said to be alive.³⁸ If the declaratory theory be dead, the recognition that judges make law through the cases raises interesting questions. The progression from descriptive (*Do* judges make law?) to normative (*Should* judges make law?) immediately brings to light the underlying questions regarding the metric from which the judge-made law stems, and the prevailing ethics reflected in the decisions which are made. This may not have been an issue in the early formation of the common law, for the overriding social ethic originated from the Catholic Church's widespread teaching and monopoly of literacy (see Chapter Two). In a philosophically competitive, pluralistic society the use of an extra-legal social ethic in determining 'justice', which may represent at best a fractional proportion of the surrounding community, becomes a far more contentious issue. If the surrounding social environment does not have a prevailing social ethic upon which judges draw to settle cases in an ethically consistent fashion, the competing social ethics reflected in the myriad of decisions in modern society undermines the principle that the law should be predictable.

³⁷ Mason CJ. [1993] 67 *A.L.J.* 568 at 570.

³⁸ Mason A. 1987, "Future Direction in Australian Law", (1987) 13 *Monash University Law Review* 149; Toohey, L.J. 1990, "Towards an Australian Common Law", (1990) 6 *Australian Bar Review* 185.

Predictability

Courts uphold the policy that the law should be predictable. Many writers on this aspect of public policy seem to assume that predictability is good, for to take the alternate position would be contrary to an orderly administration of the law.³⁹ This policy was recently reiterated by the High Court of Australia in *Perre v Apand Pty. Ltd.*⁴⁰ (1999) where the court held:

Law is one of the most important means by which a Western society remains socially cohesive while encouraging the autonomy of its individual members and the achieving of its social, political and economic goals. But the effectiveness of law as a social instrument is seriously diminished when legal practitioners believe they cannot confidently advise what the law is or how it applies to the diverse situations of everyday life or when the courts of justice are made effectively inaccessible by the cost of litigation. When legal practitioners are unable to predict the outcome of cases with a high degree of probability, the choice for litigants is to abandon or compromise their claims or defences or to expose themselves to the great expense and unpredictable risks of litigation.⁴¹

The perceived need for curial predictability is reflected in the judicial preference for tangible evidence and predictable outcomes, and abhorrence of speculation. In *Murphy v Houghton & Byrne*⁴² (1964) the court refused to allow evidence with respect to the future decline in the value of money, although it was related to the court's assessment of the plaintiff's loss of future earning capacity. In light of the compensatory goal of damages awards, the refusal to receive evidence pertinent to an integral part of the plaintiff's claimed losses reveals a conflict between the public policy that law should be predictable

³⁹ Mayanja, J. 2002, "No-shop, No-talk and Break-up Fee Agreements in Merger and Takeover Transactions: the Case for a Fresh Regulatory Approach" 14 *Australian Journal of Corporate Law*; AJCL Lexis 1 (corporate law). Baron, A. 2000, "The "Mystery" of Negligence and Economic Loss: When is a Duty of Care Owed?" *Australian Bar Review* vol. 19, 14 February, 2000; 2000 ABR Lexis 4 (tort and economic losses), *Crimmins v Stevedoring Industry Finance Committee* [1999] HCA 59 (unreported) per McHugh J. at pp. 15-16. McHugh J. tacitly argues that the entire process of argument by analogy underpins the policy of predictability in common law and that cases should proceed on the sound basis of "principle and policy".

⁴⁰ [1999] HCA 36, (unreported) High Court of Australia (12 August 1999).

⁴¹ [1999] HCA 36, (12 August 1999) per McHugh J.

⁴² [1964] *Q. L. Rep.* 14; [1964] QWN 6.

and *restitutio in integrum*. In that case, Gibbs J. (as he then was) manifested a clear slippery slope fallacy:

If evidence is admissible as to the possibility of the continuance of inflation, why is it not also admissible to show, by expert evidence, whether or not, during the years when the plaintiff might have earned, his prospects of employment might have been affected by economic depressions, political upheavals, strikes or wars? If evidence of this kind is admissible, a simple action for damages for tort will soon have all the complications of a proceeding before an industrial tribunal for a determination of the basic wage; but the evidence is, in my view, too remote from the question the jury has to consider, and it is inadmissible.⁴³

Contrary to Gibbs J's position, courts have indeed allowed evidence of the detrimental contingent future events, incorporating this into damages awards through the inclusion of a reduction factor for the "vicissitudes of life".⁴⁴ It does not follow that the extremely draconian judicial burdens which Gibbs J. feared will result simply because evidence is allowed on a matter, the purpose of which is to fully compensate a plaintiff for losses incurred as a result of the defendant's actions. In the USA, where economic evidence was introduced long before such evidence was allowed in Australian courts,⁴⁵ there is no basis upon which to substantiate such a resistant attitude.

Judges have been shown to have other reasons to justify their negative stance towards the legitimacy of economic evidence. In 1967, in *Parente v Bell*,⁴⁶ the plaintiff introduced evidence of loss of future earnings which included evidence of inflation to justify a lower

⁴³ [1964] *Q. L. Rep.* 14 at 16.

⁴⁴ *Skelton v Collins* (1966) 115 C.L.R. 94; *Sharman v Evans* (1977) 138 C.L.R. 563; *Dait v Commonwealth of Australia* 1989 NSW LEXIS 10994 (unreported) New South Wales Supreme Court, Newman J. Indeed, in the very year that *Murphy v Houghton & Byrne* was handed down, the High Court of Australia examined the doctrine of "vicissitudes of life" and approved it in *G.M.-Holden's Pty. Ltd. v Moularas* (1964) 111 C.L.R. 234 at 241-2 per Barwick CJ, at 245 per Taylor J, and 248 per Menzies J. As early as 1879 in *Phillip's Case* (1879) c. CPD 280, the doctrine was recognised. (1879) C CPD 280 at 287 per Bramwell LJ, at 291-2 per Brett LJ, at 293 per Cotton LJ. *Phillip's Case* was cited with approval and provides authority for its entry into the common law of Australia in *McDade v Hoskins* (1892) 18 V.L.R. 417, and *Richie v Victorian Railways Commission* (1899) 25 V.L.R. 272.

⁴⁵ Malone 1979.

⁴⁶ (1967) 116 C.L.R. 528.

discount rate. Windeyer J. rejected the evidence for two reasons: firstly the *actuary was not an expert in economic prophecy*, and secondly, the evidence would still not be admissible, though given by an expert economist, because the loss was not a loss of the exact weekly sums, but a loss of earning capacity such that the plaintiff was to receive its present value. This distinction contains an inherent contradiction.

Suppose for a moment that a landowner has a small mill which produces high quality sawn timber in modest quantities. After some time of operating the mill a sizeable quantity of timber is neatly stacked on the mill owner's land. Because of the defendant's negligence, the entire wood stack is burnt and, therefore, rendered unusable. It is not to the point to argue that damages should be less than the full value of the timber simply because there is a likelihood that the landowner might not have used or sold it. The landowner is entitled to receive the full value of the asset which was destroyed without any consideration for what his intentions might have been for the timber. In addition, suppose that the mill was capable of producing, say, one thousand lineal metres of sawn timber per twenty four hour period, and the mill is also destroyed in the fire. Is the court to award only a fraction of the value of the mill on the grounds that the landowner only operated the mill at half its capacity? It is submitted that the landowner is entitled the full value of the assets which were destroyed by the defendant's actions.

Returning to Windeyer J's comments, His Honour may have correctly identified that the lost asset was earning capacity, but contradicted himself by denying both the incorporation of unused capacity in the calculations of lost future earnings, and then returned to the actual weekly sums earned in the past to derive the figures necessary to assign damages. The plaintiff was manifestly under-compensated, the injustice of the damages award escaping the notice of Windeyer J. It would be the rare person able to

assess that the full personal earning capacity has been reached. Subsequently, to assess the loss in the light of Windeyer J's comments, surplus personal earning capacity should have been included as an integral part of the loss. The better view of the case above is that His Honour simply did not understand the implications of his decision. This is supported by his first objection to the actuary's evidence. This appears true despite the fact that by 1967, when this case was decided, inflation had become an economic pariah.⁴⁷ Windeyer J. introduces an internal contradiction which indicates that the issues may not have been carefully considered.

In 1968, in *Tzouvelis v Victorian Railways Commissioners*,⁴⁸ the court held that evidence regarding future aspects of lost earnings capacity, which were generated by an actuary regarding the past increases in the basic wage, and inflation, were inadmissible. His Honour, Smith J., argued that if 5% inflation were considered and then discounted at the (then) conventional 5% discount rate, the plaintiff would be over-compensated, being able to enjoy presently, the future goods of which present payment for future losses would buy. This view, as Luntz⁴⁹ points out, although theoretically true, ignores that the consumption of future goods, especially needed medical services, cannot be purchased for instant consumption. In addition, it is not immediately clear why this consideration should be relevant, given that the court's decision should be centred upon what the plaintiff has lost, and not what he can consume. The rejection of the evidence, and the entrenched posture of reticence in the courts is strikingly similar to aspects of the courts' behaviour in cases dealing with opportunity cost recovery.

⁴⁷ Twigger, 1999, table 1, shows succinctly that inflation had been entrenched deeply into the economic environment since at least World War I, and to have excluded expert evidence designed to inform the court of the future trends of inflation may be open to the criticism that the bench exercised a wilful ignorance regarding the evidence of future inflation.

⁴⁸ [1968] VR 112.

⁴⁹ Luntz 1990, pp. 304-5.

The influence of the underlying public policy of prediction and the resultant rising contradictions which have plagued the courts were succinctly illustrated by Barwick CJ. in *Pennant Hills Restaurants Pty. Ltd. v Barrell Insurances Pty. Ltd.*⁵⁰ (1981) His Honour recognized the reluctance of Australian Courts to allow evidence of future inflation:

The attitude of Australian courts has hitherto been substantially to disregard questions of the impact of future inflation upon awards of damages. They have been influenced by the obvious difficulty of predicting the future, by the speculative nature of the evidence upon which predictions of the economic future must rest, and by the added complexity which accounting for inflation would introduce into trials.⁵¹

Although courts may be justified in raising objections to criticism that the task of administering justice in cases where the issue of time and hypothetical events is very difficult, it does not mean that there is justification in courts avoiding the issues when cases which require scrutiny of time-related issues are brought for consideration. Although a case may contain circumstances which require elements of speculation, or calculations which require future considerations which cannot be predicted with certainty, the courts must find an answer which is logically justifiable. The requirement that courts *must* find an answer was first challenged in the 1911 case of *Chaplin v Hicks*⁵² where the English Court of Appeal held that just because the loss was difficult to estimate in money, and was uncertain, the court (or in that case, at first instance, the jury) was to do its best to estimate the damage and reward according to the estimation. It was, in fact, *not* to be taken away from the jury.⁵³

⁵⁰ (1981) 145 C.L.R. 625.

⁵¹ (1981) 145 C.L.R. 625, online http://www.austlii.edu.au/au/cases/cth/high_ct/145C.L.R.625.html at para. 23.

⁵² [1911] 2 K.B. 786 at 795 per Fletcher-Moulton LJ, at 798-9 per Farwell LJ.

⁵³ [1911] 2 K.B. 786 at 800.

The court, therefore, cannot use the social imperative of predictability as a tool to avoid dealing with difficult financial or economic issues, whether they contain attributes of speculation, or not. The line to be drawn by the court, however, even if it contains some speculation, will certainly not encompass a purely speculative position. In *Seguna & Seguna v Road Transport Authority of New South Wales*,⁵⁴ (1995) the court rejected the plaintiff's assertions that they had sustained an opportunity loss attached to a diminished property value resulting from acts of the Road Transport Authority and subsequent investment losses in a portfolio. The plaintiffs, Seguna, had claimed that if the property in question had not lost value through the actions of the RTA, then the plaintiffs would have been able to borrow more against the property, increasing their investments, yielding an overall higher return. Talbot J. rejected the plaintiffs' claim, noting that the plaintiffs had not actually had the claimed funds in an investment, and that they had speculated that the lost value of the property would have theoretically meant that they were precluded from borrowing more against their property, making additional investment funds unavailable. His Honour commented that the plaintiffs had shown no evidence that they actually intended to borrow extra funds, that the investment strategy of the plaintiffs "was devised by [the plaintiff's advisor] only for the purpose of giving support to the claim [for opportunity cost]," and that "[t]he Court is being asked therefore to make presumptions not only as to the return on investments but what the investments might have been."⁵⁵ This reveals that the policy of predictability dictates that courts prefer actual expenditure rather than theoretical cost.⁵⁶

⁵⁴ *Raymond Joseph Seguna Ailsa Louise Seguna v Roads and Traffic Authority of New South Wales* [1995] NSWLEC 147, (12 September 1995), (unreported), New South Wales Land and Environment Court, Talbot J.

⁵⁵ [1995] NSWLEC 147 at p. 8.

⁵⁶ See *Federal Commissioner of Taxation v Western Suburbs Cinemas Limited* [1952] 86 C.L.R. 102, where the High Court of Australia openly expressed this preference.

The courts may be willing to concede that the conceptual issues are difficult to delineate in a way that clearly shows distinct limits in principle, but that does not mean that courts will attempt to find a way for processes of estimation to be conceptually defined. In *JLW (Vic.) Pty. Ltd. v Tsilogolou*⁵⁷ (1994), Brooking J. expressed the view that there is no rigid line dividing cases where guess work is permissible and cases in which it is not. The border line was certainly indistinct, but the plaintiff in that case had failed to call credible evidence to show how the courts could ascertain the quantum for loss of stock stolen from a shop, producing neither a list of what was lost, nor other credible evidence of quantum. Brooking J. held against the plaintiff, despite his opinion that the loss had certainly incurred.

Although some sympathy can be generated toward the courts in recognition of the difficulties of assessing evidence pertaining to intangible losses, the refusal to undertake a reasoned approach to the intangible, but rationally defensible, aspects of plaintiffs' claims has resulted in plaintiffs bearing all risk of future changes in most cases, with defendants escaping the true social cost of culpable actions.⁵⁸ Luntz objects, holding that this criticism is unjustified, pointing out that it is rare for defendants to bear any loss at all in a modern insured world and that the loss will be born anyway by society through increased insurance premiums or a social security net which provides for those whose awards are inadequate for their long term support.⁵⁹ It is not clear why this should be relevant to the consideration that the plaintiff suffers an injustice through damages

⁵⁷ (1994) 1 VR 237.

⁵⁸ A contrary argument can be mounted where future losses are awarded in a probabilistic decision model. This was considered in Chapter Seven, and will be considered below under the section which examines the public policy of accuracy.

⁵⁹ Luntz, 2002, pp. 9-10.

awards diminished through reference to a policy of predictability, but the point is not lost that modern social circumstances should be included in any discussion regarding changes in policies of the courts when awarding damages. Courts, though, traditionally look more to past cases for guidance through the doctrine of precedent, than to extraneous and sometimes ill-defined social circumstances.

Predictability and Stare Decisis

The policy of predictability manifested itself historically through the doctrine of *stare decisis*. Cardozo touched on this doctrine in practical language:

I am not to mar the symmetry of the legal structure by the introduction of inconsistencies and irrelevancies and artificial exceptions unless for some sufficient reason, which will commonly be some consideration of history or custom or policy or justice. Lacking such a reason, I must be logical, just as I must be impartial, and upon like grounds. It will not do to decide the same question one way between one set of litigants and the opposite way between another. If a group of cases involves the same point, the parties expect the same decision. It would be a gross injustice to decide alternate cases on opposite principles. If a case was decided against me yesterday when I was defendant, I shall look for the same judgment today if I am plaintiff. To decide differently would raise a feeling of resentment and wrong in my breast; it would be an infringement, material and moral, of my rights.⁶⁰

The court must go through not only an exercise of discretion with respect to both the facts of a case and the search for the applicable rule of disposition, but also must balance the underlying policy of predictability and “fidelity to the rule of law”⁶¹ through the doctrine of *stare decisis*. This doctrine is the central mechanism by which the rules are generated and propagated. It is, at its very heart, the core of the common law itself, for

⁶⁰ Cardozo, B., 1921, *The Nature of the Judicial Process*, 1970 edition, Yale University Press, p. 21.

⁶¹ *Ha & Anor v New South Wales & Anor* S45/1996 High Court of Australia, Kirby J. (24 May 1996); *Trade Practices Commission v Abbco Ice Works Pty. Ltd. & Others* (1994) 123 A.L.R. 503; 14 A.C.S.R.T 359; (1994) F.C.R. 96.

“[t]he common law ... has been developed by the method of building upon the precedents provided by previous decisions.”⁶²

It is well-known legal doctrine that only the *ratio decidendi* of a case is binding upon later courts. As the legal process reduces questions in legal disputes into a form which reflects what is thought to be the legal principle at issue between the parties, the process of applying past rules taken from other decisions is more uniform in its application than trying to fit facts into a rule directly, or finding a rule which covers the facts of a novel case. What exactly comprises the *ratio* of a case can be debatable. This is true especially if one considers that many judgments are lengthy, legally esoteric in nature, and reflect the arguments given by the parties themselves which, of course, do *not* always appear in the case reports. Judges, in addition, do not always have habits of accurately summing all the arguments in judgments. This is acutely so in the older judgments, but increasingly in High Court and Appeal Court judgments the underlying arguments of opposing counsel appear to be canvassed and summarised at the beginning of reported cases⁶³. In addition, the language used to ‘distinguish’ a prior ruling may only be a tool for expressing an intuitive sentiment regarding where justice may lie in an instant case, where a member of the judiciary perceives more than can be logically justified. Judges, in short, have discretion within a framework to change the way a past case will influence both the instant case and future cases.

Case *rationes* can be used with a wide latitude, distinguished on the facts of the previous case, commented upon in *obiter dicta* which may affect later consideration, and in the

⁶² Birchett J. in *Trade Practices Commission v Abbco Ice Works* (1994) 52 F.C.R. 96 p. 13.

end be overturned by a later, or higher court. The courts, however, still uphold the *doctrine* itself. *Stare decisis* can therefore be said to be an introduced bias of legal rule-making within both the perceived 'justice' paradigm and the changing social milieu. Stone took the position that:

[P]recedents should be seen as illustrating "a probably just result in another context for comparison with the present", so that their use thus remains a "a rational means towards judgment", rather than as containing legal propositions of general force independent of their former context, to be used as premises from which to deduce future legal rules. ... the structure of precedent law constantly produces and reproduces both new rules, and new areas for choice-making. ... This notion both creates leeway for the play of contemporary judicial insight and wisdom, and also keeps judicial attention close to the contexts of earlier cases, and to the views of logical consistency, experience and values shown by judges in the earlier context.⁶⁴

MacAdam and Pyke take issue with this position. They assert that it is prevailing social sentiment in two forms which affects the way cases are used, notably values of strictness and dominance, as opposed to values of fairness, compassion, or reasonableness.⁶⁵ In MacAdam and Pyke's analysis, as these two opposing factor sets shift, the cases decided will shift as well.⁶⁶ This may not sit well juxtaposed with the concept of the 'rule of law,' but is nevertheless a part of the mechanism of the common law. The appointment of judges, therefore, may have significant impact on the outcome of overtly political cases where the judges themselves have been appointed with overtly political values.⁶⁷

⁶³ It seems that some writers get quite carried away with this aspect of the later case reports. In *Australian Communist Party v The Commonwealth of Australia* (1951) 83 C.L.R. 1, the summary of arguments and headnote consumed 140 pages of a case reported at a total length of 276 pages.

⁶⁴ Stone, J. 1964, *Legal System and Lawyers' Reasoning*, 2nd printing, 1968 Maitland Publications, p. 210.

⁶⁵ MacAdam, A. and Pyke, J. 1998, *Judicial Reasoning and the Doctrine of Precedent*, Butterworths, p.321.

⁶⁶ This does not imply that the common law changes with each gradient of change in the outer social sphere. When fundamental changes take place in the society, though, the law takes notice. A most notable example is the tremendous change in which the indigenous people of Australia have recovered land rights which were cruelly suppressed by the colonial governments. The change, from 1960 to the present is starkly manifest, collateral with the rise in social awareness of their plight.

⁶⁷ Kirby noted ten factors which he concluded were to bear responsibility for the High Court of Australia, and notably Mason CJ, choosing to forge new pathways in legal thinking away from the English Appeal Courts, essentially forming a new Australian common law. Kirby, M. 1996, "A F Mason – From Trigwell to Teoh" [1996] 20 MULR 1087. His Honour's relevant points are noted below.

Personal political influences can be seen in the common law as well. In 1837, in *Priestly v Fowler*⁶⁸ a servant had been injured when the master's carriage had been overloaded and collapsed through the negligence of a fellow servant, without fault on the part of the servant who was injured. The judgment of Lord Arbinger, whereby relief to the plaintiff was refused, manifests an attitude of contempt for the claim, where the alternative consequences would have had a significant impact upon the members of the bench, who were Barons of the Exchequer. MacAdam suggests that it was simply on the grounds that each member of the Bench undoubtedly had household servants of his own. Luntz and Hambly support this view.⁶⁹ Lord Arbinger's tirade took an absurd consequential perspective endemic to the common law. He noted that if the master was liable in the instant case, he would be liable for the negligence of all his inferior servants. Contemporary judges would have no problems finding that any servant acting in the performance of his/her duties can render the master liable for actions done, whether a fellow servant is injured or not.

It is questionable whether judges can actually give full fidelity to the doctrine of precedent in any event. Where there are competing lines of authority over an issue, a judge must choose between them in order to settle the instant case. By choosing one line over the other the judge's fidelity, by definition, can only be partial, and never complete. Lord Tenterden's choice between the competing lines of authority in *Page v Newman*⁷⁰ in 1829 shows that where judges have two powerful lines of authority, social policies,

⁶⁸ (1837) 150 E.R. 1030.

⁶⁹ Luntz, H., and Hambly, D., 2002, *Torts: Cases and Commentary*, 5th edition, Butterworths, p. 377.

⁷⁰ (1829) 9 B & C 377; 109 E.R. 140.

which dictate that tedious scrutiny of the legal issues is prohibited, can have far reaching consequences.

The doctrine of precedent, then, can be used in a wide discretionary manner. Rather than interpreting it to be a rigid doctrine, it is more appropriate to characterise it as a mechanism which can be manipulated by the participants of a case to add weight to a preferred course of action. It is, according to its use, both an inhibiting mechanism and a manipulative tool, used to add social legitimacy to a decision of the courts. The use of precedent also enables judges to dispose of cases more quickly. An appeal to a recognised case from which a rule can be drawn gives judges the ability to avoid meticulous justification in every judgment. This framework also promotes a more efficient legal process.⁷¹

Efficiency

It can be taken from Gibbs J's judgment noted above in *Murphy v Houghton & Byrne*⁷² (1964) that His Honour feared a rise in the inefficient use of the court's resources as a possible consequence where cases involved consideration of future losses. Use of resources in the court system is constrained by the same scarcity as the use of resources in any commercial enterprise. In short, the search for exact truth cannot last forever in litigation.

It is an old maxim of wide influence throughout the law that it is vital to society that litigation should not be interminable, lest (as an old judge said on civilian authority ... suits be immortal when the litigants are only mortal.) If courts insisted upon exploring every conceivable avenue of

⁷¹ *Perre v Apand Pty. Ltd.* [1999] HCA 36, (unreported), 12 August 1999, High Court of Australia.

⁷² [1964] Q. L. Rep. 14.

ascertaining the true facts involved in the cases before them, the entire administration of justice would come to a standstill immediately.⁷³

Efficiency is enhanced by the use of 'rules' to dispose of cases to alleviate the need for the principles of each judgment to be tediously explored and justified. The doctrine of precedent also fills this function, being a shorthand way for the bench to come to a conclusion respecting formerly decided cases and avoiding detailed philosophical argument in each case. There are writers who assert that the common law has always relied on this underlying public policy in disposing of cases. The recent rise in the amount of literature available on the economic analysis of law supports the presence of this underlying policy and asserts even further that judges should use principles of efficiency to adjudicate between parties, seeking the most efficient outcome of a dispute, measured in terms of social wealth. Since the 1960's the works of Coase,⁷⁴ Becker,⁷⁵ Calabresi,⁷⁶ Posner,⁷⁷ and Priest,⁷⁸ among others, have highlighted the economic analysis of law. These writers are not, however, asserting that the courts have been recently *motivated* by economics, only that there is a more overt *recognition* of considerations of economic analysis. According to Hovencamp "[i]n common law subjects such as torts, contracts, and the law of property interests judges have not incorporated much explicit economic analysis until recently, although they often did so implicitly."⁷⁹

⁷³ Stone and Wells, 1991, p. 61.

⁷⁴ Coase, R. H. 1960, "The Problem of Social Cost" (1960) 3 *Journal of Law and Economics* 1.

⁷⁵ Becker, G. S. 1976, *The Economic Approach to Human Behaviour*, University of Chicago Press.

⁷⁶ Calabresi, G. 1961, "Some Thoughts on Risk Distribution and the Law of Torts", 70 *Yale Law Journal* 499.

⁷⁷ Posner, R. A. 1992, *The Economic Analysis of Law*, 4th edition, Littleton, Brown & Co.

⁷⁸ Priest, G. L. 1977, "The Common Law Process and the Selection of Efficient Rules", [1977] 6 *Journal of Legal Studies* 65-82.

⁷⁹ Hovencamp, H. 1990b, "The First Great Law & Economics Movement", 42 *Stanford Law Review* 993 at 993-4.

There are two relevant considerations with respect to efficiency. The first is the use of the court's time. This influences the time allotted to the disposition of each case, and rules of procedure which deal with the posture courts should assume when being challenged in principle over tedious and minute details, the relevance of which are questionable. An objection to issues on the ground of relevance reflects that courts assume time is to be used to attain a high standard of efficiency without compromising the core issues of justice.⁸⁰

Judges who have objected to the introduction of evidence which would focus argument on hypothetical issues such as 'what *would* have been' have generally appealed to the need for efficiency to justify their position. Opportunity cost falls directly within this category of damages and the reluctance of courts to initiate deep discussion upon an issue regarded as intangible, hypothetical, and open to criticism, manifests clearly the tension between tedious scrutiny of cases to avoid injustice, and the processing of cases to maintain case disposition throughput. Court delays frustrate litigants who would generally wish for their case to be heard in an expeditious manner. Added to this is the consideration that court rulings apply to other cases through the use of precedent, and where one case introduces approving consideration of a probability, then consideration of probability can be used in other cases. This, in the court's eyes, would open up the court to interminable wrangling:

If [the appellant's] argument on appeal that other events would have occurred which would have caused [the plaintiffs] the same loss is unlimited, every action for damages will be subject to a range of speculation that would, if nothing else, lengthen cases immeasurably and make the assessment of damages inconsistent and unpredictable. Statistics might be produced to show the victims of motor vehicle accidents had a reasonable chance of being injured anyway, even perhaps some more than others. Compensation to relatives cases would admit evidence of the chances that

⁸⁰ The requirement that all adduced evidence at trial be strictly relevant is now entrenched in legislation.

the deceased and the spouse would have divorced if the death had not occurred or the deceased might have died from other non-compensable causes, in both cases again some more than others. Commercial cases might be in danger of embracing concepts such as that the particular claimants might anyway have lost their investment in other enterprises.⁸¹

The hatred for wasted time is not a modern phenomenon. In 1596, in *Mylward v Weldon*⁸² Lord Keeper Puckering ordered that a young lawyer who had filed more than 120 pages of handwritten pleadings “fraught with much impertinent matter not fit for the court” ordered that the drafter be hung with the writings around the neck and paraded through the courts whilst they were in sitting in Westminster Hall, bareheaded and barefaced, and then ordered confined until he paid both the defendant’s costs and £10 to the Crown. Efficiency, in a narrow sense, is a justifiable concern of officers of the bench from early cases to the present time. This aspect of efficiency certainly appears as part of the common law court process.

The other aspect of efficiency is not as easily dealt with. The emphasis of this particular strand is whether or not the common law, as an institution, promotes efficiency through its decision-making processes (the descriptive mechanism), and more, whether or not it *ought* to do so (the normative mechanism). The literature on this aspect of efficiency is problematic. The definition of the criteria to be used upon which to judge ‘efficiency’ is openly questioned, based on either a search for the highest ‘social wealth’ or ‘utility’, terms which are both defective and insufficient for measuring levels of perceived social living standards. Coase opened up the modern discussion on this subject by arguing that rights will always be allocated to the most efficient party in a conflict, in the absence of

See *Evidence Act* 1995 (Cth), ss. 55-58.

⁸¹ *Lockyer Investment Co. Pty. Ltd. v Smallacombe and Smallacombe and Swanwood Pty. Ltd.* (1994) 122 A.L.R. 659; (1994) A.T.P.R. 41-328. This passage is strikingly similar to the passage of the judgment of Gibbs J. in *Houghton v Murphy & Brown*, which was discussed above.

transaction costs.⁸³ Posner⁸⁴ argued in terms of ‘social wealth’, that the common law has always had a propensity to favour efficient rules. He takes the position that judges should make decisions which promote the highest social wealth, measured in a currency metric. The underlying motivation, according to these writers, seems to be the allocation of resources in an economic sense, whether the subjective metric of ‘utility’ is used, or a more objective ‘wealth’ criterion is employed. “The theory is that the common law is best (not perfectly) explained as a system for maximising the wealth of society.”⁸⁵ This analysis of the common law has sparked debate for almost four decades in the USA and other common law countries.

Posner has been the leading proponent in the economic analysis of law movement since 1973,⁸⁶ when the first edition of *The Economic Analysis of Law*⁸⁷ was published. Posner argued for both the descriptive (the common law is efficient and promotes efficient rules) and the normative (the common law *should* be efficient, and promote efficient rules) aspects of the common law’s rule-making mechanism. Kornhauser⁸⁸ supplemented the debate by arguing that common law processes select more efficient rules, and individuals will support more efficient rules, while Priest⁸⁹ and Rubin argued that common law process litigates less efficient rules into oblivion.

⁸² (1596) Reg. Lib. folio 692.

⁸³ Coase argued in the context of both contract and tort, that where transaction costs were zero, efficiency will result regardless of the structure of the law. Coase, R. H., 1960, “The Problem of Social Costs”, 3 *Journal of Law and Economics* 1. Also see Cirace, J. 1990, “A Synthesis of Law and Economics”, 44 *Southwestern Law Journal*, 1139 at 1145, where Cirace mentions criticism by Baumol and Cooter regarding the Coase Theorem.

⁸⁴ Posner, R., 1992, *The Economic analysis of Law*, 4th ed., Little, Brown, and Company, Canada.

⁸⁵ Posner, 1992, p. 23.

⁸⁶ Kornhauser, L. 2001, “The Economic Analysis of Law”, *Stanford Dictionary of Philosophy*, <http://plato.stanford.edu/entries/legal-econanalysis/> p.1.

⁸⁷ Posner, R. 1973, *The Economic Analysis of Law*, Boston, LittleBrown.

⁸⁸ Kornhauser, L.A., 1984, “The Great Image of Authority”, 36 *Stanford Law Review* 349, cited in Kornhauser, 2001, p. 1.

⁸⁹ Priest 1977, p. 65; Rubin, P. H. 1977, “Why is the Common Law Efficient?”, [1977] 6 *Journal of Legal Studies* 51.

Posner's initial approach is to view sections of law generally, and then to extract economic principles. Within the context of his analysis, there is an internal cogency in his arguments. To argue that copyright law is to promote efficient, imaginative, and creative resources within society, or that the law of property is, in effect, the way that the law deals with the allocative problem of large tracts of unowned land and its associated impact on the wealth of society, certainly retains validity within the argument as far as it is able to be extracted in principle. Rubin points out that although Posner is persuasive in his arguments that the common law is best understood economically, he is less persuasive in argumentation to explain why this is so.⁹⁰

Rubin analysed the common law and surmised that efficient rules survive and inefficient rules largely do not because inefficient rules are more prone to constant litigious challenge than efficient rules, and impose a higher social cost. His model also incorporates the relative interest of the litigating parties with respect to the precedent that the case will generate if litigated, and attempts to show that this will create a bias which the common law will exploit to promote efficient rules. Rubin attempts to explain the model with arithmetic examples showing the relative costs to each party and that the party with the higher cost will have a higher interest in litigating, mitigated by the probability of precedent bias for or against that party. The explanation, however, concentrates on principle but does not incorporate any consideration for individual facts of each case, a prominent weakness. Priest⁹¹ amplifies Rubin's model, and incorporates judicial bias toward or against efficient rule-making and attempts to extract some generalisations with respect to the judicial treatment of efficient rules.

⁹⁰ Rubin 1977.

Criticism can be levelled at both Rubin and Priest in that the over generalisation of 'efficient' rules ignores the fact that litigation takes place case by case, and only rarely are cases heard together.⁹² Priest goes so far as to say that individual cases should be ignored. "[T]o understand the effects on litigation of the inefficiency or efficiency of rules, it is important to ignore the individual case and to consider the effects on the set of all disputes."⁹³ Priest justifies his stance by appealing to aggregate economic principles and by characterising legal rules as economic goods. He focuses, therefore, on *systematic* changes in the aggregate set of legal rules in force.

Like consumers, judges are restrained by a budget, derived from the aggregate budget of litigants, which determines the cases that proceed to judgment. ... [W]here the opportunity set of commodity choices changes, legal rules in the aggregate, like consumer decisions in the aggregate, can be expected to be shifted toward the relatively cheaper commodities (cheaper rules).⁹⁴

Goodman⁹⁵ criticises this approach, both on the lack of ability to verify these and other assertions, but also on the recognition that these approaches ignore the historic approach to the way precedents have been formed in the common law, the approach which still operates today.

There is another criticism of the economic view of common law which can be raised. Judges, no matter what their background, have some unique perspective with respect to

⁹¹ Priest, 1977.

⁹² This statement ignores class action suits which present different issues generally and warrant a different approach to the underlying public policy.

⁹³ Priest, 1977, p. 73; Priest cites Becker, G. S. 1976, "Irrational Behaviour and Economic Theory" in *The Economic Approach to Human Behavior*, p. 153.

⁹⁴ Priest, 1977, p.75.

⁹⁵ Goodman, J. C. "An Economic Theory of the Evolution of Common Law", [1978] 7 *Journal of Legal Studies*, pp. 393-406 at 393-4.

where justice will lie in each case which is brought before them.⁹⁶ Even if, for argument's sake, the issue of *stare decisis* is ignored, to assume that rules which are efficient are litigated less, and therefore are less prone to change than inefficient rules, (which is the underlying basis of the Rubin-Priest model) is to assume that judges' perspectives on justice align, even if only loosely, with efficiency. This promotes the idea that the law and economics condone a theory of value where life is treasured only in relation to production, i.e. everything of value is measured with a currency metric. As a result, the idea that life has some worth which cannot be measured in money terms is severely deprecated; an idea which impoverishes the law and economics by valuing all virtue, honour, and justice in currency terms. Posner attempts to justify his position in a highly detailed fashion from examples in a wide ranging set of legal studies, but despite the legitimacy of certain *areas* of law being economic in motivation, it appears that Posner cannot overcome the criticism that he commits the fallacy of hasty generalisation. Sifting through much of the discussion in Posner, he asserts the generalisation that "the common law establishes property rights, regulates their exchange, and protects them against unreasonable interference – all to the end of facilitating the operation of the free market, and where the free market is unworkable of simulating its results."⁹⁷ His substantive explanations, however, appeal only to a very simple sample of cases and, therefore, use specific examples to substantiate generally, a position which, it is submitted, should be cautiously approached unless there is a more systematic defense.

Posner is difficult to accept wholesale, especially when considering the historicity of the common law, the evolution of the common law doctrines and that the common law was

⁹⁶ *Chappel v Hart* [1998] HCA 55, (2 September 1998), at 19-23, per Kirby J.; *Crimmins v Stevedoring Industry Finance Committee* [1999] HCA 59, (10 November 1999), at pp. 15-16, per McHugh J.

⁹⁷ Posner 1992, P. 252.

formed in a time when there were competing social values which needed to be placated, especially when the various influences of the disparate courts are considered. That a 'common law' was formed at all may strike some as miraculous, but to assert that the common law has, and by implication has always had, economic underpinning is to ignore the historic facts as to its formation and continuance. Justice, the aim of the King's Courts from early medieval times, was not usually compromised, covertly or otherwise, by economic considerations, and most certainly not by the overt economically oriented principles which Posner asserts.

In addition, criticism of the advocates of the law and economics movement can be brought into other areas. Posner dismisses criticism that lawyers' and judges' are not economic in their approach to the common law as a "trivial objection", and may also give too much emphasis to the perceived *laissez-faire* posture of 19th century English government. Atiyah, has cautioned against this, even going so far as to concur with Watson that "the idea of an age of *laissez-faire* is a myth, 'one of the grander misunderstandings of intellectual history'."⁹⁸ Posner concedes other criticism, but nevertheless, does not answer his critics completely.⁹⁹ Kronman went so far as to deprecate Posner's wealth maximisation principle (which he asserts Posner holds to be a blend of Kantian individual autonomy and utilitarianism) as "exhibit[ing] the vices of both and the virtues of neither".¹⁰⁰ Posner, however, retorts that Kronman

⁹⁸ Atiyah, P. S. 1979, *The Rise and Fall of Freedom of Contract*, p. 234; Watson, G. 1973, *The English Ideology* London, p. 69; Cameron, A. 1989, *A Concise Economic History of the World*, Oxford University Press, p. 213.

⁹⁹ E.g. Posner, R. A. 1980b, "The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication", [1979-80] 8 *Hofstra Law Review* 487.

¹⁰⁰ Kronman, A. T. 1980, "Wealth Maximization As a Normative Principle", (1980) 9 *Journal of Legal Studies* 227-242.

misunderstands his perspective with respect to utilitarianism and that he rejects it for its difficulty in objective measurement.¹⁰¹

It is conceded, however, that in contract, Posner and the associated models may have more apparent validity than in most other areas of common law. This is largely because of the ability of contractors to bargain over terms of contracts, in effect making their own law. The underlying premise of contract enforcement is that the contractors are in a position, more than any other party, to know what is in their own best interests. This is not to say, however, that the common law, in a loose sense, is overtly *non-economic* or that judges have an inherent bias against efficiency. It is only to point out that the adversarial system in the common law countries has far more than economic pressures which comprise its working mechanism in the social sphere. Efficiency, therefore, defined as the search for the highest social wealth, can be seen to be *part* of the matrix of underlying public policy, but the overt interpretation of the common law as economic, or driven by an underlying public policy of efficiency, is certainly problematic. In addition, to adopt the stance of Posner, Becker, Rubin, and Priest, is to adopt a tacit presupposition that efficiency equals justice, a congruence which is difficult, if not impossible, to accept. Posner goes to great lengths to establish that indeed this is a congruence to be accepted. Dworkin succinctly criticised Posner's defence and asserted that justice and social wealth were two "distinct, sometimes competing social virtues".¹⁰²

¹⁰¹ Posner, R. A. 1980a, "The Value of Wealth: A Comment on Dworkin and Kronman", 9 *Journal of Legal Studies* (1980) 243-252 at 251.

¹⁰² Dworkin, R. M. 1980, "Is Wealth a Value?", [1980] 9 *Journal of Legal Studies* 191 at 203; also Dworkin, 1980, "Why Efficiency?", [1979-80] 8 *Hofstra Law Review* 563-590.

Dworkin's objection is echoed by Calabresi,¹⁰³ and in a tacit way by Hovencamp, who reiterates Dougan and Posner's example of the miserable, yet rich old grandfather who is murdered by his grandson, who takes great pleasure in killing the old man. Although the devolution of the grandfather's great wealth upon the old man's rather shrewd entrepreneurial sons and daughters would probably increase social wealth, and certainly increase the happiness of those associated with the miserable old man, it cannot be right in any event.¹⁰⁴ That this objection should be brushed aside without delving deeply into the ramifications of the issues it raises significantly detracts from the credibility of the economic efficiency advocates' position. Hovencamp, though, defends the historic assertion that the common law was economic in its posture, at least from Blackstone forward, who he asserts, was labelled by Bentham (rather unfairly he holds) as "nothing more than an apologist for the conservative status quo."¹⁰⁵

Horwitz, claimed that the common law 'subsidised' efficient development by "a process amounting to transfer payments from the 'inactive' to the 'active' elements of society".¹⁰⁶ His thesis, criticised by Epstein,¹⁰⁷ Posner,¹⁰⁸ and McLain,¹⁰⁹ in some ways echoes critical legal theorists who criticise mainstream analysis as a mask for underlying political activism. Horwitz argued that the common law was used because "change

¹⁰³ Calabresi, G.1980, "About Law and Economics: A Letter to Ronald Dworkin", [1979-80] 8 *Hofstra Law Review* 553-562.

¹⁰⁴ Hovencamp, H., 1983, "The Economics of Legal History" [1983] 67 *Minnesota Law Review* 645 at 652. It was comforting to read that Hovencamp writes against the utilitarian-economic analysis especially when he raises the example that it might be more beneficial for human happiness in general to kill all the lawyers and spend vast sums to raise a generation of minstrels. [p. 657]; *Riggs v Palmer* (1889) 115 N.Y. 506, 22 N.E. 188.

¹⁰⁵ Hovencamp, 1983, p. 665.

¹⁰⁶ Horwitz, M. 1973, *The Transformation of American Law*, cited Hovencamp, 1983, p. 670 *et seq.*

¹⁰⁷ Epstein, R., 1982, "The Social Consequences to Common Law Rules", (1982) 95 *Harvard Law Review* 1717, especially at pp. 1724-5.

¹⁰⁸ Posner R. A., 1981, *The Economics of Justice*, Cambridge, Harvard University Press.

¹⁰⁹ McLain 1980 "Legal Change and Class Interests: A Review Essay on Morton Howitz's *The Transformation of American Law*", (1980) 68 *California Law Review* 382 at 392-4; also cited Hovencamp 1983, p. 673.

brought about through technical legal doctrine can more easily disguise underlying political choices”.¹¹⁰ Critical legal studies (CLS) attempt to discredit efficiency analysis, as incoherent, and a legitimising mechanism for “oppressive social orders [which] hides the tensions in those orders”.¹¹¹

Efficiency, as a public policy active in the common law courts, therefore, in one sense is self-evident. It is in this sense that judges suffer under time constraints, budgetary considerations, and are jealous of the court’s time. Thus, judges weigh up the cost of inquiry and the amount at stake between parties, and regulate the efficiency of the court’s productive time. This must colour the way judges appraise the consequences of admitting evidence and giving parties liberty to argue minute aspects of each case. Whether or not judges make *rules* of law that have an underlying public policy of efficiency, is more problematic. According to Hovencamp:

In short, one is left with the view that although economics may explain some aspects of legal change, it does not explain everything. At least, it does not explain everything very well. One is inevitably drawn back to an argument like Ronald Dworkin’s that individuals have some rights that they are entitled to assert even though the protection of those rights is not the best public policy as measured by utilitarianism, Pareto optimality, wealth maximisation or any other criterion of efficiency.¹¹²

Distributional claims do not affect the amount of social wealth in a society. It does not matter whether social wealth in any society is measured in terms of ‘utility’ or a currency metric. Justice is simply not an added convenience for efficiency. Justice considerations dictate that legal rights are to be protected, and the law and economics movement may institutionally overlap concepts of allocative efficiency, distributional equity, and

¹¹⁰ Horwitz, p. 100, cited Hovencamp 1983, pp. 672-3.

¹¹¹ Caudill, D. S., 1987, “Disclosing Tilt: A partial Defense of Critical Legal Studies and a Comparative Introduction to the Philosophy of Law-Idea”, 72 *Iowa Law Review* 287, at p. 291.

¹¹² Hovencamp 1983, pp. 693-4.

utilitarianism,¹¹³ a position which, to many, is simply untenable. In addition, by seeking ‘efficient outcomes’ the underlying public policy of accurate damages awards risks compromise and sacrifice. It does not seem consistent with justice that some ideals are sacrificed only because it is cheaper for society to do so.

Accuracy

The conservatism which gripped the English Judiciary at the end of the 18th and beginning of the 19th century,¹¹⁴ has not disappeared. This is clear from the reported cases which involve claims for compensation referring to inflation, starting from the 1950’s, where damages awards, inflation, and investment returns were first considered in Australia. Some cases portray a contradictory attitude by judges toward evidence and provide examples where the professed goal of accuracy in compensation can be seen to be in conflict with an underlying policy of efficiency.

In *Scott v. Heathwood*¹¹⁵ (1953) the Queensland Supreme Court was entitled, as plaintiff’s counsel argued, to take into account the changed value of money between the date of the tortious conduct and the trial date, and with respect to the loss of future earnings. Stanley J. refused to consider the changed value of money, stating:

In arriving at my decision I am not taking into consideration the fact that in awarding general damages the court can take into consideration the decreased value of money. ... [I]f a man can only pay £X to the support of his wife and child, then their damages cannot exceed £X. It may be a matter of great hardship to them that £(X-Y) are needed now to buy what £X would have bought at the date of the deceased breadwinner’s death. But I fail to see on what principle I can make a

¹¹³ Eg Kornhauser, L. A. 1979, “A Guide to the Perplexed Claims of Efficiency in the Law”, [1979] 8 *Hofstra Law Review*, 591-639, where the author comments that “[c]omponents of wealth, the amounts of various goods and their prices, therefore, do not fluctuate with the acts of sheep”. Kornhauser argues that the Law and Economics analysis is actually an heir of legal realism, which asserts a reciprocal relationship on community behaviour and the direction and support of law. See pp. 635 *et seq.*

¹¹⁴ Atiyah 1979, chapters 17-21.

¹¹⁵ [1953] St. R. Qd. 91.

wrongdoer in a case like this pay more than the amount of money that would have been available to the dependants from the deceased's earning capacity.¹¹⁶

If an attempt to compensate for the 'true' loss is a policy of the court, and the aim of *restitutio in integrum*, then the approach of the court in *Scott* ensures that these will certainly not be met. To avoid any evidence which would value the loss with respect to what money could buy as opposed to the money itself, is to value all goods in life with a static nominalistic theory of money (see above). This theory, which equates a currency's unit at one point in time with its nominal unit at another point in time is largely discredited in the courts today, but would have appeared appropriate to the courts prior to the 20th century¹¹⁷ where inflation was not such an endemic economic factor.¹¹⁸ In the 1968 High Court case of *O'Brien v McKean*,¹¹⁹ Barwick CJ refused to allow evidence with respect to future inflation and the impact on lost future earnings, but was willing to allow evidence with respect to the probability of merit advances for the plaintiff. The philosophical logic of the distinction in His Honour's reasoning is difficult to substantiate, given that both of the categories involved future earnings, the effluxion of time, and probability.

The conservatism of the judiciary was confronted by litigants in 1981 in the case of *Pennant Hills Restaurants Pty. Ltd. v Barrell Insurances Pty. Ltd.*,¹²⁰ where the plaintiff sued an insurance broker who negligently failed to obtain indemnity insurance for a restaurant. The consequence of this made the restaurant owners liable for the workers

¹¹⁶ [1953] St. R. Qd. 91 at 94.

¹¹⁷ Mann 1992, pp. 85-102, outlines the history and acceptance of nominalism in English Law. His contention that the most repugnant form of nominalism is with respect to taxation is well taken, especially the power asymmetry which can be inferred from his account regarding capital gains taxation and the effects of inflation and the losses involved for income tax purposes.

¹¹⁸ Twigger 1999, table 1.

¹¹⁹ [1968] 118 C.L.R. 540.

compensation payments to an injured employee for life. In the case, the High Court of Australia was confronted with the indexation clause in the worker's compensation legislation which ensured that the benefits to the paraplegic employee were indexed to inflation and the weekly minimum earnings. The High Court refused to abrogate its earlier ruling with respect to evidence on future inflation despite, in the intervening period, Murphy J. drawing attention "to the injustice to plaintiffs that was being perpetrated by ignoring future wage increases while discounting at comparatively high rates of interest"¹²¹. It would seem, in light of the facts of the case, that the court was confronted with the legislature's opinion on the certainty of some measure of future inflation, yet despite this evidence, refused to allow further evidence to establish a forward-looking view. The High Court distinguished *O'Brien v McKlean*,¹²² as a "rule of practice," rather than a "rule of law". In light of past intransigence, this was a major concession for the High Court, and although Murphy J. was the only dissenter, the High Court adopted a discount rate of 3%. The inference that the court considered the inflationary factor, without addressing the evidentiary issues with respect to the discount rate, is inescapable. The court was able to avoid the issue while dealing with it in a veiled manner. This, in the end, may not be the best way to uphold the integrity of the judicial system.

The recent incorporation of mathematical probabilities into uncertain aspects of damages claims has additionally weakened the policy of determining accurate damages awards. When assessing hypothetical events, both past events and future events, the courts, in the manner discussed in Chapter Six regarding the causation issue, have now assumed a

¹²⁰ (1981) 145 C.L.R. 625.

¹²¹ Luntz 1990, p. 306.

¹²² (1968) 118 C.L.R. 540.

probabilistic decision procedure. An economic approach which defines an expected value of a plaintiff's loss according to the probability of different events, favourable and unfavourable, would derive a final figure through the sum of the probability-adjusted return for each event. This is now the method which the courts use to assess future losses, which are uncertain, and past hypothetical losses. The procedure, however, overlooks one important point. Regardless of the number of considerations incorporated into the hypothetical scenario, only one of the considerations (or perhaps none of them) will eventuate. Even if all possible scenarios could be incorporated into the probabilistic model, only one path will finally be borne out as the accurate assessment of the future loss. By incorporating a probabilistic decision procedure, the courts have entrenched a method by which accuracy cannot be achieved in any circumstance.

To illustrate the preceding concerns, assume that a contractor is prevented from fulfilling a contractual obligation through the actions of the defendant. Assuming all other evidential objections are overcome, the court may assess the loss and award 80% of the claimed loss because the court is intuitively convinced that there is a 20% chance that the plaintiff might not have undertaken the contract if the defendant had not defaulted. If the contract loss is assessed at, say, \$1 million, the court awards \$800,000 in compensation.¹²³ This scenario overlooks the criticism that the plaintiff would have invested, or not, and would have received the profit, or not. Thus, the imposition of a probabilistic assessment ensures that every award will *certainly be inaccurate*. For if the plaintiff had invested s/he would have received \$1 million, and if s/he had not invested, s/he would have received nothing. S/he neither receives the lost million, nor receives nothing under the probabilistic model.

¹²³ *Hungerfords v Walker* (1989) 171 C.L.R. 125.

In contrast to the entrenched error in the probabilistic model above, it is well-known that courts go to great lengths to ascertain losses and award proper compensation in cases where this can be done. Chapter Five argued that in the common law system two or more special interest groups argue in stark opposition to each other before judges as third party adjudicators. This creates the situation where judges who award overtly large or small sums in contrast to the claims of the litigators may be charged with appellable error. Courts go to significant lengths to avoid this criticism and judgments routinely focus very carefully upon the amounts to be awarded.¹²⁴

Summary

When courts decide cases they apply social policies. In the early formation period of the common law, public policy, especially in the form of Christian Church doctrine, permeated decisions of the judges. Insightful observers have recognised that judges have always made law in this way. This chapter presented material which argues that judges make law quite prolifically according to identifiable policies of predictability, efficiency, and accuracy. The impact of public policy application in case judgments may, therefore, be inescapable with the result that there is conflict in the application of underlying policies in the disposition of cases regarding opportunity cost recovery. The consideration of other economic principles with common characteristics of intangibility

¹²⁴ Examples are, *Sharman v Evans* (1977) 138 C.L.R. 563 (High Court of Australia), *Fuller v Meehan* [1999] QCA 37 (Queensland Court of Appeal), *LED Builders Pty. Ltd. v Eagle Homes Pty. Ltd.* [1999] FCA 584 (Federal Court of Australia). Indeed the examples would be far too numerous to list here, for perusal of nearly any significant damages case shows the prominence which the effort to achieve an accurate award holds within the judgment, bearing in mind that opposing parties are contending for generally opposite outcomes in damages. It does not seem to be necessary to examine this point, as it is so well known.

and hypothetical occurrence which have been litigated in the courts shows the difficulties facing the courts when considering opportunity cost, which also possesses these traits.

The legal contradictions may not be settled in a consistent fashion in the courts until a coherent underlying theoretical framework can be established. As the subjective notion of 'justice' is influenced by the underlying motive of each special interest group in litigation, court policies of efficiency, accuracy, and predictability cannot always be easily reconciled between cases, and the vast array of litigious issues coming before the courts might not be the best way for judges to gain a deep understanding of complex economic theory. There is, however, a changing legal environment. The High Court of Australia has recognized the underlying conflicts and the lingering influence of many of the points raised above.

Almost like a funnel carrying oil and water which are inevitably mixed but not dissolved, the evidential issues, applicable rules of law, and recognition of conflicting social policies were mixed together in the case of *Hungerfords v Walker*, which comprises the seminal leading case regarding opportunity cost recovery in Australia. This case, examined in the next chapter, preceded the probabilistic decision model mentioned in antecedent sections of this thesis. *Hungerfords* comprehensively altered the common law approach to damages awards specifically affecting opportunity cost, and arguably made a fatal, if not final, assault against the classification dilemma.

CHAPTER NINE: PARTIAL RESOLUTION OF THE CLASSIFICATION DILEMMA, THE RULE IN *HUNGERFORDS*

Introduction

Chapter Two examined how the church promulgated hatred for the practice of usury from the time of the fall of Rome to the Protestant Reformation. Henry VIII introduced subsequent legislation in England which redefined usury to be loans with interest outside the statutory limits. Chapter Three examined how the common law was vaccinated against acceptance of commercial practices through the use of clerics as judges and the formation of doctrine through the church teachings which were socially predominant during the relevant formation period of the 12th to the 14th centuries. Chapter Four showed how a classification dilemma took firm root in the common law and circumscribed the growing judicial practice of leaving interest components of damages awards to juries to decide. Salient methodological conflicts were examined in Chapter Five and the subsequent three chapters examined conflicts which originate from the burdens placed upon parties to litigation, rules which are drawn from past cases, and the underlying conflicts of applying public policy in court decisions, respectively. The direction and content of the material has attempted to systematically expose difficulties which have confronted plaintiffs who sought recovery of the whole loss incurred as a result of a defendant's actions, many of which have their origins in the influence of religious doctrine.

The High Court embraced modern commercial reality through the decision, in 1989, to recognise a common law remedy for the loss of the use of money which is lost or otherwise paid out by the plaintiff from the act or omission of the defendant. In recognising the church's condemnation of usury and the subsequent historical prohibitions of lending at interest, which resulted in curial refusal to allow recovery of opportunity cost, the court acknowledged subsequent obstacles facing litigants who sought recovery of the consequential opportunity losses of a sum of money. The loss of the use of money is the opportunity cost of a capital sum, and would have been proscribed from recovery in the past on the basis that the additional award was usurious and beyond common law courts' powers to award. After examining the leading case of *Hungerfords v Walker*,¹ subsequent cases will be examined which will show how the leading case removed the judicial reticence to acceptance of economic theory in Australian courts.

Making the Rule in *Hungerfords v Walker*

Facts and Background of the Case

The plaintiffs were originally a partnership, operating a rental business in South Australia for electrical goods, Radio Electrix. They hired a firm of accountants who had also been the accountants for Radio Rental, a firm in a similar line of business owned by a related party, to do the taxes for the partnership starting in the year ending 30 June, 1974. The amounts allowable for depreciation of the assets of the business for accounting purposes are different from that allowed depreciation for tax purposes. An adjustment was necessary for the income tax returns of the partnership to properly account for the

¹ (1989) 171 C.L.R. 125. The section recounting the facts was taken from the High Court Appeal. (1989)

differences. For the year ending 30 June 1974, the accountants properly adjusted the tax return amounts to account for the allowable differences between the tax return and the partnership accounts. For the next year, the accountants added back an amount, which, in the circumstances, turned out to be an error. The accountants added back the entire amount of accumulated depreciation, not the adjustment from the prior year. This overstated the next year's income, and the partnership overpaid the tax for that year. This error was carried over for each successive year, resulting in the partners overpaying income tax and provisional taxes each successive year.

In 1982, the partnership sought to incorporate, and in the process of the incorporation, another accountant was consulted who discovered the mistake. The tax return for the year ending 30 June 1981 was amended, and for the years ending 30 June 1980, 1979, and 1978, the amounts overpaid were able to be recovered. For the prior years, however, the recovery was statute barred. The plaintiffs, now Walker Stores, sued the accountants, Hungerfords, alleging negligence and breach of contract, seeking recovery of damages for the loss of the amount of income tax overpaid in the relevant years, totalling \$47,469.62. In addition, they sought compound interest at market rates upon that amount and upon the increased provisional tax required to be paid during the relevant period. Alternatively, they claimed damages for the loss of the use of the sums overpaid.

At first instance Bollen J., in the South Australian Supreme Court, found the accountants liable for the negligent discharge of their duties. He held that the clients were not entitled to interest by way of damages on the overpaid amounts except under s. 30C of the *Supreme Court Act 1935* (S.A.), but that they could recover for the loss of the use of the

overpaid amounts. In calculating the amount, he accepted that the clients would have put most of the overpaid tax into the business and assessed the damages for the loss of the use of the money by reference to an interest rate of 10 % per annum. His Honour then reduced the sum to allow for the possibility that part of the funds would not have been used in the business, consistent with the probabilistic decision model examined in Chapter Six. Damages, therefore, were assessed at \$145, 378.71.²

The defendants had sought to limit the interest component to that found under Section 30C of the *Supreme Court Act* 1935 (S.A.) which reads as follows:

30C. (1) Unless good cause is shown to the contrary, the court shall, upon the application of a party in favour of whom a judgment for the payment of damages, compensation or any other pecuniary amount has been, or is to be, pronounced, include in the judgment an award of interest in favour of the judgment creditor in accordance with the provisions of this section.

(2) The interest—

- (a) will be calculated at a rate fixed by the court; and
- (b) will be calculated in respect of a period fixed by the court (which must, however, in the case of a judgment given on a liquidated claim, be the period running from when the liability to pay the amount of the claim fell due to the date of judgment unless the court otherwise determines); and
- (c) is payable, in accordance with the court's determination, in respect of the whole or part of the amount for which judgment is given.

(3) Where a party to any proceedings before the court is entitled to an award of interest under this section, the court may, in the exercise of its discretion, and without proceeding to calculate the interest to which that party may be entitled in accordance with subsection (2) of this section, award a lump sum in lieu of that interest.

(4) This section does not—

- (a) authorise the award of interest upon interest; or
- (ab) authorise the award of interest upon exemplary or punitive damages; or
- (b) apply in relation to any sum upon which interest is recoverable as of right by virtue of an agreement or otherwise; or
- (c) affect the damages recoverable upon the dishonour of a negotiable instrument; or

² (1987) 44 S.A.S.R. 532.

- (d) authorise the award of any interest otherwise than by consent upon any sum for which judgment is pronounced by consent; or
- (e) limit the operation of any other enactment or rule of law providing for the award of interest.

Walker appealed the award of damages, and Hungerfords cross appealed. The full South Australian Supreme Court (King C.J., Millhouse and Jacobs JJ.) allowed the appeal, increased the total award amount to \$330,382.38, and dismissed the cross appeal. The court held that the damage suffered, resulting from the loss of the use of the money, was within the reasonable contemplation of the parties under the second limb of the rule in *Hadley v Baxendale*³ and should be included in the damages award. They found that the money would have been used to pay off the loans bearing the highest interest and that some of the money might have been used in the business in other ways. With this in mind, the court concluded that “their loss ... could not be less than the rate of interest which they were paying on the [highest interest] loans”⁴ which, at that time, was 20%. Because there was a probability that not all of the funds would have been used in the business, the court reduced the additional amount awarded to \$270,000. This additional amount was held to be recoverable under the second limb of *Hadley v Baxendale* on the view that the accountants had significant knowledge of the partnership business and the circumstances were such that it was within their reasonable contemplation that this loss would result from the negligent preparation of the tax returns. The accounting firm, Hungerfords, appealed to the High Court of Australia over the award on the loss of the use of money, and Walker Stores cross appealed the ruling that not all of the sums would have been used in the business.

³ 9 Ex. 341 (1854) 156 E.R. 145.

⁴ (1989) 171 C.L.R. 125 at 135.

These facts reveal circumstances which made it difficult for the courts to avoid consideration of the issue of opportunity cost. The first consideration is the evidential burden, examined in Chapter Six. The original plaintiffs were business persons who accurately recorded expenditure and profit in documentary form which was used to prepare the tax returns and satisfy governmental requirements. There would have been little room to argue against the direct losses, and very strong evidence to accept the consequential losses. The consequential losses were assessed by referring to the actual amounts paid in interest to the plaintiffs' bank to maintain liquidity and for working capital purposes. These were directly ascertainable from the bank statements and other lending contract documents.

Arguments of Counsel

Counsel for Hungerfords, Bennett Q.C., argued that Walker Stores' claim was a purely financial loss, and the consequential damages from the unavailability of the funds should not be awarded. "This, he asserted, is the first time that a court has awarded damages for loss of use of money caused by a negligently inflicted loss of money".⁵ Bennett Q.C. constructed an argument for the accountants based on four points. The first was an appeal to the public policy of efficiency in the courts:

[T]here is a policy problem that if in every case where financial loss is inflicted there has to be calculated not merely that loss but its consequences on the plaintiff, considering what he would have done if the loss had not been inflicted or, in the case of liquidated damages, what he would have done if the debt had been paid on time, the inquiry will require a trial within a trial which will often be expensive, difficult and erratic in its result.⁶

⁵ (1989) 171 C.L.R. 125 at 136 per Mason CJ and Wilson J.

⁶ (1989) 171 C.L.R. 125 at 129.

Counsel also argued that the real cause of the plaintiffs' losses was because they were impecunious in the situation. He defined "impecuniosity" in this case as "damage [that] had been incurred as a result of the non-payment or the loss of a sum of money and the unavailability of other funds which might have enabled the injured party to do something about it."⁷ The issue of causation was examined in Chapter Six, and 'efficiency' as a public policy issue was examined in Chapter Eight.

Bennett Q.C. also challenged whether, on appeal, the interference by the Full Federal Court with the findings of the trial judge concerning what would have been done with the additional funds was permissible, and then raised the issue that the original plaintiffs were subsequently incorporated. As a result of the corporate legal personality coming into being from the incorporation process, the company as plaintiff was not the same party as the original partners. Lastly, Bennett Q.C. asserted that s. 30C was evidence that the legislature had intervened and interest should, therefore, not be awarded except under that section.

The case argument for the accountants was constructed upon the line of cases beginning with *London, Chatham and Dover Railway Co. v South Eastern Railway Co.*,⁸ (1893) using the decisions to assert what historically had been the objections to awards for the loss of the use of money,⁹ as examined in Chapter Four. Counsel pointed out that there should be a strict division between the way courts deal with losses flowing from an intentionally inflicted loss and one which was merely negligent, supporting this stance on public policy grounds:

⁷ (1989) 171 C.L.R. 125 at 131.

⁸ [1893] A.C. 429. this case was examined in Chapter Four.

⁹ (1989) 171 C.L.R. 125, 128-131.

[Damages] should be recoverable only in respect of deliberate as opposed to negligent breaches of contract and intentional as opposed to negligent torts. Such a rule would be justifiable on public policy grounds that first, there are fewer claims in the relevant categories and, secondly, it accords more with the needs of justice to compensate in cases of deliberate breaches or intentional torts.¹⁰

Counsel for Walker Stores, Gray Q.C., presented an argument which relied mainly upon the second limb of the rule in *Hadley v Baxendale*¹¹ and the specific knowledge possessed by the firm of accountants who operated in close relationship with the business of the plaintiffs. “The critical feature of this case is that the accountants had special knowledge which made the loss foreseeable so that the court [can] deal with the matter under the second limb of *Hadley v Baxendale*.”¹² The loss, he asserted, was a direct consequence of the negligent act, and as Walker Stores was entitled to recover losses foreseeable at time of the contract, the loss of the use of the money was recoverable from the defendant accountants. “For reasons of principle and policy the Court should follow the approach of the New Zealand Court of Appeal ... and state a rule having more commercial reality.” Gray, Q.C. relied upon support from *Wadsworth v Lydall*¹³ (1981), examined in Chapter Four, and *Sanrod v Dainford* (1984).¹⁴

The Court's Judgment

Mason C.J. and Wilson J., in a joint leading judgment, dealt with the points asserted by counsel for the accountants in a systematic fashion. They acknowledged early common law hostility to the award of interest,¹⁵ and noted the tension in the common law position of prohibition of interest awards on overdue debts and damages from the time of *Page v*

¹⁰ (1989) 171 C.L.R. 125 at 130.

¹¹ [1854] 9 Ex. 341; 156 E.R. 145.

¹² (1989) 171 C.L.R. 125 at 131.

¹³ [1981] 2 All E.R. 401.

¹⁴ (1984) 54 A.L.R. 179.

¹⁵ (1989) 171 C.L.R. 125 at 137.

*Newman*¹⁶ (1829), which led to the enactment of *Lord Tenterden's Act* in 1833.¹⁷ Their Honours noted the restrictive circumstances in section 28 of that Act upon which courts were allowed to give interest. Noting that it was upon this ground that the House of Lords had refused relief in *London, Chatham & Dover Railway Co. v South Eastern Railway Co.*¹⁸ despite being dissatisfied with the (then) state of the law on awards of interest, they further observed that *Hadley v Baxendale* had been conspicuously absent from the judgment in *London, Chatham & Dover Railway* case. This was, in their Honours' opinion, "no doubt"¹⁹ because the House of Lords in the *London, Chatham* case had considered that the awards of interest had stood apart in their Lordships' opinion from the general principles of damages. This conspicuous lack of comment on the major damages cases decided in the 19th century on the part of the House of Lords in *London, Chatham & Dover Railway* was mentioned in Chapter Four.

Mason CJ and Wilson J then turned to consider the cases which were decided after World War II which reflected a different judicial approach to the award of interest. In succession, their Honours considered *Trans Trust S.P.R.L. v Danubian Trading Co. Ltd.*²⁰, *Wadsworth v Lydall*²¹, and *La Pintada*²², where the House of Lords approved *Wadsworth v Lydall*, and ruled that the consequential damage caused by a defendant's action upon which interest was claimed could fall under the second limb of the rule in *Hadley v Baxendale*. This brought their Honours to the conclusion that the House of Lords in *La Pintada* had been able to flee the restrictive chains of *stare decisis* by concluding that *London, Chatham & Dover Railway* was concerned solely with the *first*

¹⁶ (1829) 9 B & C 378; 109 E.R. 140. This case was extensively examined in Chapter Four.

¹⁷ *Civil Procedure Act, 1833* (U.K.), 3 & 4 Will. 4, c. 42, was examined in Chapter Four.

¹⁸ [1893] A.C. 429.

¹⁹ (1989) 171 C.L.R. 125 at 139.

²⁰ [1952] 2 Q.B. 297.

²¹ [1981] 2 All E.R. 401.

limb of the rule in *Hadley v Baxendale* and not the second. This allowed Mason CJ and Wilson J to turn to the issues which would dispose of the case at hand, and apply the second limb of the rule in *Hadley*'s case to the present facts.

It is significant to note that the High Court referred to the migration of recovery of opportunity cost from the second limb of the rule of *Hadley v Baxendale*, to the first limb. Mason CJ and Wilson J questioned whether a loss that falls under the second limb of the rule in *Hadley*²³ will *always* fall under the second limb:

[T]he circumstances which are now held to attract the second limb in *Hadley v Baxendale* – take, for example, those in *Wadsworth v Lydall* – are very often circumstances which in any event would attract the first limb. If a plaintiff sustains loss or damage in relation to money which he has paid out or foregone, why is he not entitled to recover damages for loss of the use of money when the loss or damage sustained was reasonably foreseeable as liable to result from the relevant breach of contract or tort? After all, that is the fundamental rule governing the recovery of damages, according to the first limb in *Hadley v Baxendale*²⁴ ... and subject to proximity, in negligence.²⁵

Mason CJ, and Wilson J noted the inconsistencies which arise when the strict division of the limbs of the rule in *Hadley* are applied:

If the distinction between the two limbs is to be rigorously applied in claims for damages for loss of the use of money, a plaintiff who actually incurs the expense of interest on borrowed money to replace money paid away or withheld from him will be entitled to recover that cost, so long as the defendant was aware of the special circumstances, but not otherwise. The expense must fall within the second limb of *Hadley v Baxendale* in order to be compensable. It cannot fall within the first limb because the defendant cannot be fixed with imputed knowledge of the plaintiff's financial situation and of his need to incur expense by borrowing money. Furthermore, a plaintiff who is not compelled to borrow money by way of replacement of money paid away or withheld will not be entitled to recover for the opportunity lost to him, i.e., lost opportunity to invest or to maintain

²² [1985] A.C. 104.

²³ Damages which are recoverable under the second limb of the rule in *Hadley* are those in the contemplation of the parties at the time they executed the contract as liable to result from a relevant known or contemplated breach of contract.

²⁴ The judgment notes the support of *Victoria Laundry (Windsor) Ltd. v Newman Ltd* [1949] 2 K.B. 528 at 539.

an investment. This is because in the ordinary course of things the defendant appreciates that the plaintiff will replace from his other resources the money lost, so that opportunity cost falls more readily within the first limb of *Hadley v Baxendale*. How can the difference in treatment be justified? In each case the plaintiff sustains a loss and, ex hypothesi, the defendant's wrongful act or omission is the effective cause of that loss...²⁶

The reasons given for avoiding the award of opportunity cost in past cases within the argument from the limbs of the rule in *Hadley*, were, in this view, a contradictory nonsense. In order to recover through the second limb, which focuses upon what was in the contemplation of the parties when they made the contract, the defendant must be pinned with the knowledge of the strict financial impact upon the plaintiff, so that the defendant can fairly be said to have been aware of the circumstances of the plaintiff's loss. The reason for this, according to their Honours, was because a plaintiff might be able to find money from somewhere else to make up the loss and, therefore, the opportunity cost from the defendant's actions is avoided. The court was drawing to notice that the plaintiff's loss is only shifted where alternative funds are used, and not really alleviated or avoided at all. The compensation for the loss, by implication, should be in reference to the loss of the plaintiff and the determination of how the plaintiff accounts for the loss is irrelevant. Their Honours pointed out that if a plaintiff shifts a loss incurred from the acts of the defendant by moving funds around, how can it be said that a plaintiff who cannot shift funds around suffers more of a loss than one who does?²⁷ The inconsistencies plaguing this area of law were no longer acceptable to the High Court.

²⁵ (1989) 171 C.L.R. 125 at 142.

²⁶ *ibid.*

²⁷ (1989) 171 C.L.R. 125 at 142-3.

Their Honours were, by implication, ignoring the assumption of stasis tacitly imported through the doctrine of *stare decisis*. From their perspective the imputed knowledge which the court will assume to be part of the criteria viewed as ‘usual’ within the first limb of the rule in *Hadley v Baxendale* is not a static assumption. On the contrary, they argued that the imputed level of knowledge is flexible, recognizing the increased learning and societal changes in the wider commercial environment.

We reach this conclusion more readily, knowing that legal and economic thinking about the remoteness of financial and economic loss have developed markedly in recent times. Likewise, opportunity cost should not be considered as too remote when money is paid away or withheld.²⁸

This was a courageous statement, given the history of the common law, the restrictions upon the subject by the doctrine of *stare decisis*, and the length of time the courts have prohibited the recovery of opportunity cost. The House of Lords in this case, however, was not the final court of appeal. In 1985, the Federal Parliament of Australia and the U.K. simultaneously passed legislation effectively prohibiting appeal from the High Court of Australia to the House of Lords or Privy Council. In order to appeal to those courts from a ruling emanating from an Australian jurisdiction the High Court must issue a certificate to do so. No certificates have ever been issued.²⁹

Judicial hypocrisy which prohibited admission of evidence on opportunity costs of plaintiffs, including inflationary consideration, yet officially adhered to the doctrine of *restitutio in integrum* based on either the public policy of accuracy or efficiency was rejected outright by Mason CJ and Wilson J.

If a justification exists for the difference in treatment [for the award of damages for the loss of the use of money] it must have its genesis in a policy that encourages recovery of expense actually incurred and discourages or denies recovery of opportunity cost. Yet it is not easy to see any

²⁸ (1989) 171 C.L.R. 125 at 146.

cogent reason for the adoption of such a policy; the award of compensation for opportunity cost would not expose the courts to insuperable problems in fact-finding.³⁰

This point reflects just how far the courts have evolved in the time from *Page v Newman*, in 1829, to the present. The recognition that courts cannot hide from difficult questions, and that they have a social obligation to those seeking the court's intervention seems to underpin the attitude of the majority judgment in *Hungerfords*. The fundamental conflict between the numerous previous instances of curial policy in refusing evidence pertaining to intangible economic concepts analogous to opportunity losses and the fundamental rule of *restitutio in integrum* was highlighted by the court. To uphold this conflict as a matter of policy, and refuse to recognise that a continuous economic loss was suffered by a plaintiff who is waiting for a sum to be paid by a debtor in default was not, in their Honours' opinion, a defensible position:

[S]uch a policy would be at odds with the fundamental principle that a plaintiff is entitled to *restitutio in integrum*. According to that principle, the plaintiff is entitled to full compensation for the loss which he sustains in consequence of the defendant's wrong, subject to the rules as to remoteness of damage and the plaintiff's duty to mitigate his loss. In principle he should be awarded the compensation which would restore him to the position he would have been in but for the defendant's breach of contract or negligence. Judged from a commercial viewpoint, the plaintiff sustains an economic loss if his damages are not paid promptly, just as he sustains such a loss when his debt is not paid on the due date. The loss may arise in the form of the investment cost of being deprived of money which could have been invested at interest or used to reduce an existing indebtedness. Or the loss may arise in the form of the borrowing cost, i.e., interest payable on borrowed money or interest foregone because an existing investment is realized or reduced.³¹

This loss, according to their Honours, was "a plainly foreseeable loss because, according to common understanding, it represents the market price of obtaining money".³² As a

²⁹ Kirby J. 1996, pp. 1095 – 1098; Mason, A., 1993, p. 570-571.

³⁰ [1989] 171 C.L.R. 125 at 143.

³¹ *ibid.*

³² (1989) 171 C.L.R. 125 at 143.

result, opportunity cost could now be a “loss or damage flowing naturally and directly from the defendant’s wrongful act or omission, particularly when that act or omission results in the withholding of money from a plaintiff or causes the plaintiff to pay away money.”³³

On this view, the distinction between interest on damages, and interest as damages was rejected by their Honours. The artificial distinction between damages for late payment which formed part of the original action, and damages in addition to the principal sum and, therefore, not part of the original action,³⁴ was abandoned. Differentiating between the case where a defendant disputes the action and the situation where the incurred expense and opportunity cost arise from paying money away due to the defendant’s wrong, Mason CJ. and Wilson J. held that “they are pecuniary losses suffered by the plaintiff as a result of the defendant’s wrong and therefore constitute an integral element of the loss for which he is entitled to be compensated by an award of damages”.³⁵ The former was concerned with finding a cause of action, and the latter was concerned with the limits of recoverable damages.

The fact that the courts did not recognise claims for pure economic loss in tort until well into the 20th century³⁶ did not escape the court’s attention.³⁷ The distinction between economic loss attached to injury to a plaintiff’s property or person, and economic loss

³³ (1989) 171 C.L.R. 125 at 143-4.

³⁴ *London, Chatham & Dover Railway Co. v South Easter Railway Co.* [1893] A.C. 429; *Sanrod v Dainford* (1984) 54 A.L.R. 179 at 191; *President of India v Lips Maritime Corp.* [1988] A.C. 395; *Norwest Refrigeration Services Pty. Ltd. v Bain Dawes (W.A.) Ltd.* (1984) 157 C.L.R. 149.

³⁵ (1989) 171 C.L.R. 125 at 144.

³⁶ *Caltex Oil (Australia) Pty. Ltd. v The Dredge “Willemstad”* (1976) 136 C.L.R. 429. This case was examined in Chapter Eight.

³⁷ (1989) 171 C.L.R. 125 at 140.

negligently inflicted without attached damage, seemed an empty distinction. To Mason CJ and Wilson J:

Once it is accepted that the cost of borrowing money to replace money paid away or withheld is not too remote, it is pointless to insist on a distinction between the award of damages for loss of the use of money in the case of a liquidated claim and the award of such interest in an unliquidated claim.³⁸

In their Honours' opinion, there was now no longer any reason to delay in awarding opportunity cost by reference to an appropriate interest rate, for the loss of the use of money.³⁹ "[T]he argument for denying the recovery of incurred expense and opportunity cost ... [a]s a matter of logic and principle, as well as commercial reality, ...has little to commend it". Brennan and Deane JJ were slightly more ambivalent on this particular point. They incorporated a conservative element in relation to the award of interest in compensation for the delay in obtaining payment, but they concurred with Mason CJ and Wilson J in that:

there is no acceptable reason why the ordinary principles governing the recovery of common law damages should not, in an appropriate case, apply to entitle a plaintiff to an actual award of damages as compensation for a wrongfully and foreseeably caused loss of the use of money. To the extent that the reported cases support the proposition that damages cannot be awarded as compensation for the loss of the use of a specific sum of money which the wrongful act of a defendant has caused to be paid away or withheld, they are contrary to principle and commercial reality and should not be followed.⁴⁰

The phrasing of Brennan and Deane JJ in this passage has an interesting connotation regarding the priorities which the law and commercial reality enjoy. It appears the Brennan and Deane JJ. measured the law in the light of commercial reality which puts commercial reality in a superior philosophical position. This may be interpreting the

³⁸ (1989) 171 C.L.R. 125 at 146. Pure economic loss and the difficulties previously associated with recovery are discussed in Chapter Eight.

³⁹ (1989) 171 C.L.R. 125 at 143.

words too widely, but in any event it portrays how consideration of commercial practices has changed the perspectives of the judiciary in the late 20th century.

Mason CJ and Wilson J dealt with the claim that the court should not award any interest except under the provision of s. 30C of the *Supreme Court Act* 1935 (S.A.). Their Honours were unconvinced that any evidence had been presented which gave a sound reason why the enactment of the statute in the form above precluded an award under a common law principle:

We see no reason for construing s. 30C in such a way that it forecloses the authority of the courts to award damages in accordance with the principle established by *Hadley v Baxendale* and the measure of damages governing claims in tort. The section is not intended to erect a comprehensive and exclusive code governing the award of interest... It would be a strange result if, in the face of this provision, the Court were to hold that the enactment of s. 30C precluded the award of damages for loss of the use of money, in accordance with the logical development of fundamental common law principle so as to accord with commercial reality... Where a legislative provision is designed to repair the failings of the common law and is not intended to be a comprehensive code, the existence of that provision is not a reason for this Court refusing to give effect to the logical development of common law principle. It would be ironic if a legislative attempt to correct defects in the common law resulted in other flaws becoming ossified in the common law.⁴¹

The court avoided the consequence of the statute by narrowly construing the effect of the legislation and the interpretation that s. 30C(4)(e), which states that s. 30C does not “limit the operation of any other enactment or rule of law providing for the award of interest.” This, in the court’s opinion, expressly exhibits the intention that interest at common law may be recoverable. By denying that s. 30C was intended to cover the field of interest awards, the court avoided the criticism that the judiciary was abrogating the

⁴⁰ (1989) 171 C.L.R. 125 at 152 per Brennan and Deane JJ.

⁴¹ (1989) 171 C.L.R. 125 at 147-8.

doctrine of Parliamentary sovereignty by refusing to submit to the express intention of the legislation.

The gate, against which the historically conservative religious prohibition against the practice of usury had stood, was now openly ajar, even if only partially. Although opportunity cost was awarded with reference to a compound interest rate in this case, opportunity cost as recognized in financial theory as “the most profitable alternative use” of a sum still did not fit into the legal paradigm.⁴² This may be expected if it is considered that the evidential burden, tangibility of proof, and disdain for unnecessarily theoretical issues still characterise the court system. The internal inconsistency between the issues of remoteness and the doctrine of *restitutio in integrum* still largely remains, although through *Hungerfords* it was noticeably eroded. Subsequent cases to *Hungerfords* show how the controversy is still lingering within the common law in Australia.

Subsequent Cases

Since the decision in *Hungerfords*, the courts have further developed awards of opportunity cost in some respects, but restricted awards in other ways. A significant number of reported cases have dealt with the principle in *Hungerfords*, and the following cases will attempt to put the developments into perspective.

⁴² In *Dart v Décor* (1993) 179 C.L.R. 101, however, the court recognised the economic definition of opportunity cost in the context of an intellectual property dispute. This case will be considered below.

In *Jad International Pty. Ltd. v International Trucks Australia Ltd.*⁴³ (1994) the plaintiff/appellant was unanimously refused compound interest despite evidence showing that it carried an overdraft during the entire relevant period. A dealership had purchased a truck from the defendant in circumstances where both the defendant and the plaintiff had thought the truck had a late model diesel engine. The plaintiff's mechanic, upon receiving and examining the truck, gave advice to the dealership owner that the engine was in poor condition. The owner still sought to 'on sell' the truck, but without success. When the dealership subsequently failed to sell the truck, it then attempted to repudiate the contract of purchase for misrepresentation. The Federal Court of Australia, noting that Jad had availed itself of opportunities to sell the truck at a profit in the 12 months between purchase and subsequent attempt to rescind the original purchase contract and, therefore, as the failure to sell the truck at a profit was unconnected to the misrepresentations entitling it to rescission, refused to award compound interest on a major portion of the damages award.⁴⁴

In *Dart Industries v Décor Corporation*⁴⁵ (1993) The High Court of Australia, in an intellectual property dispute, was faced with the problem of how to determine the 'profit' of a company charged with violation of a copyright relating to plastic container lids. The choice open to the plaintiffs in compensation for the violation was either to seek damages for the violation, or to require an account of the profits. An account of profits is an equitable remedy, whereas damages is a common law remedy. "Damages and an account of profits are alternative remedies ... an account of profits retains its equitable characteristics in that a defendant is made to account for, and is then stripped of, profits

⁴³ (1994) 50 F.C.R. 378.

⁴⁴ (1994) 50 F.C.R. 378 at 393.

⁴⁵ (1993) 179 C.L.R. 101.

which it has dishonestly made by the infringement and which it would be unconscionable for it to retain.”⁴⁶

The problem confronting the court was how to calculate the profits attributable to the offending product which the defendants had manufactured and sold in contravention of the plaintiff's patent. The plaintiffs contended that no overhead expenses should be included in the amount the defendants were allowed to deduct from the sale price of the offending products, whereas the Full Federal Court had allowed the defendants to be “at liberty to show that various categories of overhead costs contributed to the obtaining of the relevant profit, and to show how and in what proportion they should be allocated in the taking of the account of profit.”⁴⁷ The High Court was faced with differing accounting methods (incremental, or marginal cost, and absorption method) and how such methods affected the concept of profits, and whether or not, faced with a complex manufacturing enterprise, the court should consider that the defendant would have employed the manufacturing capacity to an alternative product, where instead it was used to manufacture the offending product. The plaintiffs asked the court to find that no overheads should be allowed to be deducted from the sale price of the offending products in calculating profits,⁴⁸ relying on *Colbeam Palmer Ltd. v Stock Associates Pty. Ltd.*⁴⁹ (1968) where Windeyer J., in the High Court of Australia, had prohibited inclusion of managerial expenses and general overheads in an account of profits ordered against a defendant for trademark violation.⁵⁰ If, on the other hand, manufacturing efforts were directed toward the offending product which would otherwise have been profitably

⁴⁶ (1993) 179 C.L.R. 101 at 109.

⁴⁷ *Décor Corporation Pty. Ltd. v Dart Industries Inc.* (1991) 104 A.L.R. 621 at 629.

⁴⁸ In trial at first instance, King J. of the Federal Court refused to allow consideration of overheads to be included in the account of profits, as none of them were shown by Décor to be directly attributable to the offending products. *Dart Industries Inc. v Décor Corporation Pty. Ltd.* (1990) 20 I.P.R. 144 at 152.

⁴⁹ (1968) 122 C.L.R. 25.

employed in an alternative product, the defendant would be worse off than if no offending products were produced, for it would not be able to recoup overhead expenses which it otherwise would have been able to recover from manufacturing a non-offending product.

The court unanimously allowed overheads “attributable” to the offending product to be included in the deductions from the sale price to derive the appropriate profit figure. In the course of judgment the court noted that the cost of manufacturing and marketing an offending product may include the cost of :

forgoing the profit from the manufacture and marketing of alternative products ... called an opportunity cost. “Opportunity cost” can be defined as “the value of the alternative foregone by adopting a particular strategy or employing resources in a specific manner...” As used in economics, the opportunity cost of any designated alternative is the greatest net benefit lost by taking an alternative.⁵¹

As Décor Corporation had incurred overhead expenses attributable to the production and sales of the offending product, the court ordered that they were at liberty to show what overhead expenses were appropriate to be deducted, for the court assumed that Décor was a “rational” manufacturer who, if presented with a prohibition against manufacturing an article in contravention of an enforceable patent, would not have left the excess manufacturing capacity idle. The court found that Décor would have redirected unused capacity into profit-making alternatives instead of being left idle. The court used the term “rational” in the context of which it seems their Honours took it to mean a ‘rational’ investor in the financial sense,⁵² but did not define it.

⁵⁰ (1968) 122 C.L.R. 25 at 39.

⁵¹ (1993) 179 C.L.R. 101 at 119.

⁵² “Rationality” in the financial sense states that for a given level of risk, an investor or manufacturer will prefer the highest return and, therefore, is irrational if idle capacity is not used in the highest productive

A Full Bench of the Federal Court relied on *Dart v Décor* in *Apand v Kettle Chip*⁵³ (1999) where another account of profits was ordered. The inclusion of a deduction for overhead expenses was again being considered, and the court relied on the definition of opportunity cost in *Dart*. Beaumont J. correctly pointed out that opportunity costs were “what would have been”⁵⁴ and Heerey J argued that the defendant was precluded from deducting the opportunity cost of the *profit* from the offending product.⁵⁵

In *Federal Commissioner of Taxation v. Northumberland Development Co. Pty. Ltd.*⁵⁶ (1995) the Full Federal Court affirmed that interest as damages were to be included in the award from a single cause of action.⁵⁷ Nevertheless, the court noted that the interest so awarded formed part of the compensation awarded and, therefore, was not taxable as income. This was an interesting outcome, for the ‘compensation’ was assessed at a value from a starting date (31 December 1982) and then increased by an “incremental factor” which was labelled at least in one place in the case as an “interest rate”.⁵⁸ The court based the decision on a strict interpretation of the statute giving rise to the “compensation” which employed the words (s. 5) “interests in the coal”, which meant, *exclusio alterius*, that it did not comprise an element for lost income. The characterisation of the supplemental factor in this case, although consistent with the interpretation the court put upon it, does not seem consistent in a wider sense with the attributes normally impressed upon interest components. The fact that the case was

effort. See Reilly, F. K. 1994, *Investment Analysis and Portfolio Management*, 4th edition, Dryden Press, pp. 240-3.

⁵³ *Apand Pty. Ltd. v Kettle Chip Co. Pty. Ltd.* [1999] FCA 483 (unreported), 23 April 1999, Federal Court of Australia.

⁵⁴ *Apand Pty. Ltd. v Kettle Chip Co. Pty. Ltd.* [1999] FCA 483 (23 April 1999) p. 8.

⁵⁵ [1999] FCA 483 at p. 17.

⁵⁶ (1995) 95 A.T.C. 4,483.

⁵⁷ (1995) 95 A.T.C. 4,483 at 4,485.

decided for purposes of income tax may have had an impact. The High Court of Australia, though, in *M.B.P. (S.A.) Pty. Ltd. v Gogic* (1991) in refusing an order for commercial rates of interest to apply to pre-trial economic losses, said that a plaintiff who is awarded interest at 4 per cent on those damages has not had to risk his or her capital and arguably does not have to pay income tax on that interest, noting that “most investors in fixed securities in Australia since 1982 would be well satisfied to have maintained the real value of their capital and to have received an arguably tax-free return of 4 per cent per annum on the current value of that capital.”⁵⁹ The interesting part of this judgment is that the High Court seemed to have ignored the arguments of counsel that some regard needed to be taken of the prevailing interest rates during the relevant period in that case. Counsel for the respondent, Gogic, had argued that “the use of the commercial rate of interest is more consonant with the objectives of an award of interest on damages for pre-trial non-economic loss”. The court returned that

[t]he question remains, however, whether it is not fairer to the parties to use a formula which applies the real rate of rates of interest applicable in the relevant period rather than a fixed figure such as the 4 per cent figure selected in *Wheeler v Page*. This could be done, for example, by taking the commercial rate or the ten-year bond rate and deducting a figure for inflation. This approach has the advantage of focusing on the real interest rate which would have been available to a plaintiff for the purpose of investment during the period that the plaintiff was kept out of his or her money. But it tends to assume – erroneously – that the purpose of the award of interest is to compensate a plaintiff for being deprived of the opportunity to invest his or her money. A plaintiff is awarded interest because he or she has been deprived of the use of his or her money, not because he or she has forgone investment opportunities.⁶⁰

This statement indicates that the courts’ view of opportunity cost, and the financial substantiation of opportunity cost is still far from being reconciled. The High Court, in

⁵⁸ (1995) 95 A.T.C. 4,483 at 4,489 per Beaumont J.

⁵⁹ *M.B.P. (S.A.) Pty. Ltd. v Gogic* [1990-1991] 171 C.L.R. 657 at 665.

⁶⁰ [1990-1991] 171 C.L.R. 657 at 666

Gogic acknowledged that the rate fixed in *Wheeler v Page*⁶¹ (1982), was somewhat arbitrary. The South Australian Supreme Court had set a rate of 4% on past non-economic loss for purposes of recovery in litigation, but noted that it seemed wrong for a court to base compensation interest rates on the *real* rate of interest,⁶² for in times of negative real interest rates, it would be wrong to refuse to award a plaintiff interest, and a plaintiff who receives interest as a real-life investor also must pay income tax on that interest, where the court's interest award is tax-free.⁶³ *M.B.P. v Gogic* was affirmed by the High Court again in *Andjelic v Marsland*,⁶⁴ (1996) where the court was called upon to determine whether the 'full' interest rate should apply to pre-trial non-economic losses. In bowing to statutory intervention, the court limited the rule in *Hungerfords* by affirming the judgment of Brennan and Deane JJ.⁶⁵ in that case. The Court took a narrow view of *Hungerfords* in that it maintained that there was a strict difference between an award for the loss of the use of money which was paid away as a result of the defendant's wrongful conduct, and "the power of a common law court to award a payment of interest to compensate for the delay in obtaining payment of what the court determines to be the appropriate measure of damages in tort or for breach of contract."⁶⁶ This distinction appears to have little meaningful difference, and highlights the difficulties in seeking to establish recognition of the concept of opportunity cost in the common law.

⁶¹ (1982) 31 S.A.S.R. 1. *Wheeler* was a tort case in South Australia which set an interest rate of 4% on past non-economic loss for purposes of recovery.

⁶² This is defined to mean an interest rate after incorporating an inflationary factor consistent with financial theory.

⁶³ [1990-1991] 171 C.L.R. 657 at 666.

⁶⁴ (1996) 70 A.L.J.R. 435.

⁶⁵ (1989) 171 C.L.R. 125 at 152.

⁶⁶ (1996) 70 A.L.J.R. 435 at 443.

In *Nominal Defendant v Gardikiotis*⁶⁷ (1996) the High Court refused to uphold an award for the additional cost to a plaintiff in managing the sum of her award in a personal injury payout. Invoking the once-for-all-time attitude of common law damages awards, their Honours asserted that the opportunity costs to the plaintiff of the additional sums paid to money-managers was beyond the role of the court. “To the inadequate extent that monetary compensation can compensate for the effects of personal injury, a court has done its duty when it makes its award of damages. What the plaintiff does with the verdict moneys is a matter entirely for the plaintiff.”⁶⁸ In this respect, the court was differentiating between the opportunity cost incurred as a result of damage inflicted by the defendant, and the opportunity cost inflicted simply because the plaintiff now has compensation in money form. The former, by implication, may be recoverable, and the latter, expressly, is prohibited.

In *SCI Operations v Commonwealth of Australia*⁶⁹ (1996), involving two companies, SCI and ACI, as plaintiffs⁷⁰, the majority of the Federal Court (Beaumont and Einfeld JJ., Sackville J. dissenting) ordered interest be paid upon the refund sum due to the taxpayers, despite the fact that evidence was led that the taxpayers had already passed on the amount of the burden of tax to purchasers. The implication was that no opportunity cost had been borne by the taxpayer plaintiffs. The court wished to illumine the fact that the taxpayer had suffered for seven years by waiting for the Comptroller-General of Customs to issue a Commercial Tariff Concession Order under s. 269C(1) of the *Customs Act* 1901 (Cth), an intolerable period. The court took the stance that “the court

⁶⁷ (1996) 70 A.L.J.R. 450.

⁶⁸ (1996) 70 A.L.J.R. 450 at 456; also see *Todorovic v Waller* (1981) 150 C.L.R. 402 at 412 covered in the section regarding the applicable rules.

⁶⁹ (1996) 139 A.L.R. 595.

⁷⁰ Two cases were heard together involving the same point in law against the same statutory authority giving rise to the amalgamation of the cases.

should not at all embrace a situation where the Crown, as the model litigant, should be seen to take advantage of its own default”.⁷¹ On appeal, the High Court of Australia reversed the decision, holding that the plaintiff SCI was not entitled to the claimed opportunity cost (as interest), but only held this position from a narrow statutory interpretation of the plaintiff’s specific right to claim back money paid to the customs department.⁷² The Commonwealth was therefore able to take an advantage from its own delay.

In contrast, the Federal Court refused to allow an insurance company to take advantage of its own delay in *Mowie Fisheries Pty. Ltd. v Switzerland Insurance Australia Ltd.*⁷³ (1996) where an insurance company delayed settlement of a claim on a lost fishing vessel on technical grounds. Compound interest rates were awarded on an insured sum of \$640,000.00. This was done, according to Tamberlin J., to “accurately reflect the applicant’s loss”.

‘Accuracy’ as a goal of the court, still eludes a legal theoretical grasp. Inconsistency in the reception of evidence with regard to the opportunity cost suffered by a plaintiff and, of course, a subsequent rebuttal by a defendant, still sits in an uneasy juxtaposition with a public policy of efficient use of the court’s time and resources. In *Beach Petroleum NL and Claremont Petroleum NL v. Malcom Keith Johnson and Others*⁷⁴ (1993) the Federal Court drew upon *Cullen v Trappell*⁷⁵ (1980) and *Todorvic v Waller*⁷⁶ (1981) to support the stance that it is not the actual opportunity cost, i.e., the likely use that *this* plaintiff

⁷¹ (1996) 139 A.L.R. 595 at 621.

⁷² [1998] HCA 20 (unreported) (26 March 1998).

⁷³ [1996] 140 A.L.R. 57.

⁷⁴ (1993) 11 ACS.R. 103.

⁷⁵ [1980 -1981] 146 C.L.R. 1.

⁷⁶ [1981] 150 C.L.R. 402.

would have made of sums at issue, but there is a presumption that market rates of interest should be used in calculating interest on a damages award. This was to be the preferred procedure unless “it is clearly established by evidence that a particular plaintiff would not invest available capital and cash reserves in a way that would produce at least the market rates”.⁷⁷ The evidence in the *Beach* case showed that Beach would “almost certainly have invested its shareholders’ funds in oil and gas exploration interests or producing properties rather than leaving millions of dollars on cash deposit over a three year period.” From a strictly theoretical standpoint, to scrutinize evidentially the opportunity cost of a particular plaintiff seems more consistent with a minimisation of tension between the legal perspective in the assessment of opportunity cost, and the economic perspective. As the courts have maintained a somewhat global viewpoint, consistent with the governance of *stare decisis*, this tension is unlikely to be resolved in the foreseeable future. It also indicates a concern with a public policy of efficiency in the courts and the lingering fear of the time that trials may take when examining this issue, as examined in Chapter Eight. Another view is that the courts discourage claims by plaintiffs or defendants regarding specific activity by their respective adversary which would lengthen trials in needless scrutiny of tedious details unless a plaintiff or defendant can clearly anticipate that the evidence introduced regarding the plaintiff’s opportunity cost (or the defendant’s rebuttal) is enough to convince the court to deny (or award) it. This would encourage consent orders between the parties and help to shorten litigation costs. This is consistent with the judicial attitudes towards the use of courts’ time in keeping with the policy of efficiency examined in Chapter Eight.

⁷⁷ [1993] at § 657.

This does not mean that courts are insensitive to the opportunity costs of a particular plaintiff. In *Fuller v Meehan*⁷⁸ (1999) the Queensland Court of Appeal (de Jersey CJ, Pincus and Thomas JJA) scrutinized the financial circumstances of the appellant very carefully to ascertain the tax implications on a sum included in a prior property settlement between former de facto partners. Concluding that the appellant would receive a tax penalty, as he had clearly withheld cash income from his income tax returns to the Federal Commissioner for Taxation and, subsequent to the original action, had been served with a notice of amended returns by the Commissioner. In the court's opinion it would be unjust to award compound interest against the appellant for a part of the period from the rise of the cause of action until judgment without adjusting the opportunity costs awarded to the respondent in the previous settlement to take account of the appellant's income tax burden.

These cases reflect judicial attempts to incorporate notions of recoverable opportunity cost on a case by case basis. Within Chapter Eight, which examined the public policy of efficiency, it was noted that the common law develops on an incremental basis, case by case, attempting to do justice between the litigants in each particular conflict. The somewhat disjointed statements and assertions of the courts in the time from *Hungerfords* to the present reflect what would be expected where a loss is to be proven by evidence. It seems fundamentally contradictory to defend the point that opportunity costs should be governed by a rule of evidence, and then to point out inconsistencies in awards where crucial elements were decided upon matters of evidence. Courts do not speculate upon matters needlessly, but hand down judgments based on the facts in each case which have satisfied the evidential burden. The courts do not normally attempt to

⁷⁸ [1999] QCA 37.

speculate upon unproven matters. The court tacitly accepted this point in *Seguna and Seguna v Road and Traffic Authority of New South Wales*⁷⁹ (1995) where the opportunity cost the plaintiffs claimed as part of the degradation of land value from the defendant's works, failed to be recoverable on the ground that the plaintiffs had failed to prove that they intended to take the course of action which would have increased their investment returns, the opportunity costs of which plaintiffs had sought to claim. The court considered the claim in this case required the court to presume not only what the return would have been, but also what the investments might have been.⁸⁰ This failed to discharge the burden placed upon the plaintiffs to convince the court that the opportunity cost was sufficiently real to be awarded.

The same cannot be said for the plaintiffs in *LED Builders Pty. Ltd. v Eagle Homes Pty. Ltd.*⁸¹ (1999) where the court examined in minute detail the lost opportunity costs (lost profits in this case) which were generated from the defendant's wrongful use of the plaintiff's copyrighted building plans. The defendant had built and sold 89 infringing homes based on the plaintiffs registered copyright between 1991 and 1996. The court concluded that the evidential hurdle had been surmounted by the plaintiff and awarded damages with compound interest. Lindgren J. relied extensively throughout the judgment on *Dart v Décor* and *Kettle Chip Co. Pty. Ltd. v Apand Pty. Ltd.*,⁸² both of which are examined above, to determine the amount which the defendant was required to disgorge in an account of profits. The court recognized that a defendant:

⁷⁹ [1995] NSWLEC 147 (12 September 1995) (unreported) New South Wales Land and Environment Court.

⁸⁰ [1995] NSWLEC 147 at p. 8.

⁸¹ [1999] FCA 584 (7 May 1999) (unreported) Federal Court of Australia.

⁸² Between the time when the last hearing in *LED Builders* was concluded and the judgment handed down, the appeal the *Kettle Chip v Apand* was handed down, but Lindgren J. noted that there were no matters of law which influenced him to change anything in the principal judgment. The appeal case, however, was used for analytical purposes in the text above.

may not deduct the opportunity cost, that is, the profit foregone on the alternative products. But there would be real inequity if a defendant were denied a deduction for the opportunity cost as well as being denied a deduction for the cost of the overheads which sustained the capacity that would have been utilized by an alternative product and that was in fact utilized by the infringing product. If both were denied, the defendant would be in a worse position than if it had made no use of the patented invention. The purpose of an account of profits is not to punish the defendant but to prevent its unjust enrichment. Where the defendant has foregone the opportunity to manufacture and sell alternative products it will ordinarily be appropriate to attribute to the infringing product a proportion of those general overheads which would have sustained the opportunity. On the other hand, if no opportunity was foregone, and the overheads involved were costs which would have been incurred in any event, then it would not be appropriate to attribute the overheads to the infringing product.⁸³

This approach indicates that increasingly economically sophisticated arguments are originating from members of the bench, especially in commercial litigation. Quoting *Dart v. Décor*, the court in *LED Homes v Eagle Homes* attempted to incorporate into the decision matrix a consideration of the opportunity cost of the defendant's overhead fixed costs and relevant accounting methods (absorption and marginal/incremental). Lindgren J allowed a deduction to the defendants in accounting for profits for general overheads in running the business on an absorption cost basis.⁸⁴ In addition, the court accepted the assumption of the Canadian Federal Court of Appeal where "in normal circumstances an award of only simple interest requires some explanation".⁸⁵ This comment and curial method is far removed from the cases examined in earlier chapters which refused to accept evidence of opportunity costs, reflected an entrenched refusal to accept changes in commercial practice, and refused to award interest on sums due, let alone compound interest. What a long and tortuous path the common law has taken to recognise what was

⁸³ [1999] FCA 584 at p. 41.

⁸⁴ [1999] FCA 584 at p. 44. Absorption costing in accounting terms is where fixed and overhead costs are allocated to saleable inventory using criteria of assignment such as percent of sales. Under this method, all overhead is "absorbed" into the inventory. The cases indicate that the courts prefer this method of accounting for overheads in determining profits for intellectual property violations as examined above in *Dart v Décor*, *Apand v Kettle Chip Co.* and *LED Builders v Eagle Homes*.

essentially happening in the surrounding society the entire time! Perhaps the question might be asked, “At what price was the centuries-old refusal to recognise commercial reality maintained?”

Summary

The ruling by the High Court in *Hungerfords* has resolved to a great degree the conflict generated by the classification dilemma. The common law judgments, in recognizing opportunity cost more consistent with financial theory, have neither produced the catastrophic results, nor been faced with insurmountable difficulties prophesied by curial officers of the bench in times past. On the contrary, the ability of the common law to be flexible enough to incorporate novel facts into a consistent and just paradigm has been vindicated. This starkly contrasts with the slippery slope fallacies anticipated. The intrinsic characteristic of the common law’s case-by-case incremental evolution, though, may still hinder a systematic development in this area. Some aspects of apparent oscillation are to be expected with an issue which is determined on evidence.

The recovery of opportunity cost has not been completely relegated to a rule of evidence in any event, being still governed within the legal framework assigned by the courts to govern all recovery of damages. The issue of remoteness, therefore, will remain a formidable obstacle to any plaintiff seeking recovery of opportunity costs. In addition, the issue of causation still remains clouded in some respects. Whether the courts will continue to refine the rule in *Hungerfords*, or whether they may narrow its application in future cases breeds uncertainty. The historic relic of hatred for usury, the entrenched

⁸⁵ *Beloit Canada Ltd. v Valmet Oy* (1995) 61 C.P.R. (3d) 271 at 287-288, cited in *LED Homes Pty. Ltd. v Eagle Homes Pty. Ltd.* [1999] FCA 584 at p. 56.

reluctance of the common law to embrace changes from surrounding commercial environment and economic theory, and the manifest injustice which has been perpetrated upon plaintiffs by unscrupulous defendants have all been modified to incorporate consideration of the opportunity cost of the use of money. The courts are now willing, and in some respects anxious, to receive evidence of a tangible nature where a plaintiff can overcome the prohibition on opportunity cost recovery from the late payment of a debt or damages by a defendant. There is still a difference in the way the courts assess damages in relation to losses in tort, as opposed to losses in contract. A plaintiff's tort action which alleges and proves a defendant's deceit may also be viewed with a higher level of acrimony by judges⁸⁶ who may be more willing to award remotely intangible opportunity costs. The changing view of the limits of the concept of restitution in damages may also continue to add some uncertainty.

⁸⁶ *Sellars v Adelaide Petroleum N.L.* (1994) 179 C.L.R. 332; also see the passage by Seddon and Ellinghaus 1997 pp. 776-8.

CHAPTER TEN — CONCLUSION

Opportunity cost is a real cost determined by the next most profitable alternative available for an investment. It is always time-oriented. Indeed, the time value of money is at the heart of economic and financial theory. Opportunity cost can be portrayed as the difference between what ‘would-have-been’ and ‘what is/was’ in the plaintiff’s financial position. Despite the fundamental need in economics/finance to incorporate consideration of the time value of money, prior to 1989 opportunity cost had no credible recognition in the common law courts, other than simple statutory interest. Thus, plaintiffs were prevented from recovering the opportunity cost of funds withheld from them by defaulting defendants. In 1989, the topography of damage recovery was substantially altered. Opportunity cost may now be recoverable in the common law courts under an action for the loss of the use of a sum of money. On this view, money has value in use and the wrongful unrecompensed withholding of a sum of money inflicts a real loss to plaintiffs who could otherwise use the funds for profitable investment or trading purposes. The courts now recognise the economic measure of opportunity cost as a real cost to plaintiffs. The foundational change which took place through *Hungerfords v Walker* has dramatically delimited consequential damage recovery involving capital sums withheld from payment. Opportunity cost does not only encompass capital placements, though, for lost profits in intellectual property disputes have proved to be leading cases in the acknowledgment of economic theory in the courts. Opportunity costs in common law, subsequently, are enjoying greater prominence in a wide variety of cases where the evidential burden can be met.

Although in 1989 the High Court of Australia recognised the common law action for the loss of the use of money, there are still daunting barriers to universal recovery of

opportunity costs which linger within the common law recovery paradigm. Common law still maintains its ancient heritage. In the methodology of the modern court system which originated in the ecclesiastical influence of both the doctrine and personnel of the church, the most salient feature of the common law refusal to award opportunity costs originated in the church's hatred of usury.

Usury, connoting the *use* of an asset or sum of money, was an invidious practice in the eyes of the church. The church assumed the same philosophical position as the ancient writers, especially Aristotle, who tolerated traders as performing an unpleasant but necessary social practice. In contrast, usurers, those who lent money in return for an interest component in addition to the capital sum, were considered the lowest form of thief, preying upon desperate and starving families who would risk the entire family estate to last through a drought or harsh winter. Naturally the church stood against this practice when the agrarian feudal nature of society precluded loans for production or manufacturing purposes.

The church's trenchant criticism of the practice of usury grew concomitant with its ascendance to the pinnacle of political and social influence in the 13th century. This rise to dominant power was only possible because the church had monopolized the instruments of learning and literacy. By controlling the flow of literate servants able to contribute to the governmental tasks of oversight, the church controlled the societies in which it operated. Governmental officers were clerics, and the church's law comprised the single most influential factor in the formation and execution of the laws of the political entities in Europe and England during this time.

Thus, the King's law was the church's law. The early judges in England were clergymen trained in ecclesiastical law and the church's doctrines. The church dominated commercial practice and enforced contracts in the secular as well as the sacred realm, legitimizing its oversight of commercial practice through the social belief that contracts were covenants of faith between people. The church regarded commerce as an unruly horse, which needed continual breaking. The *sacerdotal* powers were well aware that merchantmen, traders, and Jewish financiers continually sought ways to circumvent the church's prohibition on the practice of usury. This persistent tension gave credibility to the church's view that usury was a hateful practice, perpetuated by evil men who cared only for profits at the expense of their souls, and who sought to infect society with the idea that usury was not a mortal sin. As the church confronted other heresies throughout society during the Medieval Inquisition, usury was included into those prohibited practices which led to capital punishment. Both the Medieval Inquisition and the Investiture Struggle, beginning in the 11th century, motivated social interest in the growth of universities and raised the social legitimacy of legal argument. The church, at first, was the master of this technique, and triumphed victorious in the struggle for nearly universal supremacy in Europe and England during the period.

The time during which the church enjoyed the very apex of social power and influence was the coincidental formation period of the English common law. The very life blood of the common law flowed from the King's justices on assize who gradually molded the various customary oral traditions of the Germanic English clans, shires, and boroughs into law 'common to all England'. These same justices, as well as the later Chancellor, were clerics who carried into the courts the hatred of usury in all its various forms. When the tumultuous social transition of the English monarchy to the Angevine lineage after the anarchical reign of Stephen ended in 1154, and in 1215 the Magna Carta specified

that courts should be held in one place, the settling of the courts at Westminster in the subsequent period birthed the precursor to the modern model of the common law. This model, built upon the integral use of clergy during the church's overwhelming social influence, was thoroughly infected with church doctrine, and by default, the hatred of usury. The extant case reports and plea roles from early times manifestly indicate the hatred that the members of the bench exhibited toward usurers who sought recovery of any sum in excess of the capital sum lent.

Repression by the church of commercial practices did not easily acquiesce to the burgeoning commercial practices collateral with the Renaissance period. The shift to a capitalist society, essentially complete by the end of the 16th century, bred social forces unswervingly against the church's prohibition of usurious practices. Yet, the church had an almost unassailable ally in the common law. The common law doctrines developed in the early formation period provided a strong defense against the critics who sought to have courts overturn the prohibition in the common law, despite the intervention of the Henrician statutes in the 1540's which redefined usury and limited its legal practice to an interest rate of ten percent. The doctrine of *stare decisis* proved fundamental in this curial resistance by enabling members of the bench to reach back to previous case judgments and extract rules which lent social legitimacy to the judicial rejection of usury. Opportunity cost recovery, as it is intimately connected with the practice the courts called usury, did not escape judicial acrimony.

The time value of any sum dictates one aspect of the opportunity costs of a capital placement, determined by reference to the alternative choices in the financial environment. Since usury was defined in terms which, in modern terminology, comprise an opportunity cost, the courts' refusal to award opportunity costs in any litigation which

was tainted with usurious overtones is understandable. In contrast to the refusal to award opportunity costs on sums of money, the common law recognised opportunity costs associated with fixed assets such as land. The widespread view that money was a fungible good, the existence of which was extinguished with its use, constituted an intellectual barrier which created a blindness in the common law. Suits involving land enjoyed curial privilege in that the opportunity costs, in the form of *mesne profits*, were awarded when proved. Money enjoyed no such privilege. This constituted a classification dilemma in law, where judges did not recognise that money could purchase land, rendering the philosophical justification for the distinctive treatments between the two assets logically indefensible. This double standard, entrenched through the decision in *Page v Newman*¹ in 1829, rigidified the classification dilemma which lasted until trampled by the High Court of Australia in 1989, in *Hungerfords v Walker*.² The longevity of this dilemma is all the more amazing in light of the momentous advancement in economic theory and practice which took place during the same period when the classification dilemma was enforced.

The relentless assault of economic doctrine against the prohibition on recovery of opportunity cost began with the pragmatic demands of commercial practices, especially the extension of credit, collateral with the 19th century Industrial Revolution. Although evidence of a rising social awareness of the time value of money and rejection of the court's position came as early as the late 18th century, in the cases before Lord Mansfield, momentum was stifled by the decision in *Page v Newman* and the subsequent statutory compromise erected through the *Civil Procedures Act* 1833 (U.K.) which awarded simple interest in restricted circumstances and served to obfuscate the underlying tension

¹ 9 B & C 377; (1829) 109 E.R. 140.

between the commercial and the curial worldviews. The rapidly evolving social economic practices were not long placated by this compromise. Cases in the 20th century show that courts were increasingly uneasy about the enforcement of such an ancient restriction in the light of widely accepted modern practices. Uneasy forced cohabitation between the commercial and the curial positions broke into open conflict as a series of celebrated cases after World War I indicate. Judges found novel ways to award sums which were, in effect, recognizant of the injustice inflicted upon plaintiffs who suffered pecuniary losses from culpable acts of defendants who sought to escape from the liabilities created by their behaviour. As the cases were handed down one by one in the period after 1976, a distinct trend can be discerned which indicates that the High Court was aware that the law in the area of consequential damages recovery was in philosophical disarray.

In 1976, in *Caltex Oil v the Dredge "Willemstad"*³ the doctrine against recovery of pure economic loss without physical damage to property or person was overturned. In 1981, in *Pennant Hills Restaurant v Barrell Insurances*⁴ the High Court tacitly recognised inflation as a real economic phenomenon by setting discount rates at a low level, reflecting the underlying economic reality of the effects of inflation on damages awards with future loss components. In 1986 appeals to the English Privy Council and House of Lords were effectively abolished. Finally, in 1989, in *Hungerfords v Walker*,⁵ the High Court removed the proscription of curial recognition of opportunity cost as a real loss when it recognised a common law action for the loss of the use of money.

² (1989) 171 C.L.R. 125.

³ *Caltex Oil (Australia) Pty. Ltd. v. The Dredge "Willemstad"; Caltex Oil (Australia) Pty. Ltd. v. Decca Survey Australia Ltd.; Australian Oil Refining Pty. Ltd. v. The Dredge "Willemstad"* (1976) 136 C.L.R. 529.

⁴ *Pennant Hills Restaurants Pty. Ltd. v Barrell Insurances Pty. Ltd.* (1981) 145 C.L.R. 625.

⁵ (1989) 171 C.L.R. 125

Thus, the common law and economics/finance have been at least partially reconciled. Judicial acceptance of economic theory has increased during the period since 1989, with distinct curial recognition and use of economic theory in a variety of commercial and personal cases where an opportunity cost was considered. These include: intellectual property disputes where opportunity cost was considered as lost profits on products manufactured in contravention of the plaintiffs' patents;⁶ a family law property settlement dispute where opportunity cost was considered as a price paid for holding cash unreported on tax returns;⁷ a commercial contract dispute where only the opportunity cost of the difference in benefits negotiable by contract was awarded and the capital sum was precluded from the award.⁸

To illustrate the fundamental change in the legal environment regarding damages awards which has taken place in the last two decades, only a short twenty years ago no additional sum, apart from statutory simple interest, could be awarded for a money withheld by a defendant. The courts also refused to recognise the economic principle of inflation. At present, inflation is recognised, the courts are willing to entertain evidence regarding opportunity losses, and plaintiffs who suffer the consequential opportunity losses can prove and recover in litigation.

The reconciliation of the classification dilemma and recognition of opportunity costs does not mean that plaintiffs will find that damages awards will necessarily increase. The

⁶ *Dart v Décor* (1993) 179 C.L.R. 101; *Perre v Apand* [1999] HCA 36 (unreported), High Court of Australia, Gleeson CJ, Gaudron, McHugh, Gummow, Kirby, Hayne And Callinan JJ.

⁷ *Fuller v Meehan* [1999] QCA 37, (unreported) Queensland Court of Appeal, de Jersey CJ, Pincus and Thomas JJ.

⁸ *Sellars v Adelaide Petroleum NL* (1994) 179 C.L.R. 332; (1994) A.T.P.R. 41-301 F.C. 94/010.

difficulties facing plaintiffs seeking opportunity cost recovery are still daunting. Issues of evidence, causation, and remoteness of damage still operate within the court system as limitations on a plaintiff's ability to recover. Although the common law has recognised the economic principle that a sum of money has a time value and, therefore, an opportunity cost, this does not translate into a corollary that the courts' decisions mirror economic theory, or that the policies applied in courts are consistent with current economic thought. The two worldviews, that of commerce and the common law, are still methodologically disparate. The lack of a prevalent cohesive interface defines the lack of theoretical agreement between the two disciplines.

The common law will always deal with issues which are inherently non-economic in nature and require consideration of legal privileges and obligations which have no assigned value in currency terms. The common law must, therefore, focus on the rights and obligations of parties *directly*, prior to any consideration of the *value* of the rights or obligations which have been breached by defendants. The idea that a monetary value can be assigned to the injury or net loss in a conflict between litigious parties is logically secondary to the primary considerations of rights, duties, causation, and remoteness of damage. Some facets of courts' reflections cannot be valued at all, including the concept of 'justice', the obligation to adjudicate between parties 'for the common good', and declaratory rights, all of which, *prima facie*, have no monetary consideration included within them. In contrast, commerce values everything in monetary terms, reducing all of virtue to currency values. As this commercial approach must undertake a conversion process for every valuation, all of life is subsequently valued *indirectly*. The conclusion that the value system of economics and finance is, therefore, a *derivative* normative framework is difficult to deny. The advocates of economic rationalism are currently attempting to move the courts toward a corporate model which would ultimately directly

impress the derivative monetary value mechanism indelibly upon court processes. This has not been met with an enthusiastic embrace from the judiciary.

The idea of an independent judiciary has been a central pillar within the defense of the concept of natural justice within the court system and for the curial premise of legitimacy based on the rule of law.⁹ The recent advocacy and introduction of performance targets, national benchmarks for comparative data in case disposition, and the introduction of performance indicators linked to the change in judicial salaries indicates that courts are under pressure to conform to a corporate commercial model¹⁰ which, in effect, is a total capitulation to the bitter enemy of commercial practice which the court abhorred for seven centuries. Administering justice, in the court's eyes, is inherently non-economic. The resistance of judges to the imposition of these economically-oriented measurement criteria in the courts is only a sign of the deeper conflicts which have not been reconciled. Further, they are not likely to be reconciled in the near future without widespread statutory intervention. According to Spigelman CJ, “[n]ot everything that counts can be counted”.¹¹ The normative conflict between the common law and economics still exists, despite the acquiescence of the courts in recognition of the economic principle of opportunity cost.

The societal trend toward an economically rational worldview is not limited to the conflict between courts and commercial practice which assumes the time value of a capital sum. During previous periods courts have been able to legitimize the rigid

⁹ *Waterside Workers Federation of Australia v J. W. Alexander Ltd.* (1918) 25 C.L.R. 434

¹⁰ Spigelman, J.J. 2001, "Quality in an Age of Measurement: The Limitations of Performance Indicators", The Sydney Leadership Alumni Lecture, http://www.lawlink.nsw.gov.au/sc/sc.nsf/pages/CJ_281101 , 28 November 2001.

enforcement of usury statutes and enjoy the liberty to denounce odious aspects of commercial practice through appeal to public policy, resting in the knowledge that the Christian worldview still proliferated in English society. The bishops of the Church of England still had the ability to exert substantial political pressure upon the politicians who strayed too far from the church's idea of social morality. This situation does not exist in the present pluralistic society. The courts are not as prolifically dominant in the role of *custos moram* as they were in the 19th century. It is highly questionable whether they have the accepted social authority which enables them to rigidly stand against a prevalent social paradigm shift which seeks to interpret all of social value through a commercial model. In addition, parliamentarians have a far wider ability to legislate to enforce changes in the courts than existed in past centuries. This is constitutionally balanced by the powers of the High Court of Australia to invalidate legislation which seeks to fetter the decisions of the courts in contravention of the courts' idea of judicial independence, especially on public policy grounds.

Where the unruly horse of commercial demands in litigation places such pressures upon courts, through increasing assertion of 'accepted economic theory', that judges perceive that the decision pendulum has overstepped prudent limits in any direction, the proscription of further growth of curial compliance with economic principles can always be initiated by reversion to argument on grounds of public policy. The articulate means by which judges distinguish prior cases, limit them to their facts, consider cases without applying the rules contained in them, and generate argument in the reasons for judgment that the alternative choices open to the bench are to be forsaken for the 'common good'

¹¹ Spigelman, J.J. 2001, "The Dangers of Partial Rationality", Address at the launch of the University of New South Wales Law Journal, http://www.lawlink.nsw.gov.au/sc/sc.nsf/pages/spigelman_280801 , 28 August 2001.

gives members of the judicial hierarchy the unique capacity to bridle the aspirations of litigants who claim increasingly intangible opportunity costs.

The ability of judges to revert to public policy arguments may invoke criticism that judges appeal to extra-legal and intuitive criteria to settle judgments in hard cases. The criticism offered against judicial use of the 'common good' curiously parallels the denigration offered against the test of 'common sense' which is presently used to determine the issue of causation in tort cases. In addition, other legal rules still limit the amount of recoverable damages through the doctrines of remoteness and mitigation. The case-by-case method of judicial legislation dictates that changes in the common law doctrines are tediously slow and limited to the pronouncements necessary to dispose of a specific case being heard. Courts still constrain the liberty of judges to pronounce on matters which are impertinent to an instant case through the doctrine of *obiter dicta*. This doctrine renders those pronouncements virtually useless for purposes of precedent which do not form part of the case *ratio*. This preserves the future discretion of judges to decide cases according to the perceived justice in novel situations.

The realization that judges make law according to a preconceived social ethic should come as no surprise, for an honest evaluation of the history of the common law reveals that judges have exercised this type of discretion since the early King's justices travelled on assize. Indeed, statements examined in this dissertation imply that the great majority of the legal content and the whole of equity have been judge-made. If this premise is accepted, any modern censure may not be able to uproot seven centuries of tradition and legal development, despite potential condemnation of the practice of judge-made law and calls for the practice of judicial discretion to cease. The continuing paradox is that the strength and resilience of the common law is where the discretion of judges is both

exercised and circumscribed at the same time. The flexibility of the bench in dealing with borderline cases motivates the law to change concurrent with major social environmental adjustments, but the rigidity of strict application of *stare decisis* coupled with the right of appeal chains the law to past accepted decisions which are theoretically based in sound legal principle. This portrayal of discretion and precedent immediately invokes questions regarding the personal worldview which judges assume when deciding cases.

In prior times, when Christianity comprised nearly the whole of the common law, conflicts arising from competing epistemological perspectives did not arise. Modern society is far more philosophically pluralistic and this will undoubtedly lead to greater conflicts both in society and in the courts when competing worldviews, which may have completely antithetical notions regarding personal rights, freedoms, and social responsibilities, are party to litigation where the courts are forced to fundamentally examine the basis of the ethics used in case disposition. Economic rationalism, Christianity, Islamic fundamentalism, postmodernism, secular humanism are only a brief sample of the variety of the competing social worldviews which have adherents in Australian and western society. As Christianity is no longer the overwhelmingly prevalent social ethic, the future may bring open confrontation between competing social worldviews which have previously lay hidden. The momentous changes in damages awards, the subject of this thesis, is only an example of the changes which have altered the social atmosphere which surrounds the courts deciding the ability of plaintiffs to recover for consequential losses. The trend since 1976 has been for courts to accept economic principles into the curial decision paradigm, and this comprises only a part of the wider shift toward economic management of government in a corporate model. The reformation of courts, as an arm of government, based on a corporate service model potentially threatens the traditional view of courts as social arbiters of justice. The social

pressure to perform this fundamental shift, however, is not universally prevalent in common law jurisdictions and an increasing divergence can be seen between them, especially between the English House of Lords and the Australian High Court.

The English House of Lords has not readily followed the example of the Australian High Court in recognizing a common law right of action for the loss of the use of money. In addition, the House of Lords has also narrowly interpreted the evidence which has been presented regarding inflation and plaintiffs' future losses. In *Wells v Wells*¹² the court scrutinized the interest rate and discount rate attributable to future losses by injured victims of horrific tortuous accidents and seized upon the introduction of Index-Linked Government Securities¹³ (I.L.G.S.) to derive a discount rate which should be used in assessing future losses. Approving the dissenting judgment of Stephen J. in *Todorovic v Waller*¹⁴, the court wrestled with the discount rates to be applied. Throughout the judgment none of the Law Lords gave thought to inflation as an opportunity cost in its purest sense. Inflation is time-oriented, erodes the real buying power of the nominal sum of money, and accurate assessment of inflation clearly illumines an ordinal reference of the original buying power of a sum in contrast with the subsequent diminution of the buying power in later periods. The court clearly assumed a more conservative and traditional approach to the issue of inflation and economic theory, ignoring the opportunity to pronounce approval of the position and direction of the High Court of Australia in accepting economic principles in common law actions. The High Court's

¹² [1999] 1 A.C. 345

¹³ These securities are issued by the British Government, and the interest associated with them is linked to the published consumer price index levels, thus creating a government-backed security which is secured from inflation and considered the closest instrument to a risk-free capital preservation security. They enjoy tax advantages if kept for a certain period and upon maturity, they never default.

¹⁴ (1981) 150 C.L.R. 402

recognition of opportunity cost has generated some interesting twists of characterization regarding the damages awards.

It is interesting to portray the courts as having generated an artificial security over the time a plaintiff must wait for payment subject to the court's decision. In effect, the court generates a derivative based on the difference between 'what would have been', which is the plaintiff's position if the injury or loss had not occurred, and 'what actually is', comprising the plaintiff's position subsequent to the injury or loss. The security is derived through a damages award and particularly through an opportunity cost award. This is the same basic approach employed in futures markets where a derivative contract is bought or sold, the price of which is based upon the sale price of an underlying asset or commodity. The court-generated security is rewarded much the same as an index future generated between private parties, i.e. settled in cash as the difference between the plaintiff's two positions above. The role of the players in the curial derivative security is reversed from the market derivative. In a market security, the parties to the contract generate the security and it is regulated by the State. In contrast, the opportunity cost security is generated by the State (the court) and is regulated by the evidence presented in each case (the parties to the contract, i.e. litigation). The risk involved in the market security is market risk, but the risk involved in the court-generated security is litigation risk. The market derivative security is generated chronologically prior to any movement in the price of the underlying asset or commodity, and the value of the derivative is the difference between the strike price of the security and the market price of the underlying asset on or before expiry of the derivative contract when the derivative suffers disposition. In contrast, the court's derivative is issued chronologically subsequent to the movement in the underlying asset (the plaintiff's position) and is *only* generated when the plaintiff's position has deteriorated. The expiry date is analogous to the date judgment is

handed down. A plaintiff never suffers a margin call when the position is shown to have moved against the plaintiff, unless the burden of costs of the defendant in a losing case can be characterized as a margin call against the plaintiff. This caricature of opportunity cost awards in litigation is an interesting analytical anomaly which may provide further research opportunities in the future.

The future directions of courts regarding economic theory is more uncertain. Although the classification dilemma appears to have been reconciled, the common law framework derived from the ancient forms of action still maintains barriers to opportunity cost recovery through both the rules of evidence and rules of law. Plaintiffs must still overcome the onus of proof in both its evidentiary sense and according to the overall proof of the cause of action and losses. The doctrine of remoteness of damages also still limits the recovery of the whole loss a plaintiff incurs in instances where foreseeability in tort, or the second limb of the rule in *Hadley v Baxendale* in contract, is not satisfactorily discharged in the court's eyes. This still conflicts theoretically with the principle of *restitutio in integrum*. In addition, as the courts seek to refine parameters of recoverable opportunity costs, there is no guarantee that the types of recoverable consequential opportunity losses will increase. Other uncertainties, such as how the courts will seek out and specify the parameters of 'common sense' in dealing with causation issues still exist, with no clear prognostic answers. The tediously slow, case-by-case method of development in common law will not answer quickly questions regarding these legal principles, and the outcomes of cases which involve arguments over the limits which the courts should set upon recoverable opportunity costs will still be subject to arguments by inventive counsel seeking to both limit and enlarge the class of recoverable damages falling into this genre. This has been the same process which the courts of common law

have endured since surrogate legal practitioners were allowed to partake in the early counting.

Although the changes affecting the area of opportunity cost recovery have been far reaching, the resolution mechanism of the courts is still preserved intact. This is the same model which was outlined in the canons of the Fourth Lateran Council in 1215, which set out the ecclesiastical mandate for jurisdiction, third party adjudication, venues of courts set by distance, and the forsaking of irrational forms of proof. This model has survived through seven centuries of social pressure and conflict. It is uncertain how it will change in the future, for circumstances exist for which there is no prior example or precedent.

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