IT'S TIME EXEMPLARY DAMAGES WERE PART OF THE JUDICIAL ARMORY IN CONTRACT

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This article challenges the traditional approach that exemplary damages [1] are unavailable for breach of contract. Given the exceptional nature and infrequent use of the remedy, the principles relating to exemplary damages are often misunderstood. A survey of key arguments in support of the traditional approach reveals that such arguments are, in fact, weak and unpersuasive. This article briefly examines other jurisdictions' positions on awarding exemplary damages in contract, placing particular emphasis on Supreme Court of Canada jurisprudence, which has employed exemplary damages in this context. Ultimately, this article recommends that exemplary damages be available for, at least, intentional and deliberate breaches of contract in Australia.[2]

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[1] Exemplary damages are sometimes referred to as punitive, penal, retributive and vindictive damages. However, the term 'exemplary damages' has found judicial favour in Australia: see *Uren v John Fairfax & Sons Ltd* (1966) 117 CLR 118; *Lamb v Cotogno* (1987) 164 CLR 1; *XL Petroleum (NSW) Pty Ltd v Caltex Oil (Aust) Pty Ltd* (1985) 155 CLR 448; *Trend Management Ltd v Borg* (1996) 40 NSWLR 500; *Blackwell v AAA* [1997] 1 VR 182; *Gray v Motor Accident Commission* (1998) 196 CLR 1; *Gardiner v Ray* [1999] WASC 140; *Digital Pulse Pty Ltd v Harris* (2002) 166 FLR 421; *Chen v Karandonis* [2002] NSWCA 412; *Harris v Digital Pulse Pty Ltd* (2003) 56 NSWLR 298; *Amalgamated Television Services Pty Ltd v Marsden (No 2)* (2004) 57 NSWLR 338; *Fatimi Pty Ltd v Bryant* (2004) 59 NSWLR 678; *Knight v State of New South Wales* [2004] NSWCA 791. Accordingly, for the purposes of consistency in this article, reference will solely be made to 'exemplary damages'. However, it is acknowledged that there is some support for preferring the use of punitive damages to exemplary damages. Those commentators who prefer punitive damages to exemplary damages base their preference on the purpose of those kinds of damages being to punish the defendant as opposed to making an example out of the defendant: see N McBride, 'A Case for Awarding Punitive Damages in Response to Deliberate Breaches of Contract' (1995) 214 *Anglo-American Law Review* 369; Feldthusen, 'Recent Developments in the Canadian Law of Punitive Damages' (1990) 16 *Canadian Business LJ* 241 at 250-251; Ontario Law Reform Commission, *Report on Exemplary Damages* (1991) at 31-39; and Tilbury Factors Inflating Damages Awards in Finn(ed), *Essays on Damages* (Lawbook Company, Sydney, 1992) 101-102. The writer respectfully disagrees with that approach and advocates that there are three aims of exemplary damages- punishment, deterrence and vindication- not simply one aim.

[2] The scope of this article does not extend to the computation of exemplary damages.

I INTRODUCTION: A BRIEF HISTORY OF EXEMPLARY DAMAGES

To contextualise the present discussion, a brief overview of the legal history of exemplary damages in Australia is appropriate. Australia derives its use of exemplary damages from England.[3] Until 1964 in England, although exemplary damages were never available in contract, in tort, there were no particular limitations on their award.[4] At the time of introduction of such damages, the English courts were unclear about their purpose. Some judges and commentators began to explain large jury verdicts as awards of exemplary damages.[5] Another explanation was that the awards serve the purpose of punishing the defendant for his or her misconduct.[6]

In 1964, the landscape of exemplary damages in England changed following the decision of the House of Lords in *Rookes v Barnard*[7]. Lord Devlin, who delivered the leading speech in that case, showed that he was not in favour of the use of exemplary damages. As such, Lord Devlin restricted the use of exemplary damages by, *first*, distinguishing between exemplary and aggravated damages. His Lordship enunciated that aggravated damages compensate the claimant for the mental distress caused by the defendant's wrongdoing, whereas exemplary damages are punitive and intended to punish the defendant. *Secondly*, Lord Devlin restricted the availability of exemplary damages to three categories of torts:[8]

1. oppressive, arbitrary or unconstitutional action by servants of the government;[9]
2. wrongful conduct that has been calculated by the defendant to make a profit for himself, which may well exceed the compensation payable to the plaintiff;[10] and

[3] For a more detailed account of the history of exemplary damages in England, see Harvey McGregor, *McGregor on Damages* (London: Sweet & Maxwell, 18th ed, 2009) 420-452.

[4] Andrew Tettenborn, 'Punitive Damages – A View from England' (2004) 41 San Diego Law Review 1551 at 1552.

[5] Ralph Cunnington, 'Should punitive damages be part of the judicial arsenal in contract cases?' (2006) 26(3) *Legal Studies* 369 at 370.

[6] *Merest v Harvey* (1815) 5 Taunt 442.

[7] [1964] AC 1129.

[8] *Rookes v Barnard* [1964] AC 1129 at 1226-1227.

[9] This category is based on the 18th Century cases which introduced the general doctrine of exemplary damages. Two conditions must be satisfied. Firstly, the conduct of the defendant must be shown to be, in Lord Devlin's words, oppressive, arbitrary or unconstitutional. Secondly, the defendant must be a servant, which includes police and local and other officials: *Holden v Chief Constable of Lancashire* [1987] QB 380 CA; *AB v South West Water Services* [1993] QB 507 CA.

[10] This category focuses on the intention or motive behind the defendant's conduct. This category gives rise to difficulties of definition and delineation. See further McGregor, above n 3, 432-438.

3. where such an award is expressly authorised by statute.[11]

Following the decision of the House of Lords in *Rookes v Barnard*, several members of the House of Lords suggested that *Rookes v Barnard* introduced a second test into the law - the 'cause of action test' - which denies exemplary damages for any tort where its use was not established by previous authority.[12] The cause of action test, however, was heavily criticised as irrational and unworkable.[13] The state of the law on exemplary damages caused practical difficulties for practitioners. It meant that practitioners were required to trawl through authorities to discover whether exemplary damages were available.[14] The task was made more difficult by the fact that, prior to 1964, the distinction between exemplary and aggravated damages was not so pronounced.[15]

In 2002, the case of *Kuddus v Chief Constable of Leicestershire Constabulary* [16] abolished the 'cause of action test' in accordance with recommendations by the Law Commission's Report of 1997, which declared the state of the law on exemplary damages as "rationally indefeasible".[17] The House of Lords in *Kuddus*, however, regrettably stopped short of overruling Lord Devlin's 'categories test.'[18]

The High Court of Australia went further than *Kuddus* and rejected the 'categories test' in *Uren v John Fairfax & Sons Pty Ltd*[19]. Taylor J observed that:

[T]he limitation of [exemplary damages] to the categories specified in Rookes v Barnard is not, in my view, justified either upon principle or upon authority, and the adoption of those categories would not remove the suggested anomaly, but on the contrary, introduce others.[20]

Windeyer J enunciated a new test which had two requirements:

a) the cause of action must be of a kind for which exemplary damages are available as a remedy; and

[11] Where a statute makes no express reference to exemplary damages but is so phrased as to permit an authorisation to award exemplary damages to be inferred, such an inference is not likely drawn by the courts. See McGregor, above n 3, 440.
[12] *Broome v Cassell & Co* [1972] AC 1027 at 1086. These comments were applied by the Court of Appeal in *AB v South West Water Services Ltd* [1993] QB 57.
[13] WVH Rogers, *Winfield & Jolowicz on Tort* (London: Sweet & Maxwell, 15th ed, 1998) 746.
[14] Cunnington, above n 5, 372.
[15] Cunnington, above n 5, 372.
[16] [2002] 2 AC 122.
[17] Law Commission, *Aggravated, Exemplary and Restitutionary Damages* (Law Commission Report No. 247, 1997) 1.49.
[18] Three years after Lord Devlin's speech in *Rookes v Barnard*, Spencer J in the Supreme Court of Canada declared that the jurisdiction to award exemplary damages in Canada was not limited to Lord Devlin's three categories: *Vorvis v Insurance Corporation of British Columbia* (1989) 58 DLR (4th) 193 at 206.
[19] (1966) 117 CLR 118.
[20] *Uren v John Fairfax & Sons Pty Ltd* (1966) 117 CLR 118 at 139.

b) the facts of the case must include evidence of positive misconduct of the particular character which would justify an award of exemplary damages.[21]

The test espoused by Windeyer J in *Uren v John Fairfax & Sons Pty Ltd* remains the current test for the application of exemplary damages in Australia.

II EXEMPLARY DAMAGES IN AUSTRALIA

The application of exemplary damages in Australia at present is as follows.

A *Breach of contract*

To this day, Australian courts have continued adopt the historical standing that exemplary damages are not available for breaches of contract.[22] The reasons for this stance are explored and discussed below and are found to be poor justifications.

B *Torts*

A plaintiff may recover exemplary damages in tort whenever the defendant acts in contumelious disregard for the plaintiff's rights. This includes most intentional torts,[23] trespass to chattels,[24] trespass to land,[25] trespass to the person,[26] deceit,[27] reckless negligence[28] and product liability cases.[29] Previously, the courts were content to award exemplary damages for some unintentional torts involving recklessness.[30] In recent times, however, it appears that exemplary damages will only be awarded for intentional torts. An intentional tort is a deliberate action performed with the intent to cause death or injury to another person.[31] For example, in *Crump and Ors v Equine Nutrition Systems Pty Limited Trading As Horsepower and Anor*[32], the Supreme Court of New South Wales concluded that such a claim might be made for injuries sustained

[21] *Uren v John Fairfax & Sons Pty Ltd* (1966) 117 CLR 118 at 154.
[22] This position has been clear since *Butler v Fairclough* (1917) 23 CLR 78 and has recently been reaffirmed in *Gray v Motor Accident Commission* (1998) 196 CLR 1 at 6-7 and *Hospitality Group Pty Ltd v Australian Rugby Union Ltd* (2001) 110 FCR 157 at 191, [142] - [143].
[23] *Cantebury Bankstown Rugby League Football Club v Rogers* [1993] Aust Tort Reports 62,538.
[24] *Healing (sales) Pty Ltd v Inglis Electrix Pty* Ltd (1968) 121 CLR 584.
[25] *XL Petroleum (NSW) v Caltex Oil (Australia)* (1985) 155 CLR 448.
[26] *Lamb v Cotogno* (1987) 164 CLR 1.
[27] *Musca v Astle Corp* (1988) 80 ALR 251.
[28] *Midalco v Rabenalt* [1989] VR 461.
[29] *Vlchek v Koshel* (1988) 52 DLR (4th) 371, cited with approval by Kirby J in *Gray v Motor Accident Commission* (1998) 196 CLR 1.
[30] *Uren v John Fairfax & Sons Pty Ltd* (1966) 117 CLR 118.
[31] See *Zorom Enterprises Pty Ltd v Zabow* [2007] NSWCA 106.
[32] [2006] NSWSC 512.

by horses as a result of consumption of defective horse feed. The Court, however, was not prepared to make such an award as it viewed the actions of the manufacturer as having been "careless" rather than "deliberate". [33] Accordingly, it is not simply that exemplary damages are available for all torts. The torts must be deliberate and intentional and the test enunciated by Windeyer J in *Uren v John Fairfax & Sons Pty Ltd* must still be satisfied.

The Ipp Report considered the arguments for and against the retention of exemplary damages in tort.[34] The arguments against the retention of exemplary damages were said to be, *first*, exemplary damages confuse the punishment function of the criminal law with the compensation of the civil law.[35] *Secondly*, exemplary damages constitute an undeserved windfall for the plaintiff.[36] *Thirdly*, awards of exemplary damages are unpredictable especially in jury trials.[37] *Finally*, exemplary damages awards are often too high.[38] Based on these arguments, the Ipp Report made a recommendation that any proposed civil liability personal injuries act make provision for the abolition of exemplary damages.[39]

Whilst there are arguments against the retention of exemplary damages, such damages do serve a legitimate purpose in tort, which explains why they have not yet been abolished. Some of the arguments in favour of exemplary damages in tort stem, *firstly*, from the premise that it is a legitimate function of the civil law to penalise reprehensible conduct by tortfeasors; exemplary damages fulfill this function.[40] The "roots of tort and crime" are "greatly intermingled"[41] such that it is not inappropriate for civil proceedings to effect the dual purpose of compensating the victim and punishing the wrongdoer. *Secondly*, exemplary damages provide a way of punishing tortfeasors where criminal, regulatory and administrative sanctions are inadequate.[42] Exemplary damages have value as a supplementary device, providing a remedy where there are deficiencies in tort law. In some situations, compensation is inadequate or does not effectively remedy the infringement of certain important interests,[43] for example where powerful defendants are unaffected by the normal level of damages, or where civil wrongs are deliberately perpetrated for profit or hate.

[33] *Crump and Ors v Equine Nutrition Systems Pty Ltd Trading As Horsepower and Anor* [2006] NSWSC 512 at [305].
[34] Ipp Report, *Review of the Law of Negligence Final Report*, September 2002.
[35] Ibid, [13.164].
[36] Ipp Report, above n 34, [13.164].
[37] Ipp Report, above n 34, [13.164].
[38] Ipp Report, above n 34, [13.164].
[39] Ipp Report, above n 34, Recommendation 60.
[40] Ipp Report, above n 34, [13.163].
[41] *Uren v John Fairfax & Sons Pty Ltd* (1966) 117 CLR 118 at 149-50.
[42] Ipp Report, above n 34, [13.163].
[43] J Swanton, B McDonald, 'Commentary on the report of the English Law Reform Commission on Aggravated, Restitutionary and Exemplary Damages' (1999) 7 *Torts Law Journal* 1 at 4.

Thirdly, exemplary damages provide a means for the court to express its disapproval "not only to the tortfeasor but to the world."[44]

The English Law Reform Commission has been examining the law on exemplary damages for some time. The Commission considered whether exemplary damages should be abolished altogether, or retained but refined in some way.[45] 72% of the consultees, whilst acknowledging that the arguments were finely balanced, favoured a principled expansion of exemplary damages.[46] These consultees considered that the main policy objections to exemplary damages were unfounded. The case against the retention of exemplary damages was more theoretical than practical by seeking merely to neatly categorise the functions of civil and criminal law.[47] On this basis, exemplary damages in tort seem justified.

C *Equitable wrongs*

The law is less settled in relation to equitable wrongs. Although the New South Wales Court of Appeal in *Harris v Digital Pulse Pty Ltd*[48] held that exemplary damages are not available for breaches of fiduciary duty,[49] the judges were divided on the issue of whether exemplary damages would be available in respect of equitable wrongs more analogous to torts. Heydon JA (as he was then) said there is no power to award exemplary damages in respect of a claim in equity, although he was content to decide the case on the narrower ground that there is no power to award exemplary damages for the specific equitable wrong in issue.[50] Spigelman CJ concurred, although he emphasised the contractual character of the fiduciary relationship in question[51] and refrained from deciding on whether exemplary damages would be available in respect of equitable wrongs more analogous to torts. Mason P dissented and opined that there was no principled reason to award exemplary damages in respect of common law torts but not analogous equitable wrongs.[52]

In relation to breaches of equitable duties, the debate turns not only to arguments for and against exemplary damages in principle, but also has a

[44] *Gray v Motor Accident Commission* (1998) 196 CLR 1 at 29.
[45] The Law Commission, above n 17, 1.16.
[46] The Law Commission, above n 17, 1.15.
[47] The Law Commission, above n 17, 1.37.
[48] (2003) 197 ALR 626.
[49] The defendant employees knowingly breached contractual and fiduciary duties owed to their employer by diverting business to themselves and misusing confidential information belonging to their employer.
[50] *Harris v Digital Pulse Pty Ltd* (2003) 197 ALR 626 at [471].
[51] *Harris v Digital Pulse Pty Ltd* (2003) 197 ALR 626 at [36]-[44].
[52] *Harris v Digital Pulse Pty Ltd* (2003) 197 ALR 626 at [64]-[228].

fusionist aspect to it.[53] That is, some commentators oppose such a remedy in part because its acceptance involves a fusion of a common law remedy being utilised as a remedy for an equitable wrong.[54] Heydon JA's judgment in *Harris v Digital Pulse*, to some extent, is reminiscent of this reasoning.`

In sum, although a strict application of *Harris v Digital Pulse Pty Ltd* implies that exemplary damages are not available for breaches of fiduciary duty, the decision is not authority on the application of such damages for equitable wrongs more generally.

D *Statute*

Turning to statute, the application of exemplary damages is inconsistent. For example, exemplary damages are not available under the *Trade Marks Act 1995* (Cth), which provides a compensatory regime.[55] Exemplary damages have also historically not been available for misleading and deceptive conduct under the *Trade Practices Act 1974* (Cth) (now the *Australian Consumer Law*, being Schedule 2 of the *Competition and Consumer Act 2010* (Cth)) as the aim of the relevant sections is to compensate the plaintiff, rather than punish the defendant.[56] In contrast, some statutes have expressly provided for "additional" damages awards, which may be considered analogous to exemplary damages.[57] For example, section 115(4) of the *Copyright Act 1968* (Cth) provides that, having regard to the flagrancy of the infringement and all other relevant matters, "the court may, in assessing damages for the infringement, award such additional damages as it considers appropriate in the circumstances".[58]

Palmer J in *Digital Pulse v Harris* [59] suggested that, the availability for exemplary damages for breaches of statutory duties supports the award of exemplary damages for egregious breaches of (the equivalent) equitable duties.[60] By extension, the same could be said of egregious breaches of contract. These statutory developments should be borne in mind when considering arguments to overcome the now historical notions that exemplary damages cannot be availed for breach of contact actions.

[53] Joachim Dietrich, Thomas Middleton, 'Statutory remedies and equitable remedies' (2006) 28 *Australian Bar Review* 136 at 160.

[54] R Meagher, D Heydon and M Leeming , *Meagher Gummow and Lehane's Equity Doctrines and Remedies* (Butterworths LexisNexis, 4th ed, 2002) 839.

[55] See *Paramount Pictures Corporation v Hasluck* (2006) 70 IPR 293 at 301, [35].

[56] *Musca v Astle Corp Pty Ltd* (1988) 80 ALR 251; *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 494.

[57] *Paramount Pictures Corporation v Hasluck* (2006) 70 IPR 293 at 301, [35]; *Milpurrurru v Indofurn Pty Ltd* (1994) 54 FCR 240.

[58] *Copyright Act 1968* (Cth) s 115(4).

[59] (2002) 40 ACSR 487at [27]-[32], [172].

[60] This case was overturned on appeal in *Harris v Digital Pulse* (2003) 197 ALR 626.

III Arguments against awarding exemplary damages for breach of contract

The arguments against the award of exemplary damages in contract are well established. Those arguments are scrutinised below and it is shown that they are flawed as justifications for denying exemplary damages for breach of contract.

A *Exemplary damages do not seek to compensate*

One of the common arguments in support of the view that exemplary damages cannot be awarded for breach of contract actions is that exemplary damages "cannot be awarded in a purely contractual action, since the object of such an action is not to punish the defendant but to compensate the claimant."[61] Explained more fully, the fundamental principle governing the award of damages in respect of any contractual wrong is that they are compensatory.[62] The general rule is that stated by Parke B in *Robinson v Harman*[63]:

> [W]here a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed.[64]

To the contrary, the purpose of exemplary damages is not to compensate. Rather, the aims of exemplary damages (which are explored further below) are punishment, deterrence and vindication.[65]

There are, however, flaws to this argument. *First*, the case of *Addis v Gramophone Company Limited*[66] has traditionally been used by commentators to support the proposition that exemplary damages are not available for a breach of contract as the nature of exemplary damages is to punish the defendant rather than to compensate the claimant.[67] However, the use of *Addis v Gramophone* to support such a justification is misconceived.

Addis v Gramophone concerned an action for wrongful dismissal. The plaintiff was employed as a manager of the defendant's business at a salary, together with commission on trade done. The defendant, in breach of contract, dispensed with the plaintiff's services and immediately replaced him with a new manager. This action deprived the plaintiff of the opportunity to act as manager

[61] Sir Guenter Treitel, *The Law of Contract* (London: Sweet & Maxwell, 11th ed, 2003) 935.
[62] See *Haines v Bendall* (1991) 172 CLR 60 at 63, *Attorney General v Blake* [2001] 1 AC 268 at 282, *Alfred McAlpine Construction Ltd v Panatown Ltd* [2001] 1 AC 883 at 1090, *Whitehead v Searle* [2009] 1 WLR 549 at 558.
[63] (1848) 1 Ex 850.
[64] *Robinson v Harman* (1848) 1 Ex 850 at 855.
[65] See 'The aims of exemplary damages' below.
[66] [1909] AC 488.
[67] Jack Beatson, *Anson's Law of Contract* (Oxford University Press, 28th ed, 2002) 592.

during the notice period and thus deprived him of the commission that he would have earned. Accordingly, the plaintiff commenced an action for breach of contract claiming that the level of damages should reflect the circumstances, in which he was dismissed, the damage to his reputation and the ability to find suitable employment.

The House of Lords applied the compensation principle.[68] Their Lordships held that, although the plaintiff could recover a sum which represents his salary for the notice period and for the commission that he would have earned during that period, he could not recover damages to compensate him for the harsh manner in which he was dismissed,[69] as there was no right to exemplary damages in contract claims.[70] Such claims would have to be actioned in the law of tort.

However, contrary to popular belief, *Addis v Gramophone* is not sound authority for the proposition that exemplary damages are unavailable for breach of contract. The ratio of *Addis v Gramophone* relates to the denial of recovery for mental distress or intangible loss. Only two out of the five Lords touched on exemplary damages. Further, it appears that those observations were premised on the assumption that a damages award is punitive unless justified as a head of recoverable loss.

Secondly, this argument does not take into account the fact that there will always be some cases where compensatory damages will not, on their own, suffice. In this regard, Lord Collins' dissenting remarks in *Addis v Gramophone* are noteworthy:

> I think we are not bound to disallow [exemplary] damages in this case, and I am not disposed, unless compelled by authority to do so, to curtail the power of the jury to exercise what is a salutary power, which has justified in practical experience, to redress wrongs for which there may be, as in this case, no other remedy.[71]

Thirdly, the argument assumes that punishment is the only aim of exemplary damages. In fact, the aims of deterrence and vindication which are embedded in the award of exemplary damages are also aims which tort law embraces in the award of exemplary damages. Accordingly, despite being non-compensatory, exemplary damages do have a legitimate role to play in private law and hence contract law.[72]

In sum, the argument that the aim of exemplary damages is to punish the

[68] *Addis v Gramophone Co Limited* [1909] AC 488 at 494.

[69] Today such damages would be properly labelled aggravated damages as the manner of the breach aggravated the loss.

[70] *Addis v Gramophone Co* [1909] AC 488 at 494, 496.

[71] *Addis v Gramophone Co* [1909] AC 488 at 500.

[72] The role that exemplary damages can play in contract law is explored at under the heading, 'The aims of exemplary damages' below.

wrongdoer and not compensate the victim is a weak justification for the denial of exemplary damages in contract.

B *The distinct nature of a tort justifies awarding exemplary damages*

Some commentators posit that the retention of exemplary damages in tort but not in contract is justified by reference to the distinctive nature of tort and contract. This proposition is based on the following arguments:

a) the harm done to the victim of a tortious wrong is far more serious than the harm done to the victim of a contractual wrong (the **first argument**);[73]
b) a tortious wrong affects the public interest in a way which a contractual wrong does not (the **second argument**);[74]
c) to allow exemplary damages to be awarded in response to contractual wrongs would introduce a damaging element of uncertainty into commercial transactions (the **third argument**);[75] and
d) the response to a contractual wrong is determined by the parties to the contract, while the response to a tortious wrong is determined by the court - it is therefore *ultra vires* to the powers of the court to award exemplary damages in response to a breach of contract (the **fourth argument**).[76]

McBride comments, and rightly so, that those four arguments are false.[77] The first argument is false because the harm suffered by a victim of tort and the harm suffered by a victim of breach of contract is the same - economic loss, both present and future.[78] In *Thyseen Inc v SS Fortune Star*[79], Friendly J suggested that the loss caused in tort was more serious than that in contract because breaches of contract do not cause "resentment and other mental or

[73] Nicholas McBride, 'A Case for Awarding Punitive Damages in Response to Deliberate Breaches of Contract' (1995) 214 *Anglo-American Law Review* 369 at 379.
[74] Ibid.
[75] McBride, above n 73. This reasoning was applied by the House of Lords in *Addis v Gramophone Ltd* [1909] AC 488 at 495 in refusing to award exemplary damages for a breach of an employment contract.
[76] McBride, above n 73. The majority in *Vorvis v Insurance Company of British Columbia* (1989) 58 DLR (4th) 193, in requiring that a wrongdoer have committed a tort before exemplary damages can be awarded, stated that all rights and obligations of the defendants in an action for breach of contract were determined by the contract with the plaintiff. If the contract did not provide for exemplary damages on breach there could be no award of exemplary damages no matter how the defendant had breached the contract.
[77] McBride, above n 73, 381.
[78] McBride, above n 73, 381-382.
[79] 777 F 2d 57 (1985).

physical discomfort."[80] The veracity of this statement, however, is questionable as contract damages for mental distress are now available.[81]

The second argument is false because only some torts affect the public interest.[82] The foundation behind the second argument is that only the victim of a contractual wrong has an interest in that wrong not occurring. However, the public at large only has an interest in those torts that injure people's health or property not being committed.[83] Examples of torts that may only affect the victim of the tort (and not the public at large) include injurious falsehood, negligent misstatement or misrepresentation, deceit and passing off. Cunnington also asserts that breaches of contract can, in certain circumstances, affect public interest.[84] For example, if the provider of a fire-fighting service fails to provide contractually stipulated number of fire trucks.[85]

The third argument is false because if exemplary damages were awarded for deliberate breaches of contract, businesses could be certain that, so long as they sought in good faith not to breach their contracts, exemplary damages could not be awarded against them if they inadvertently breach their contracts.[86] The idea being that, only deliberate and intentional breaches of contract would appropriately attract an award of exemplary damages. Further, ensuring that contracting parties do not fail to perform their obligations by the threat of awarding exemplary damages, will serve as a deterrent. Hence, the certainty and predictability of contracts will be promoted as the contracting parties will have more comfort in the likelihood of the contract being performed to its full term.

McBride acknowledges that the fourth argument may be true, but says that it is based on bad logic.[87] It assumes that because a contractual duty arises out of an agreement between two individuals, so too must the response to the breach of that contract. That is not necessarily true. The fourth argument assumes that the assessment of damages for torts differs from the assessment of damages for breach of contract. McBride rebuts this by adopting Lord Diplock's approach,[88] that is to hold the opposite view that, the aim is to put the victim of the tort or the victim of the breach of contract in the position he was to be in had the tortfeasor or contract breaker complied with the duty which he or she

[80] *Thyseen Inc v SS Fortune Star* 777 F 2d 57 (1985) at 63.
[81] *Farley v Skinner* [2002] 2 AC 732; *Jarvis v Swan Tours* [1973] QB 233.
[82] McBride, above n 73, 382.
[83] McBride uses the example of the tort of defamation as a tort which only affects the person being defamed. However, now that exemplary damages are no longer available for defamation in Australia, that argument is no longer applicable.
[84] Cunnington, above n 5, 379.
[85] *City of New Orleans v Fireman's Charitable Association* 9 So 486 (1891).
[86] McBride, above n 72, 382.
[87] McBride, above n 72, 382-383.
[88] See *Albacruz (Cargo Owners) v Albazero (Owners), "The Albazero"* [1977] AC 774 at 841 C-D.

breached.[89]

An extension of the fourth argument is that there is a distinction between tort and contract based on the notion that contractual obligations are voluntary, while tortious obligations are imposed by the law.[90] The idea is that the courts should tailor the remedy in contract to what was voluntarily undertaken and should be reluctant to invoke non-compensatory remedies such as exemplary damages.[91] This distinction is false. There are, in fact, some tortious rights and obligations which are voluntary. For example, as Professor Atiyah explains:

> A person who negligently injures another while driving his car is voluntarily on the road, voluntarily driving his car, and may be said to submit himself to the requirement of the law with as much or as little truth as the seller of goods.[92]

Further, both tort and contract are concerned with what people do as well as what people intend. This can be seen in the objective approach taken by the courts when considering issues of contract formation, contract interpretation and implication of terms. In all these areas, courts heavily rely on the notion of reasonableness, which involves the application of community standards.[93] Cunnington advances the argument that the courts usually need to determine the quantum of damages for a breach of contract, having regard to extrinsic material, as contracts rarely make provisions for the remedial consequences of breach.[94] Importantly, the court, not the parties, determines the availability of remedies for breach of contract. Accordingly, the voluntary argument is fictitious and unconvincing as a justification for the court's refusal to award exemplary damages for breach of contract.

Friendly J in *Thyseen* gives a further reason, aside from those four arguments scrutinised above, in favour of the general prohibition against awarding exemplary damages for breach of contract based on the distinction between contract and tort:

> [T]he law of contracts governs primarily commercial relationships, where the amount required to compensate for loss is easily fixed, in contrast to the law of torts, which compensates for injury to personal

[89] McBride, above n 72, 383.

[90] *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145 at 194 per Lord Goff of Chieveley: "*…the tortious duty is imposed by the general law, and the contractual duty is attributable to the will of the parties.*" See also *Astley v Austrust Ltd* (1999) 197 CLR 1 at 36; PH Winfield, *The Province of Tort* (Cambridge University Press, 1931) 40.

[91] Andrew Burrows, *Understanding the Law of Obligations* (Oxford: Hart Publishing, 1998) 13.

[92] P Atiyah, *Essays on Contract* (Oxford: Clarendon Press, 1986) 41.

[93] Cunnington, above n 5 at 376.

[94] Cunnington, above n 5 at 376.

> interest that are more difficult to value, thus justifying non-compensatory recoveries.[95]

Cunnington breaks down this argument into two parts. *First*, it asserts that contract loss is easily fixed, while loss in tort is not.[96] However, damages are now available for pain and suffering caused by a breach of contract[97] and for the infringement of non-commercial interests,[98] which are loses that not easily quantified.

Secondly, contract is distinguished from tort on the basis that the contract governs commercial relationships, while tort governs primarily personal relationships,[99] and "since stability and predictability are of crucial importance in commercial affairs, exemplary damages should be denied for breach for contract."[100] This argument, however, is fundamentally flawed, as it does not take into account wilful contract breakers.[101] It is also inconsistent with the efficient breach of contract theory, which promotes breaking contracts to achieve Pareto efficiency, thus jeopardising the stability and predictability of contracts.

In sum, none of the historical arguments advanced to distinguish contract and tort, as a reason for denying exemplary damages in contract, whilst retaining them in tort, are convincing.

C *The introduction of punishment into civil law confuses the criminal law and civil law functions*

Another common objective to exemplary damages for breach of contract is that the introduction of punishment into civil law confuses the civil and criminal functions of the law. In other words, punishment is an inappropriate thing for a civil court to do. The argument is that defendants subjected to exemplary damages in civil cases are not afforded the procedural safeguards applicable in a criminal proceeding, namely the higher standard of proof.[102] Accordingly, the most appropriate arena for punishment of an individual is within the criminal law. It is for this reason that the Australian position, which is confirmed in *Gray v Motor Accidents Commission*[103], is that wrong acts no longer give rise to exemplary damages in tort where a significant criminal penalty has been

[95] *Thyseen Inc v SS Fortune Star* 777 F 2d 57 (1985) at 63.
[96] Cunnington, above n 5 at 377.
[97] *Farley v Skinner* [2002] 2 AC 732.
[98] *Ruxley Electronics Ltd v Forsyth* [1996] 1 AC 344.
[99] Cunnington, above n 5 at 378.
[100] Cunnington, above n 5 at 378.
[101] This is discussed under the heading 'The efficient breach of contract theory' below.
[102] P Lee, 'Contract Damages Corrective Justice and Punishment' (2007) 70(6) *Modern Law Review* 887.
[103] (1998) 196 CLR 1.

imposed.[104] The courts have tended to restrict the availability of exemplary damages in favour of the criminal penalty.[105]

However, there are counter arguments. *First*, exemplary damages are a vehicle for policing reprehensible conduct that falls outside the criminal jurisdiction. This is most notable in the area of defamation law.

Secondly, there may be some cases where the defendant's conduct is not strictly criminal. Or, if it is criminal, the criminal law and criminal processes do not work perfectly. For example, the State does not always have sufficient resources to apprehend all criminals or the State may not wish to prosecute or to continue prosecutions which it has begun.[106] Alternatively, the defendant may not be guilty according to the criminal standard. Exemplary damages can go some way to fill that lacuna.

Thirdly, it is a fallacy that the civil courts do not afford the defendant the protections afforded to defendants in the criminal law, namely the higher standard of proof, when one has regard to the sliding nature of the civil standard of proof as Dixon J described in *Bringinshaw v Briginshaw*[107]:

> The seriousness of an allegation made, the inherent likelihood of an occurrence of a given description, or the gravity of the consequences flowing from a particular finding are considerations which must affect the answer to the question whether the issue has been proved to the reasonable satisfaction of the tribunal.[108]

Allegations of conduct that would warrant an award of exemplary damages must be proved to a higher standard, in any event.[109]

In sum, exemplary damages do not confuse the roles of the criminal law and civil law. Rather, they form part of our legal structure as a whole that assists in achieving the goals of punishment, deterrence and vindication.[110] If the criminal law argument were correct, then it would justify the abolition of all exemplary damages awards.

D *Exemplary damages result in a windfall to the plaintiff*

There are some judicial decisions which have based the refusal to allow

[104] *Gray v Motor Accidents Commission* (1998) 196 CLR 1 at 13-17.
[105] Tyrone Kirchengast, 'The Purification of Torts, the Consolidation of Criminal Law and the Decline of Victim Power' (2008) 10 *University of Notre Dame Australia Law Review* 85 at 86.
[106] The Law Commission, above n 17, 1.27(3).
[107] (1938) 60 CLR 336.
[108] *Bringinshaw v Briginshaw* (1938) 60 CLR 336 at 362.
[109] Jeremy Birch, 'Exemplary damages for breach of fiduciary duty' (2005) 3 *Australian Business Law Review* 429 at 435; CR Williams, 'Burdens and Standards in Civil Litigation' (2003) 25(2) *Sydney Law Review* 165.
[110] These aims of exemplary damages are explained further under heading, 'The aims of exemplary damages' below.

exemplary damages for breach of contract on the assertion that they will result in a windfall to the plaintiff.[111] Edelman contends that as a justification this argument is weak:

> The term "windfall" is a pejorative syllogism; it asserts the very thing it seeks to prove. Exemplary damages in tort cases allow precisely this "windfall". But they are seen as necessary in order to deter wrongdoing in cases where compensatory damages are insufficient "for the law to show that it cannot be broken with impunity" (*Rookes v Barnard* [1964] AC 1129 at p. 1227 (Lord Devlin)).[112]

Furthermore, "[i]nasmuch as every claimant whose claim is settled without litigation gains at the expense of those who do endure the travails of litigation, it can also be regarded as a reward for vindicating the strength of the law."[113] Birch correctly comments that, even if it is considered a pure windfall, "is the fact that an individual happens to be fortunate in this respect a reason for taking that benefit away?"[114]

Accordingly, the plaintiff's windfall is not a convincing argument for not allowing exemplary damages for breach of contract.

E *Large damages awards produce incentives to unfounded litigation*

There is some scepticism that the availability of exemplary damages for breach of contract will significantly increase unfounded litigation. The argument is compounded by two parts. One aspect of the argument is that exemplary damages will produce increasingly large damages awards. This part of the argument is unfounded for a number of reasons.

First, exemplary damages are rarely awarded in Australia, despite the fact that they are available for intentional torts and other exceptional cases.

Secondly, if such an award is made, they are generally quite small, unlike the multi-million dollar exemplary damages awards in the United States. This fact in itself demonstrates the very minor role that exemplary damages have played in Australia. For example, the largest award made in Australia (that is not currently the subject of an appeal) was for $300,000.[115]

Thirdly, the objection assumes that the number of torts and contract

[111] *Ruxley Electronics Ltd v Forsyth* [1996] 1 AC 344 at 353; *Tito v Waddell (No 2)* [1977] Ch 146 at 332; *Co-operative Insurance Society Ltd v Argyll Store (Holdings) Ltd* [1998] AC 1 at 15. The same arguments are also made in relation to awards of accounts of profit.

[112] James Edelman, 'Exemplary Damages for Breach of Contract' (2001) 117 *Law Quarterly Review* 539 at 542.

[113] P Birks, *Wrongs and Remedies in the Twenty-first Century* (Oxford: Clarendon Press, 1996) ix.

[114] Birch, above n 109, 435.

[115] *Chen v Karandonis* [2002] NSWCA 412. See also *Midalco Pty Ltd v Rabenalt* (1989) VR 461 where the jury awarded exemplary damages in the sum of $250,000; *Knight v State of New South Wales* [2004] NSWSC 791 where the judge awarded exemplary damages in the sum of $200,000.

breaches would remain the same once exemplary damages were allowed (for breach of contract). In fact, the making of exemplary damages awards available in breach of contract would deter wrongdoings and encourage individuals to negotiate release from their common law obligations.[116]

Fourthly, a number of limiting principles or factors could apply or could be introduced so as to limit the size and frequency of the award and thereby reduce the incentive to bring unfounded claims.[117] The England and Wales Law Commission recommended the following factors be taken into account:

a) exemplary damages awards should continue to be moderate;
b) the judge, not a jury, should determine the availability of the quantum of exemplary damages with reference to applicable principles; and
c) exemplary damages should be a remedy of last resort - the court should only award exemplary damages where there is no other sufficient remedy to punish and deter the defendant.[118]

The second part of the argument implies that introducing exemplary damages for breach of contract will increase unfounded litigation. This part of the argument is also amiss. *First*, the high cost of litigation coupled with the prospect of having to bear the costs of the litigation is likely to be enough of a deterrent to any plaintiff who is considering bringing an unfounded claim. *Secondly*, cases which are unfounded can be struck out.

Accordingly, the idea that introducing exemplary damages in contract will increase unfounded litigation and blow out damages awards is simply misconceived.

F *The efficient breach of contract theory*

Another common objection to exemplary damages for breach of contract is Posner's efficient breach of contract theory.[119] The efficient breach of contract theory was derived from Holmes' theory that there should be a right to choose between performing a contract or breaching the contract and paying compensatory damages.[120] The efficient breach of contract theory regards contractual breach as a choice, a morally neutral option for attaining efficient allocation of resources.

[116] TA Diamond, 'The tort of bad faith breaches of contract: when, if at all, should it be extended beyond insurance transactions?' (1981) 64 *Marq Law Review* 425 at 449.
[117] The Law Commission, above n 17, 1.32(2).
[118] The Law Commission, above n 17, 1.30.
[119] Richard Posner, *Economic Analysis of Law* (Aspen Law and Business, New York, 5th ed, 1998) 130-131.
[120] Oliver Holmes, *The Common Law* (1881) 301; Oliver Holmes, 'The Path of the Law' (1897) 10 *Harvard Law Review* 457 at 462 and *Globe Refining Co v London Western Oil Co* 190 US 540 (1903) at 544 (per Holmes J).

There are, however, a number of criticisms of the efficient breach of contract theory. *First*, the theory is inconsistent with what contract is all about and fails to correspond with the reasonable expectations of contracting parties. As Charles Fried stated:

> The moralist duty thus posits a general obligation to keep promises, of which the obligation of contract will only be a special case - that special case in which certain promises have attained legal as well as moral force.[121]

Secondly, the theory fails to distinguish between opportunistic breaches and efficient breaches of contract. [122] Opportunistic breaches are those breaches where the contract breaker attempts to obtain more than what was bargained for at the expense of the non-breaching party.[123] Opportunistic behaviour does not create wealth; it merely redistributes it from the victim to the opportunist.[124] Even Posner has recognised that, when a promissor breaches opportunistically, "we might as well throw the book at the promissor…Such conduct has no economic justification and ought simply to be deterred."[125]

Thirdly, the theory fails to account for the costs of litigation relevant to gaining expectation damages from breach that would leave one or both of the original parties worse off than if the contract had simply been performed.

Fourthly, the theory fails to correspond to the existing law. For example, the right to specific performance is incompatible with the efficient breach theory, since it compels the contract breaker to perform his or her contractual obligations. Holmes concedes that "it is true that in some instances equity does what it called compelling specific performance."[126] If the theory were to be accepted, specific performance, account of profits and exemplary damages, all of which seek to protect the performance of a contract by deterring breaches, would never be appropriate. McBride helpfully uses the example of inducing a breach of contract to demonstrate the inconsistency between the theory and the state of the law at present.[127] If the courts are to refuse the award of exemplary damages for a breach of contract on the basis of the efficient breach of contract theory - that it is sometimes more efficient to allow a breach of contract and for the victim to be compensated by the contract breaker - then so too should the courts refuse to award exemplary damages for inducing a breach of contract[128]

[121] Charles Fried, *Contract as Promise* A Theory of Contractual Obligation (Harvard University Press, 1981) 17.
[122] Cunnington, above n 5, 385-386.
[123] Cunnington, above n 5, 385.
[124] Cunnington, above n 5, 386.
[125] Posner, above n 119, 118.
[126] Holmes, above n 120, 236.
[127] McBride, above n 73, 385.
[128] McBride, above n 73, 385.

for the same reason. Yet, the law permits the award of exemplary damages for inducing a breach of contract as it is a tort.[129]

In light of these objections, the efficient breach of contract theory should be rejected as a stand-alone theory and also as a justification or obstacle for exemplary damages to be available for breach of contract. Economic efficiency actually requires exemplary damages in certain circumstances. That is, there are situations where exemplary damages may serve a useful purpose by "protecting the performance interest of a contract and upholding the facilitative institution of contracting."[130]

G *Account of profits is not an available remedy in contract*

Like exemplary damages, an account of profits (otherwise described as "disgorgement damages")[131] is not compensatory in nature. It is concerned with the wrongdoer's gain (as opposed to the victim's loss). It is primarily for this reason that the current position in Australia is that an account of profits is not available as a remedy for breach of contract.[132]

In *Hospitality Group Pty Ltd v Australian Rugby Union Ltd*[133], a Full Court of the Federal Court held that *Attorney-General v Blake*[134] should not be followed in Australia.[135] In *Attorney-General v Blake*, the House of Lords (Lord Hobhouse dissenting) revised the common law as it applies in England and held that an account of profits is available as a remedy for a breach of contract committed by a British double-agent, George Blake. Mr Blake had written, in breach of contractual secrecy provisions in his employment contract with the Crown, a book that discussed his time as an agent for the Secret Intelligence Services. Blake received profits from the publishers of the book. In the special circumstances of the intelligence services, the just response to the breach was to order an account of profits even though the Crown had suffered no loss from Blake's disclosure as the information was no longer confidential.

Lord Nicholls in his leading speech stated that normally the remedies of compensatory damages, injunctions and specific performance would be the only remedies available for breach of contract. However, in "exceptional cases" the question of accounting for profits will arise.[136] The following matters are relevant to the existence of exceptional circumstances justifying grant of the discretionary remedy:

[129] *Whitfield v De Lauret & Co Ltd* (1920) 29 CLR 71 is authority for the proposition that exemplary damages are available for interfering with a plaintiff's contractual rights.
[130] Cunnington, above n 5, 370.
[131] James Edelman, *Gain-based Damages* (Hart Publishing, Oxford, 2002) 85-95.
[132] *Hospitality Group Pty Ltd v Australian Rugby Union Ltd* [2001] FCA 1040 at [159]-[160].
[133] [2001] FCA 1040.
[134] [2000] 1 AC 268.
[135] *Hospitality Group Pty Ltd v Australian Rugby Union Ltd* [2001] FCA 1040 at [48], [159].
[136] *Attorney-General v Blake* [2000] 1 AC 268 at 285.

a) Standard remedies for the breach of contract (damages, specific performance, injunction) must provide an inadequate response to the breach of contract.[137]
b) Relevant circumstances include "the subject matter of the contract, the purpose of the contractual provision which has been breached, the circumstances in which the breach occurred, the consequences of the breach and the circumstances in which relief is being sought".[138]
c) A useful general guide, although not exhaustive, is "whether the plaintiff had a legitimate interest in preventing the defendant's profit-making activity and, hence, in depriving him of his profit".[139]

Matters which are not in themselves sufficient ground to grant the exceptional remedy are:

> …the fact that the breach was cynical and deliberate; the fact that the breach enabled the defendant to enter into a more profitable contract elsewhere; and the fact that by entering into a new and more profitable contract the defendant put it out of his power to perform his contract with the plaintiff.[140]

Attorney-General v Blake recognises that compensatory damages are not always adequate to protect the victim's interest in performance of a contract. Although acknowledging that other jurisdictions[141] have departed from the prevailing Australian view that damages for breach of contract can only be compensatory, the majority in *Hospitality Group* stated that would take the High Court to abolish such a rule.

In *Dalecoast Pty Ltd v Guardian International Ltd*[142], the plaintiff sought an account of profits as an alternative remedy to damages for breach of contract. The trial Judge held that, if the approach of the House of Lords in *Attorney-General v Blake* were applied, there were no exceptional circumstances justifying the grant of the discretionary remedy.[143] The Court of Appeal did not decide one way or the other whether *Attorney-General v Blake* is good law in Australia. Murray J (Wallwork J agreeing) upheld the trial Judge's conclusion that, if *Attorney-General v Blake* is good law in Australia, there were no

[137] *Attorney-General v Blake* [2000] 1 AC 268 at 285.
[138] *Attorney-General v Blake* [2000] 1 AC 268 at 285.
[139] *Attorney-General v Blake* [2000] 1 AC 268 at 285.
[140] *Attorney-General v Blake* [2000] 1 AC 268 at 286.
[141] *Adras v Harlow & Jones Gmbh* (1988) 42(1) PD 221; *Hickey v Roche Stores (Dublin) Ltd [No 1]* (1976) [1993] RLR 196 (HC, Ireland); *Hospital Products Ltd v US Surgical Corp* (1984) 156 CLR 41 (Deane J in dissent).
[142] [2003] WASCA 142.
[143] *Dalecoast Pty Ltd v Guardian International Ltd* [2003] WASCA 142 at [5], [102].

exceptional circumstances justifying the grant of the discretionary remedy.[144]

In *Andrews v Australia and New Zealand Banking Group Ltd*[145], the High Court addressed the approach at common law and equity to penalties in relation to bonds. No question of an account of profits for breach of contract or otherwise arose in that case. However, French CJ, Gummow, Crennan, Kiefel and Bell JJ said[146]:

> The law respecting bonds, like that respecting deposits, was received from Roman law and developed before the rise of what might be called the modern law of contract. The courts of equity did not treat their jurisdiction to relieve against penalties and forfeitures as extending to forfeiture of a deposit, being an amount paid as an earnest of performance. Those courts did, however, relieve against stipulations which were penal conditions in bonds.
>
> The courts of equity went on to extend their jurisdiction to deal with stipulations which were penal provisions in simple contracts. But it does not follow that that extension was a change to the nature of the jurisdiction. In particular, the requirement that equity intervene to ensure the recovery of no more than compensation, accommodated the "fundamental principle" of modern contract law to redress breach by adequate compensation.84
>
> 84 E A Farnsworth, Contracts, Aspen, 4th ed, 2004, ss 12.18; compare Attorney-General v Blake [2001] 1 AC 268 at 284–5 …
>
> [Footnotes other than footnote 84 omitted]

The proposition put by the High Court in the last sentence of the passage quoted above and the reference in footnote 55 to "compare Attorney-General v Blake"; is suggestive that the High Court was not endorsing the approach of the House of Lords in that case.[147]

If an account of profits remedy for breach of contract is not permissible in Australia, at first blush, it seems logical that an award of exemplary damages for breaches of contract is objectionable for the same reasons, being that an objective of both remedies is deterrance, not compensation. The two remedies, however, do not fulfill the same functions. There are three main differences between the remedies of exemplary damages and account of profits:

a) Exemplary damages are not a freestanding remedy; they are awarded in addition to a primary remedy such as an account of profits. The court must first consider the appropriate remedy and then add on an

[144] *Dalecoast Pty Ltd v Guardian International Ltd* [2003] WASCA 142 at [102]-[107].
[145] (2012) 247 CLR 205.
[146] *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 at 227, [43]-[44].
[147] *Testel Australia Pty Ltd v Krg Electrics Pty Ltd and Anor* [2013] SASC 91 at [108].

appropriate amount, by way of exemplary damages. For this reason, exemplary damages, unlike the account of profits remedy, can be tailored to a particular situation[148] such as to correspond with the wrongdoer's culpability.

b) The focus for exemplary damages is on the wrongdoer's improper motive, whereas the focus of an account of profits remedy is on the actual making of a profit.
c) Exemplary damages may be awarded even though they exceed the amount of the gain made by the wrongdoer since they are concerned with punishment, not simply stripping away the profits of the defendant's wrongdoing.

On the basis of these differences between the two remedies, it would be unfounded to justify the unavailability of exemplary damages as a remedy for breach of contract by analogy to the reluctance of Australian courts to accept an account of profits as a remedy for breach of contract in exceptional circumstances as per *Attorney-General v Blake*. As sated above, the compensatory arguments, which attempt to justify exemplary damages as impermissible as a remedy for breach of contract, are flawed. Further, if an account of profits is unavailable as a remedy for breach of contract, then an award of exemplary damages can appropriately provide for the deterrence purpose that an account of profits aims to achieve.

IV AIMS OF EXEMPLARY DAMAGES

In Australia, exemplary damages serve three distinct purposes. *First*, they seek to punish or 'sting' defendants for their reprehensible behaviour.[149] *Secondly*, they seek to deter the wrongdoer or other like-minded individuals from committing the same wrongdoing in the future. *Thirdly*, they seek to vindicate the victim of the wrongdoing and to satisfy the urge for revenge felt by victims. Vindication also serves to express the court's disapproval of wrongful conduct. Those aims are shown to have relevant and significant application in the context of breaches of contract. It is argued that for that reason, exemplary damages should be made available for breaches of contract.

A *Punishment*

It is trite knowledge that exemplary damages aim to punish the defendant for their wrongdoing. It is that aim that some argue make the award of exemplary damages in private law inappropriate.[150] The element of punishment as a policy

[148] *Srother v 3464920 Canada Inc* [2007] SCC 24 at [156].
[149] *Digital Pulse Pty Ltd v Harris* (2002) 166 FLR 421 at [133].
[150] *Rookes v Barnard* [1964] AC 1129; Birch, above n 109, 431.

consideration, however, is deeply entrenched in our system of civil liability. Whilst the function of damages in civil law is explicitly compensatory, there is no doubt that the framework of our civil law incorporates punitive elements. Accordingly, where a defendant makes a reckless or deliberate breach of contract, thereby disappointing the expectations of the other contracting party or parties, the breaching party will deserve to be punished.

B *Deterrence*

The word 'exemplary', which is derived from the word 'example', by definition implies that exemplary damages serves to demonstrate to others that wrongdoing of a particular kind will not be tolerated by the courts. That is, exemplary damages act as a general deterrent, sending a message to the community at large.

The aim of deterrence may operate independently from punishment. This is particularly evident in tort cases [151] where insurance companies are substituted as the defendant and ultimately pay the damages for the plaintiff's loss.[152] For example in *Lamb v Cotogno*[153], the High Court stated that despite the fact that the compulsory third party motor vehicle insurance company would ultimately pay the damages, "the deterrent effect is undiminished for those minded to engage in conduct of a similar nature."[154] Although the legitimacy of punishment as an independent goal in private law has attracted criticisms, deterrence is commonly acknowledged as a legitimate goal of private law, in particular tort law, and has been referred to as "one of the most effective powers which a civil court has."[155]

Deterrence is sometimes necessary in the context of breaches of contract.

[151] See *Gray v Motor Accident Commission* (1998) 196 CLR 1 at 29, per Kirby J. This appears to be supported by Gleeson CJ, McHugh, Gummow and Hayne J at 11, in their references to principles of assessment.

[152] It should be noted that as part of the civil liability reforms, Australian jurisdictions have legislated to preclude awards of exemplary damages in many personal injury claims. For example, exemplary damages cannot be recovered for personal injury claims in negligence in New South Wales (under section 21 of the *Civil Liability Act 2002* (NSW)), the Northern Territory (under section 19 of the *Personal Injuries (Liabilities and Damages) Act 2003* (NT)), in Queensland (under section 52(1) of the *Civil Liability Act 2003* (Qld)), unless the harm was intentional - see section 52(2))or under the *Trade Practices Act 1974* (Cth), now section 18 of the Australian Consumer Law. Exemplary damages have also been abolished in respect of motor accidents (in New South Wales through section 81A of the *Motor Accidents Act 1988* (NSW) and section 144 of the *Motor Accidents Compensation Act 1999*, and in Victoria through section 93(7) of the *Transport Accident Act* 1986 (Vic), and in actions which survive for the benefit of a deceased plaintiff's estate (through the various administration and probate laws in each State/Territory).

[153] (1987) 164 CLR 1.

[154] *Lamb v Cotogno* (1987) 164 CLR 1 at 10.

[155] *Conway v INTO* [1992] 2 IR 305.

For example, in circumstances where the time for performance of the contract is yet to occur and other remedies are not available such as specific performance[156] of the contract, the threat of liability for damages will serve as the main legal deterrent to breach. Although the prospect of paying compensatory damages for breach will serve as a deterrent, the risk of liability for a much larger award of damages will presumably enhance the deterrence considerably.[157] Exemplary damages, as a last resort, will in effect top up damages in more extreme cases.

Those commentators in favour of the efficient breach of contract theory would argue that deterrence in the form of exemplary damages should not be applied to those breaches which leave no party in a worse position than if the contract had been performed, thereby achieving Pareto optimality. In that sense, the community benefits from the breach of contract. However, there are circumstances where the breach of contract would not offend the efficient breach of contract theory. For example, where the breach is a deliberate one, not to use resources more efficiently, but to harass the other party with whom the breaching party has been embroiled in an escalating series of personal squabbles. There are many other circumstances that could be stated. The point is, those cases which could easily be distinguished from effecting an efficient breach, should be deterred for the sake of promoting the sanctity of contract. Further, there will be some circumstances where, despite the breach being an efficient allocation of resources, compensatory damages will not be enough to fully compensate the victim of the breach. There may be cases where the gain that the defendant has obtained is greater than any award of compensatory damages payable to the victim of the breach.

Accordingly, the aim of deterrence of exemplary damages fits nicely with promoting the stability and predictability of contracts.[158]

C *Vindication*

The joint judgment in *Lamb v Cotogno* establishes that the purpose of exemplary damages is not limited to punishment or deterrence. The Court identified two other objectives. *First*, appeasement of the plaintiff, to "assuage any urge for revenge … and to discourage any temptation to engage in self-help

[156] See Smith, S A, *Contract Theory* 398-408 (2004), which critically examines explanations for the common law's reluctance to grant the 'secondary remedy' of specific performance.

[157] Charles Calleros, 'Punitive Damages, Liquidated Damages and Clauses Penale in Contract Actions: A Comparative Analysis of the American Common Law and the French Civil Code' (2006) 1180 *Bepress Legal Series* 25.

[158] The extent, however, to which exemplary damages for a civil wrong do act as a general deterrent is a hard question to answer and requires some empherical evidence. Some writers, such as Duggan, argue that exemplary damages should be confined to those wrongs which are hard to discover: see Anthony Duggan, "Exemplary Damages in Equity" (2006) 26 *Oxford Journal of Legal Studies* 303.

likely to endanger the peace".[159] Vindication seeks to squash a victim's need for revenge and to prevent victims from taking the law into their own hands. Historically, exemplary damages were thought to reduce the incidence of 'duelling'.[160] The High Court has acknowledged that whilst this rationale is likely to have had more weight in earlier times, it does remain influential.[161]

Secondly, "to mark the court's condemnation of the defendant's behaviour".[162]

Birch comments that vindication also operates to restore respect and strength to the law in the eyes of society.[163] This aim of vindication is demonstrable particularly in New Zealand, where under the broad state scheme of compensation for injury, compensation is provided no matter who is at fault.[164]

Vindication, however, has been referred to as a secondary purpose of exemplary damages,[165] leaving punishment and deterrence as the primary purposes. Beever argues that, "as a matter of principle, exemplary damages are not vindicatory" as the award of exemplary damages is not concerned with the rights of the plaintiff but is "expressing condemnation of the defendant."[166] While the aims of deterrence and punishment impact on the wrongdoer, vindication specifically impacts the victim. Witzleb and Carroll, however, say that by condemning the wrongdoer, the victim's rights are nevertheless vindicated, [167] making vindication *a* purpose of exemplary damages, albeit not an independent or primary rationale.

A further reason why vindication might be referred to as a secondary purpose of exemplary damages is the separation of exemplary damages from vindicatory damages.[168] Vindicatory damages have become a distinct category of damages in human rights cases for breaches of constitutional protected

[159] *Lamb v Cotogno* (1987) 164 CLR 1 at 9 - 10.
[160] *Wilkes v Wood* (1763) 98 ER 489.
[161] *Lamb v Cotogno* (1987) 164 CLR 1 at 9.
[162] *Lamb v Cotogno* (1987) 164 CLR 1 at 9 - 10. This was cited with approval by Speilgman CJ in *Harris v Digital Pulse Pty Ltd* at 311.
[163] Birch, above n 109, 433.
[164] See Accident Compensation Corporation, *The accident compensation scheme* (2004) http://www.acc.co.nz/about-acc/accident-compensation-scheme/ viewed 24 November 2012.
[165] Norman Witzleb, Robyn Carroll, 'The role of vindication in torts damages' (2009) 17 *Tort Law Review* 16 at 27.
[166] Allan Beever, 'The Structure of Aggravated and Exemplary Damages' (2003) 23 *Oxford Journal of Legal Studies* 87 at 98.
[167] Witzleb, Carroll, above n 165.
[168] Although, it is acknowledged that vindicatory damages have not yet been awarded outside the realm of constitutional law: *Lumba v Secretary of State for the Home Department* [2011] 2 WLR 671 at [99].

rights and freedoms.[169] The separation can be explained by two distinct differences.

First, the aim of vindicatory damages (and not exemplary damages) is to impact the victim, by rectifying violation of the victim's rights, and not the wrongdoer. The concept of vindicatory damages was first adopted by the Privy Council in *Attorney General of Trinidad and Tobago v Ramanoop*[170] in the context of a serious violation of a fundamental right by a police officer. It was held that, "When exercising this constitutional jurisdiction the court is concerned to uphold, or vindicate, the constitutional right which has been contravened."[171]

Secondly, whilst there is overlap between the aims of the two forms of damages, both being gap-filling remedies to "reflect a sense of public outrage…and deter further breaches"[172], unlike exemplary damages, vindicatory damages do not seek to punish the wrongdoer. The Privy Council in *Ramanoop* made this clear at [19]:

> Although such an award, were called for, is likely in most cases to cover much the same ground in financial terms as would an award by way of punishment in the strict sense of retribution, punishment in the latter sense is not its object. Accordingly, the expressions "punitive damages" or "exemplary damages" are better avoided as descriptions of this type of additional award.[173]

The purpose of vindicatory damages was again emphasised by the Privy Council in the subsequent case of *Merson v Cartwright and Another*[174], a case in which the plaintiff claimed damages for assault and battery, false imprisonment, malicious persecution and contravention of her constitutional rights. The Privy Council said at [18], the purpose of a vindicatory award:

> …is not a punitive purpose. It is not to teach the executive not to misbehave. The purpose is to vindicate the right of the complainant, whether a citizen or visitor, to carry on his or her life in the Bahamas free from unjustified inference, mistreatment or oppression.[175]

[169] *Lumba v Secretary of State for the Home Department* [2011] 2 WLR 671 at [97]; *Attorney General of Trinidad and Tobago v Ramanoop* [2006] 1 AC 328; *Merson v Cartwright* [2006] 3 LRC 264.

[170] [2006] 1 AC 328.

[171] *Attorney General of Trinidad and Tobago v Ramanoop* [2006] 1 AC 328 at [18].

[172] Lord Nicholls in *Attorney General of Trinidad and Tobago v Ramanoop* [2006] 1 AC 328 at [19] did not deny that *"[vindicatory damages]…is likely in most cases to cover much the same ground in financial terms*" as exemplary damages. Vindicatory damages must "*reflect the sense of public outrage, emphasise the importance of the constitutional right and the gravity of the breach, and deter further breaches*."

[173] *Attorney General of Trinidad and Tobago v Ramanoop* [2006] 1 AC 328 at [19].

[174] [2006] 3 LRC 264.

[175] *Merson v Cartwright and Another* [2006] 3 LRC 264 at [18].

Despite vindication being a secondary purpose of exemplary damages, as opposed to an independent or primary rationale, it's interrelationship with the aims of punishment and deterrence makes vindication an important component of exemplary damages, nonetheless.

Of course, most will agree that purely inadvertent or innocent breaches of contract, such as those arising from non-culpable oversight, miscalculation or inability to fulfill contractual obligations despite best efforts; do not merit vindication beyond compensatory damages. The aim of vindication, applied in the form of awarding exemplary damages, should be reserved for those exceptional cases of deliberate and reckless breaches. Accordingly, the test of awarding exemplary damages for breaches of contract may incorporate asking the question whether some highly culpable breaches of contract would sufficiently offend community values as to justify vindication in the form of exemplary damages. Professor Henry Mather would find so where there is "damage to social trust and to the practice of contracting" and in any case of "clearly knowing and intentional breach" of contract, subject only to a narrow exception for breaches that were compelled by the need to perform a "higher moral duty to a third person".[176]

V EXEMPLARY DAMAGES IN OTHER JURISDICTIONS

A *United Kingdom and the Privy Council*

The current position in England is that exemplary damages are limited to the circumstances set out in the categories test in *Rookes v Barnard*. Although some recent cases would suggest that Lord Devlin's second category is now irrelevant as the employment of restitutionary damages in contract, such as an account of profits, renders it unnecessary.[177] Nevertheless, despite there being a more expansive approach to exemplary damages, as taken by the House of Lords in *Kuddus*, the state of the law on exemplary damages in England remains unsatisfactory. In a purely contractual action, the general rule, since the early twentieth century, is that exemplary damages are not available.[178] Exemplary damages are not available even though the breach was committed deliberately and with a view to profit.[179] If, however, a plaintiff has a cause of action in both

[176] Henry Mather, *Contract Law and Morality* (Westport, Connecticut and London: Greenwood Press, 1999) 119.

[177] *Kuddus v Chief Constable of Leicestershire* [2002] 2 AC 122 per Lord Scott; cf *Design Progression Ltd v Thurloe Properties* [2005] WLR 1, where the defendant's design to achieve profits failed.

[178] *Addis v Gramophone Co Ltd* [1909] AC 488.

[179] The question has been examined in detail by the England and Wales Law Commission: Law Commission, *Aggravated, Exemplary and Restitutionary Damages* (Law Commission Report No. 247, 1997), where it recommended that exemplary damages should not be available for breach of

tort and for breach of contract, then they may be able to recover exemplary damages by framing the claim in tort.

The Law Commission's Report of 1997 states that civil punishment has an important and distinctive role to play in the law and has recommended that, exemplary damages be retained and expanded from their current very limited presence in the law.[180] Further, cases arise, from time to time, which demonstrate that exemplary damages for breach of contract are necessary. An example of such a case is *Wrotham Park Estate Co Ltd v Parkside Homes Ltd*[181]. In that case, the defendant built houses on its own land in a flagrant breach of a restrictive covenant with the plaintiff. The plaintiff sued for breach of the covenant. Brightman J awarded £2500 damages, or 5% of the anticipated profits of the defendant under the Lord Cairns' Act jurisdiction.[182] Arguably, justice was not served as the Court refused to make an order, for social and economic grounds, to demolish the houses built. If exemplary damages were available for breach of contract, it may have deterred the defendant's breach of covenant in the first place. This case is also a good example of exemplary damages being available in lieu of the Court's refusal to grant another remedy such as an injunction. Accordingly, the application of exemplary damages in England needs to be reviewed to properly cater to such cases as *Wrotham* and *Attorney-General v Blake*.

A suggestion that English courts might be bold enough to recognise a role for exemplary damages in the law of contract can be seen in *A v Bottrill*[183]. In that case, the Privy Council was asked to consider whether, under the law of New Zealand, exemplary damages were available for a medical malpractice suit arising from the defendant physician's gross misreadings of cervical smears, which resulted in the plaintiff delaying her treatment. The defendant physician was found not to have been guilty of knowing or reckless wrongdoing, but was extremely culpable. The trial court awarded exemplary damages, which the New Zealand Court of Appeal reversed. The Privy Council restored the trial court's judgment on the basis that the Court of Appeal of New Zealand was wrong to hold that intentional misconduct or conscious recklessness was an essential prerequisite of the court's jurisdiction to award exemplary damages. [184]

Although this was a negligence case, relevantly, Lord Nicholls recited his earlier sentiments in *Kuddus* that the availability of exemplary damages should

contract (at 1.17-1.73); see also *Occidental Worldwide Investment Corporation v Skibs A/S Avanti (The Siboen and The Sibotre)* [1976] 1 Lloyd's Rep 293.

[180] The Law Commission, above n 17, 1.288.

[181] [1974] 2 All ER 321.

[182] *Wrotham Park Estate Co Ltd v Parkside Homes Ltd* [1974] 2 All ER 321 at 342.

[183] [2003] 1 AC 449.

[184] *A v Bottrill* [2003] 1 AC 449 at 465.

be co-extensive with its rationale,[185] which is "exceptionally, a defendant's conduct is so outrageous that an order for payment of compensation is not an adequate response. Something more is needed from the court, to demonstrate that such conduct is altogether unacceptable to society."[186] A question that arises from this statement is, can an award of exemplary damages for breach of contract ever be co-extensive with its rationale? Cases like *Attorney-General v Blake,* which demonstrates the role of non-compensatory remedies in the context of actions for breach of contract, would suggest that it is. In this regard, the application of Lord Nicholls remarks in *Bottrill*, "*"Never say never" is a sound judicial admonition*,"[187] is appropriate.

B *United States*

Exemplary damages in the United States are generally a matter of state law (although they can also be awarded under Federal maritime law). As such, the position on whether America is ill-disposed towards awarding exemplary damages in contract law is not clear cut. Exemplary damages differ in application from state to state. In many states, including California and Texas, exemplary damages are determined based on statute. Elsewhere, they may solely be determined based on case law. Many of the state statutes are the result of the insurance industry lobbying to impose caps on exemplary damages.

Although the United States is well recognised for awarding extravagant exemplary damages awards in tortious actions, most jurisdictions in the United States adhere to the traditional common law rules against awarding exemplary damages for breach of contract, if the breach neither constitutes nor is accompanied by a tortious act.[188]

There are, however, a handful of American states that do permit exemplary damages for breach of contract in circumstances where the breach is accompanied by a certain level of culpability or by certain tortious elements, regardless of whether all the elements of an independent tort have been pleaded. This is usually only for exceptional cases where the court wants to give a strong message to the community that similar conduct will not be tolerated. The juries decide the quantum of the exemplary damages to be awarded. [189]

Exemplary damages have been awarded in American states in the following circumstances:

[185] Similar sentiments are also expressed by commentators: Harvey McGregor, *McGregor on Damages* (London: Sweet & Maxwell, 2003) 373; Ewan McKendrick, *Contract Law*, (London: Palgrave, 6th ed, 2005) 404; Mindy Chen-Wishar, *Contract Law* (Oxford: Oxford University Press, 2005) 530.
[186] *A v Bottrill* [2003] 1 AC 449 at 455.
[187] *A v Bottrill* [2003] 1 AC 449 at 456.
[188] *The Restatement (Second) of Contracts* (1981) at [355].
[189] Calleros, above n 157.

a) whenever the "elements of fraud malice, gross negligence or oppression mingle" with the contract breach;[190]
b) where "the breach of a contract, [is]committed with fraudulent intent, and accompanied by a fraudulent act;"[191] and
c) where there is a "malicious breach of contract, or one that reflects a wanton disregard of the other party's rights".[192]

C *Canada*

Canada has taken a more liberal approach towards awarding exemplary damages for breach of contract. The irrationalities of Lord Devlin's categories also led to their rejection in Canada.[193] The current position is that exemplary damages are available for breach of contract where the crucial prerequisite for an award is that the inadequacy of compensatory damages is satisfied.[194]

The test of inadequacy was established in the case of *Whiten v Pilot Insurance Co*[195]. In that case, Mrs Whiten had purchased a fire insurance policy on her house. The house burnt down and was a total loss. Mrs Whiten made a claim under the insurance policy. The defendant insurer made some small initial payments and then refused to pay any more, claiming the family was in financial difficulty and had deliberately lit the fire. This was despite, however, evidence to the contrary from the local fire chief,[196] the insurer's own expert investigator and an outside expert retained by the insurer, that there was no evidence of any arson.

The Supreme Court restored a jury award of $1 million in exemplary damages, which the Ontario Court of Appeal allowed in part but reduced to $100,000.[197] Binnie J said that "the obligation of good faith dealing meant that [Mrs Whiten's] peace of mind should have been the insurance company's objective, and her vulnerability ought not to have been aggravated as a negotiating tactic. It was this relationship of reliance and vulnerability that was

[190] *Vernon Fire & Casualty Inc. Co v Sharp,* 349 NE2d 173, 180 (Ind. 1976).
[191] *Taber v Hutson*, 5 Ind. 332, 334 (1854); *Wright v Pub Sav Life Ins. Co* 204 SE2d 57, 59 (SC 1974).
[192] *Bank of New Mexico v Rice*, 429 P2d 368 (NM 1967).
[193] *Vorvis v Insurance Corporation of British Columbia* [1989] 1 SCR 1085.
[194] *Whiten v Pilot Insurance Company* (2002) 209 DLR (4th) 257 at 295 and 303; *Royal Bank of Canada v W Got & Associate Electric Ltd* (2000) 178 DLR (4th) 385 at 395. The inadequacy of damages test also applies in English law in regard to exemplary damages in tort: *Rookes v Barnard* [1964] AC 1129, 1228; *Kuddus v Chief Constable of Leicestershire Constabulary* [2002] 2 AC 122 at 144, 161.
[195] (2002) 209 DLR (4th) 257.
[196] *Whiten v Pilot Insurance Co* (2002) 209 DLR (4th) 257 at 265.
[197] *Whiten v Pilot Insurance Company* (2002) 209 DLR (4th) 257 at 265.

outrageously exploited by [the insurer]."[198]. The Court concluded that the insurer had breached the contractual duty of good faith in addition to the contractual duty to pay loss. The Supreme Court went on to say that, "[g]iven the nature of the contract, bad faith may constitute an actionable wrong and attract the sting of punitive damages."[199] In the consideration of awarding exemplary damages, the Court applied the *Rookes v Barnard* "'if but only if' model, i.e., [exemplary] damages should be awarded 'if but only if' the compensatory award is insufficient."[200] [201]

In *Vorvis v Insurance Corporation of British Columbia*[202], the Supreme Court confirmed that exemplary damages were to be allowed for a breach of contract, but qualified the application by imposing a requirement that the breach of contract must also be accompanied by an independent tortious act.[203] The comments by Wilson J (albeit dissenting) in *Vorvis*, take further the proposition that exemplary damages should be available for a breach of contract without the qualification that the breach of contract must be independent of a finding of separate tortious liability. The learned judge observed:

> I do not share my colleagues' view that punitive damages can only be awarded when the misconduct is in itself an 'actionable wrong'. In my view, the correct approach is to assess the conduct in the context of all the circumstances and determine whether it is deserving of punishment because of its shockingly harsh, vindictive, reprehensible or malicious nature. Undoubtedly some conduct found to be deserving of punishment will constitute an actionable wrong but other conduct may not.[204]

Some recent support for Wilson J's approach in *Vorvis* stems from a more recent Canadian Supreme Court decision, *Royal Bank of Canada v W Got & Associates Electric Ltd*[205]. The *Got* decision is a watershed decision by a unanimous court and confirms the Canadian position that exemplary damages may be available for breach of contract actions independent of any finding that

[198] *Whiten v Pilot Insurance Company* (2002) 209 DLR (4th) 257 at 306.
[199] *Whiten v Pilot Insurance Company* (2002) 209 DLR (4th) 257 at 315.
[200] *Whiten v Pilot Insurance Company* (2002) 209 DLR (4th) 257 at 305.
[201] The decision in *Whiten* should be contrasted with that in *Sylvan Lake Golf and Tennis Club Ltd v Performance Industries Ltd* (2002) 209 DLR (4th) 318 (decided on the same day). In that case, the Supreme Court declined to award exemplary damages. The case concerned a written agreement to purchase a golf course, which, by virtue of the defendant's fraud, did not reflect the earlier oral agreement for the purchase. In holding that compensatory damages plus costs were an adequate remedy, it was significant to the Court that the contract was between businessmen who were equals.
[202] (1989) 58 DLR (4th) 193.
[203] *Vorvis v Insurance Corporation of British Columbia* (1989) 58 DLR (4th) 193 at [55]-[56].
[204] *Vorvis v Insurance Corporation of British Columbia* (1989) 58 DLR (4th) 193 at 207-208, [59].
[205] (1999) 178 DLR (4th) 385.

a tort was also committed.[206] There are some qualifications on this proposition. The Canadian Supreme Court acknowledged that this decision is an exceptional one and exemplary damages in this situation should only be available where other remedies are inadequate to effect deterrence.

Given the exceptional factual matrix of *Got*, it is worth briefly setting out the facts of the case. The claimant bank ordered the defendant, Got, to repay a loan without giving reasonable notice. The bank then applied to the court for a motion to appoint a receiver. The master granted the order in reliance on a misleading affidavit tendered by the bank which created a 'false air of urgency'. Got's complaint arose because the Bank intentionally cut off contact with Got at this time and avoided notifying Got of the appointment of the receiver.

After the sale of Got's assets, the Bank sued for, and recovered its debt. However, Got counterclaimed for breach of contract and conversion, based on the Bank's failure to give reasonable notice in demanding payment and appointing a receiver. On the counterclaim, the bank was held liable for breach of contract and Got was awarded compensatory damages.

In addition to this compensatory sum, Got received punitive damages due to the manner in which the breach of contract was committed. Edelman helpfully summaries the reasons for which the trial judge awarded exemplary damages and which was ultimately upheld by the Canadian Court of Appeal.[207] They are that:

a) the court will not condone a clear violation of the rule of law that requires a debenture-holder to give reasonable notice;
b) the court will not condone an abuse of its process for commercial advantage;
c) because no crime had been committed, no other form of punishment was available;
d) the Bank's conduct caused grave and irrevocable consequences to the business of its client; and
e) courts are entitled to expect honest behaviour from the major chartered banks.[208]

Since *Got*, there have been two significant Canadian cases, which some might argue refine the approach Canadian courts may take in awarding exemplary damages for breach of contract. The first is *Filder v Sun Life Assurance Co of*

[206] Linden J in *Brown v Waterloo Regional Board of Commissioners of Police* (1982) 37 OR (2d) 277 had already made some observations that exemplary damages should be awarded in situations where a contract has been breached in "*high-handed, shocking and arrogant fashion.*" He expressed puzzlement that exemplary damages would be available where an individual breached a contractual duty in a why which involved a concurrent breach of tort duty while exemplary damages would not be available if not such concurrent breach had occurred.

[207] *Royal Bank of Canada v W Got & Associates Electric Ltd* (1999) 178 DLR (4th) 385 at 395.

[208] Edelman, above n 112 at 540.

Canada[209]. Like *Whiten*, *Filder* was a case concerning an insurer's bad faith refusal of an insurer's claim. The plaintiff was a bank receptionist diagnosed with chronic fatigue syndrome and fibromyalgia. The insurer paid long-term disability benefits for about seven years, which benefits were eventually terminated following video surveillance detailing the plaintiff performing activities inconsistent with her claim that she was incapable of performing light or sedentary work. The only issue at trial was the plaintiff's entitlement to exemplary and aggravated damages.

The trial judge awarded the plaintiff $20,000 in aggravated damages for mental distress, but refused to make a finding of bad faith and dismissed her claim for exemplary damages.[210] The British Columbia Court of Appeal unanimously upheld the $20,000 award for mental distress damages and two of the three judges of the Court of Appeal allowed her cross-appeal and awarded her $100,000 in exemplary damages, finding that the disability insurer had demonstrated bad faith in handling the plaintiff's claim.[211] The Supreme Court of Canada restored the trial judge's decision, holding that while the insurer's decision was "extremely troubling",[212] the trial judge had properly assessed and weighed the evidence and his conclusions that there had not been a bad faith handling of the claim were not unreasonable.

Buller, however, comments that bad-faith insurance cases can be distinguished from the egregiousness of the insurer's conduct in *Whiten*.[213] *Filder* is one such case. Buller states, "In *Whiten*, there was no question that the loss for which insurance proceeds were claimed had occurred. The house had burnt down. The sole issue was one of causation of loss, was the fire accidental or deliberately lit by the plaintiffs?"[214] By contrast, in *Filder*, there was an absence of supporting medical evidence and reliance on inconclusive video surveillance, which begs the question, was there even a loss? Illnesses like fibromyalgia or chronic fatigue syndrome are subjective. As such, cases like *Filder*, in which the question is, whether due to illness or injury there has been a loss of the ability to sustain one's own occupation or otherwise any occupation, largely depend on an assessment of the plaintiff's credibility.

Buller says, "without objective evidence of loss, which there clearly was in the Whiten case, disability insurance claims adjusters struggle as the court do to determine if insurance benefits are payable. When they deny such a subjective claim and are ultimately found to have been wrong in doing so by a court, it seems unduly hard to apply an additional sanction in the form of punitive

[209] [2006] 2 SCR 3 (Supreme Court of Canada).
[210] *Filder v Sun Life Assurance Co of Canada* [2006] 2 SCR 3 (Supreme Court of Canada) at [1].
[211] *Filder v Sun Life Assurance Co of Canada* [2006] 2 SCR 3 (Supreme Court of Canada) at [24].
[212] *Filder v Sun Life Assurance Co of Canada* [2006] 2 SCR 3 (Supreme Court of Canada) at [71].
[213] Rudy Buller, 'Whiten v Pilot: Controlling Jury Awards of Punitive Damages' (2003) 36:2 *UBC Law Review* 357 at 368.
[214] Buller, above n 213.

damages."[215]

In refusing to award exemplary damages in *Connor v Sun Life Assurance Co. of Canada*[216], the Ontario Supreme Court applied this logic:

> The very nebulous nature of the chronic pain condition that Mr. Connor suffers has been a factor. It is a difficult condition to pinpoint, to prove, because of its lack of objective indicators and because medical science appears to be still struggling to identify its features and treatments – its legitimacy.[217]

The result of this is that exemplary damages awards by Canadian courts in subjective disability insurance cases will likely be rare and will occupy only a small section of exceptional cases where exemplary damages will be awarded in contract. Thus, the denial of exemplary damages awards in *Filder* and other bad-faith insurance cases with similar factual scenarios should not be taken as an indication that "*the pendulum is swinging back to some degree*".[218]

Further, even in a subjective case, if all the evidence points to a total disability and the insurer remains willfully blind to such evidence, then exemplary damages may be appropriate.[219] One such example is *Adams v Confederation Life Insurance Co*[220]. The insurer terminated the insured's disability benefits on the basis of its unilateral determination of entitlement made in defiance of medical reports contrary to its view and without exercising its right to an independent medical examination. The insurer terminated the benefits without giving the insured an opportunity to respond. The court awarded exemplary damages of $7,500.[221]

More recently, the Supreme Court of Canada's unanimous decision in *Bhasin v Hrynew*[222] has been making headlines since its release, predominantly for the fact that it creates a duty of honest contractual performance. The decision also raises a myriad of other interesting legal issues, one of which is whether the award of exemplary damages is still permissible for egregious breaches of contract.

In *Bhasin,* Canadian-American Financial Corp. (**Can-Am**) was in the business of marketing education savings plans through retail dealers. Mr Bhasin and Mr Hrynew were major competitors for the retail sale of Can-Am's marketing education savings plans in Alberta. Bhasin was not an employee nor

[215] Buller, above n 213, 369.
[216] (29 June 2000) Simcoe 976-97.
[217] Buller, above n 210, 369.
[218] N Kent, 'Insurance Bad Faith Litigation: Recent Developments and Interest Issues Arising from the Supreme Court of Canada Decisions in Whiten and Fidler' (2008) 34 *The Advocates Quarterly* 133 at 150.
[219] Buller, above n 210, 369.
[220] (1994) 18 Alta LR (3d) 324 QB.
[221] *Adams v Confederation Life Insurance Co* (1994) 18 Alta LR (3d) 324 QB at [74].
[222] (2014) SCC 71.

a franchisee of Can-Am. Rather, their working relationship was governed by a commercial dealership agreement, which lasted for three years, and contained a provision that would automatically renew the Agreement for another three-year term unless one of the parties gave six months' written notice to the contrary. Mr Hrynew wanted to capture Bhasin's market, and personally proposed a merger of their two agencies on numerous occasions. Mr Hrynew eventually moved his agency to Can-Am and successfully pressured Can-Am not to renew its agreement with Bhasin. Although the Court eventually found no wrongdoing on the part of Mr Hyrnew, the Court found that Can-Am although within its contractual rights to refuse to renew Mr Bhasin's contract, lied to Mr Bhasin about the circumstances surrounding its decision not to renew and thereby "*acted dishonestly toward Bhasin in exercising the non-renewal clause*"[223] breaching its contractual duty to perform the agreement honestly.

Mr Bhasin was not awarded exemplary damages, but only contractual expectation damages equaling the value of his agency at the time of non-renewal in the sum of $87,000[224], namely, to put Mr Bhasin in the position he would have been in had Can-Am not breached its obligation to behave honestly about the process of renewing the contract. The decision in *Bhasin* does not provide much guidance on whether exemplary damages could be awarded for particularly egregious breaches of honest contractual performance. However, the very nature of a breach of duty of honest performance is an intentional breach of contract with negative overtones of 'dishonesty' and 'lack of candour'. In the writer's opinion, it is possible that particularly flagrant failures to adhere to the duty may give rise to an award of exemplary damages.

Such a sentiment has been recognised by the Ontario Superior Court of Justice (Small Claims Court) in *Bray v Canadian College of Massage and Hydrotherapy*[225]. Ms Bray worked for the College for nine years as an instructor teaching classes and supervising clinics and outreach programs. Upon Ms Bray's return from a pregnancy/parental leave, the College reduced her hours and then failed to assign her any courses to teach during the following semester. Ms Bray sued for wrongful dismissal, damages for discrimination under the Ontario Human Rights Code, damages for reprisal under the *Employment Standards Act, 2000*, aggravated damages and punitive damages based upon a breach of the duty of good faith in the performance of the employment contract as recently affirmed in *Bhasin*.

The College claimed that it had reduced Bray's weekly hours to zero as a form of discipline because of a complaint it received in September 2013, and about which it never told Bray. The complaint was hearsay, in which a former

[223] *Bhasin v Hrynew* (2014) SCC 71 at [94].
[224] *Bhasin v Hrynew* (2014) SCC 71 at [111]-[112].
[225] (2015) 249 A.C.W.S. (3d) 349.

student had allegedly complained about Bray leaving a class early on one occasion. The College had made no effort to investigate the complaint. The Court found that, if the College did in fact punish Bray for this complaint without explaining it to her or conducting any investigation, the punishment was totally disproportionate and the College's actions, were a violation of the duty to perform one's contractual duties in good faith, as recently established in *Bhasin*. The Court awarded Ms Bray punitive damages of $5,000.[226] Thus, the court offered the proposition, which remains to be considered by higher Canadian courts that, exemplary damages may be awarded for breach of the duty of good faith in the performance of an employment contract.

Accordingly, Canada remains the only Commonwealth jurisdiction which has taken a consistent stance that exemplary damages are available for breaches of contract.

VI Lessons from comparative analysis and projections for the future of exemplary damages

The question that the Canadian decisions pose for the Australian courts is whether it is now time to recognise that some breaches of contract should be deterred and that there are situations where compensatory damages and other remedies such as injunctive relief or specific performance are inadequate for this purpose. In other words, should the Australian courts dispense with its previous qualifications on the application of exemplary damages and simply impose the Canadian test of inadequacy of compensatory damages?

Australian courts have, from time to time, commented that the application of exemplary damages needs to be reviewed and left open that possibility. For example, Wilcox J in the Federal Court of Australia decision in *Flamingo Park Pty Ltd v Dolly Dolly Creation Pty Ltd*[227], did not dismiss the possibility, albeit the learned judge was of the view (by obiter dicta) that:

> …[it] would probably be a rare event; and if it arose it would be a matter of public policy for the courts to determine whether it was appropriate to extend what some see as an anomaly - punishment in a civil action - from tort into contract law.[228]

The majority of the High Court in *Gray v Motor Accident Commission* suggested that it might be prepared, if invited, to undertake some radical change in the law, so as to address the well-known anomalies in exemplary damages.[229] The High Court indicated that the anomalies are deeply rooted[230]

[226] *Bray v Canadian College of Massage and Hydrotherapy* (2015) 249 A.C.W.S. (3d) 349 at [78].
[227] (1986) 65 ALR 500.
[228] *Flamingo Park Pty Ltd v Dolly Dolly Creation Pty Ltd* (1986) 65 ALR 500 at 526.
[229] *Gray v Motor Accident Commission* (1998) 196 CLR 1 at 5.
[230] *Gray v Motor Accident Commission* (1998) 196 CLR 1 at 5.

and the tension in using civil proceedings to both compensate and punish might be "more apparent than real".[231] In this regard, the Court pointed to the "increasing frequency with which civil penalty provisions are enacted."[232]

The High Court has also hinted at its possible receptivity to awarding exemplary damages in contract by the comments in *Uren v John Fairfax and Sons Pty Ltd* that:

> [I]f it appeared that, in the commission of the wrong complained of, the conduct of the defendant had been high-handed, insolent, vindictive or malicious or had in some other way exhibited a contumelious disregard of the plaintiff's rights[233] [then] damages may be given of a vindictive and uncertain kind, not merely to repay the plaintiff for temporal loss but to punish the defendant in an exemplary manner for his outrageous conduct.[234]

Edelman notes that the House of Lords have already recognised that there is sometimes a need to deter breaches of contract.[235] For example, in *Attorney-General v Blake*, in a related context, the House of Lords held that an account of profits, which operates to deter wrongdoing by striping profits from a defendant, could be awarded in exceptional circumstances where the defendant had a "legitimate interest" in performance.[236] Edelman extrapolates from that case, and rightly so, that the test as to when those circumstances would exist is precisely the same test suggested in *Got* for the award of exemplary damages - the test of other remedies being inadequate.[237] The inadequacy of compensatory damages test also mirrors the test of application of exemplary damages in tort actions that is presently available in England.[238]

Further, the statutory codification analogous to exemplary damages such as that in the *Copyright Act* is an important development in Australian law which suggests potential movement towards the availability of exemplary damages for breaches of contract and equitable duties as suggested by Palmer J in *Digital Pulse v Harris*. This dispels the suggestion by some courts, as exemplified by Lord Devlin's comments in *Rookes v Barnard* that, there is no continuing justification for their existence.

If exemplary damages are to be available to deter breaches of contract in the most exceptional circumstances, what then, are those exceptional circumstances? The Law Commission provides some guidelines to reduce the

[231] *Gray v Motor Accident Commission* (1998) 196 CLR 1 at 7.
[232] *Gray v Motor Accident Commission* (1998) 196 CLR 1 at 7.
[233] *Uren v John Fairfax & Sons Pty Ltd* (1966) 117 CLR 118 (Taylor, J. at ¶ 4).
[234] *Uren v John Fairfax & Sons Pty Ltd* (1966) 117 CLR 118 (Menzies, J. at ¶ 15).
[235] Edelman, above n 112, 543.
[236] *Attorney-General v Blake* [2000] 1 AC 268 at 285.
[237] James Edelman, 'Profits and Gains from Breach of Contract' [2001] *Lloyd's Maritime and Commercial Law Quarterly* 9.
[238] *Rookes v Barnard* [1964] AC 1129 at 1226-1227, 1179, 1197, 1203 and 1238.

uncertainty in the assessment of exemplary damages.[239]

First, the application of exemplary damages should continue to be moderate and exceptional. *Secondly*, the following list of factors should be considered when awarding exemplary damages:

a) the role of assessing the amount of exemplary damages should fall on judges and not a jury,[240] as judges can apply a greater measure of consistency.[241]
b) judges should develop a non-exhaustive list of factors to consider when assessing the quantum of exemplary damages;[242] and
c) a guiding principle of 'proportionality of punishment' should also serve to promote consistency and rationality in assessment of awards.[243]

By those comments from Australian judges in recent times, it is clear that there is a yearning for a re-examination of the application of exemplary damages in general, and particularly in contract.

VII CONCLUSION

It is now time for Australian courts to combat the issue of whether exemplary damages should be available for breach of contract actions. Five propositions emerge from this article in support of the argument that exemplary damages should be available for breach of contract. Those propositions, in summary, are:

1. the historical justifications for the Courts not extending the availability of exemplary damages to breach of contract actions are weak and unpersuasive and do not stand up to scrutiny;
2. some Australian statutes are already expressly legislating for awards of damages analogous to exemplary damages, which suggests potential movement towards the availability of exemplary damages for breaches of contract;
3. the aims of exemplary damages - punishment, deterrence and vindication - are applicable to and can be fulfilled in the context of contract;
4. the pull of the Canadian approach to exemplary damages is powerful and should be emulated in Australia; and
5. there are comments and invitations made by Australian courts to the effect that the 'anomaly' that is exemplary damages and their application

[239] The Law Commission, above n 17, 1.30.
[240] See also *Australian Consolidated Press Ltd v Ettingshausen* (unreported, Supreme Court of NSW, 13 October 1993).
[241] The Law Commission, above n 17, 1.32(1).
[242] The Law Commission, above n 17, 1.32(2).
[243] The Law Commission, above n 17, 1.32(3).

> to breaches of contract is a matter which finally needs to be re-examined and addressed.

Australian courts should be allowed a broad scope to enforce exemplary damages. The Australian principles for the application of exemplary damages should align more with the principles of *Got*. The result being that exemplary damages would be, at the very least, theoretically permissible for deliberate, intentional and reckless breaches of contract. Ultimately, for the reasons set out in this article, the state of the law on exemplary damages in Australia needs to be reconsidered by the Australian courts.