A FRAMEWORK FOR THE VALUATION OF LOSS OF A COMMERCIAL OPPORTUNITY

BEN CURTIN

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Statement of originality

This is to certify that to the best of my knowledge, the content of this thesis is my own work. This thesis has not been submitted for any other degree or purpose. This further certifies that the intellectual content of this thesis is my own work, and that any assistance and sources used have been acknowledged.

Parts of chapter seven of this thesis have been published in the following refereed journal article:

Johnstone, David and Ben Curtin, 'Damages for negligent valuation of mortgage securities: A finance theory perspective', (2012) 30 *Company & Securities Law Journal* 476–92.

Ben Curtin
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Dedication

To Gerald, Clare, Kristen, Joseph and William

In memory of
Geoffrey Edward Hart 31.7.1947–21.7.2016
a friend and colleague

Acknowledgments

I would like to thank my supervisor, Professor David Johnstone, for his support, guidance, and comments. Accommodating an inter-disciplinary thesis is a major exercise, and Professor Johnstone discharged that task with patience and grace. His contribution to this thesis has been substantial.

I would also like to thank my wife, Kristen, for her comments on the legal issues and structure of the thesis. She allowed me to devote a significant amount of time to writing the thesis, and for that I am grateful.

Abstract

This thesis examines the valuation of loss of a commercial opportunity in a damages context. The object of the thesis is to consider the legal doctrine of loss of a commercial opportunity and to develop a general legal framework for the valuation of this type of loss, that is based on, and consistent with, the financial theory of valuation. This framework rests on the argument that, in principle, the loss of a commercial opportunity should be valued by reference to its market value, where market value is either observable or estimated theoretically.

The thesis comprises three main Parts. Part one examines two things by way of introduction. First, it examines the role of financial valuation theory in the assessment of damages for economic loss in a commercial context. Secondly, it examines the legal doctrine of loss of a commercial opportunity. The object of this Part is to provide the foundation for the analysis contained in Parts two and three.

Part two examines the legal principles relevant to the fact, character and valuation of loss of a commercial opportunity. The object of this Part is to analyse the legal principles and to develop a general legal framework for the valuation of this type of loss.

Part three contains a case study. The case study applies the valuation framework developed in Parts one and two to the valuation of the loss of a lending opportunity, being a particular type of loss of commercial opportunity. The object of the case study is to demonstrate the utility of the valuation framework and, more generally, to demonstrate the importance of finance theory in providing a coherent and rigourous theoretical framework with which to value the loss of a commercial opportunity.

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Abbreviations

Abbreviations

The following abbreviations are used in this thesis.

ACL = CCA, Schedule 2, Australian Consumer Law

CCA = *Competition and Consumer Act (2010)* (Cth)

CAPM = capital asset pricing model

DCF = discounted cash flow

TPA = *Trade Practices Act (1974)* (Cth)

WACC = weighted average cost of capital

References to ACL

On 1 January 2011, the TPA was renamed the CCA, and the ACL was inserted as Schedule 2 of the CCA. Sections 52(1) and 82(1) of the TPA were repealed and replaced by ss 18(1) and 236(1) of the ACL, in similar but not identical terms.

For consistency and ease of reference, references in case law to ss 52(1) and 82(1) of the TPA have been replaced with references to ss 18(1) and 236(1) of the ACL, where appropriate.

Part 1

Introduction

Chapter 1

Introduction

'For the rational study of the law the black-letter man may be the man of the present, but the man of the future is the man of statistics and the master of economics'
(Oliver Wendell Holmes)[1]

Introduction

Purpose and structure

This chapter introduces the thesis topic and outlines the subject matter. The chapter is divided into two main sections. The first section outlines the topic and the justifications for conducting this research. The second section contains an overview of the thesis and the approach to and limitations of the thesis.

The topic

Scope of topic

Introduction

This thesis examines the valuation of loss of a commercial opportunity in a damages context. The object of the thesis is to consider the legal doctrine of loss of a commercial opportunity and to develop a general legal framework for the valuation of this type of loss, that is based on, and consistent with, the modern financial theory of valuation. This framework rests on the argument that, in principle, the loss of a commercial opportunity should be valued by reference to its market value or to theoretical proxies for market value (where observed or traded market value do not exist). The topic is bounded in several respects.

[1] Oliver Wendell Holmes, 'The Path of the Law' (1897) 10(8) *Harvard Law Review* 457, 469.

Economics, and in particular finance theory, offers a highly developed theory for the measurement of economic values and losses, and the intention of this thesis is to give finance theory an *explicit* role in the valuation of loss in a legal context. The thesis will introduce the fundamentals of finance theory into the valuation of loss in this context, including, discounted cash flow, opportunity cost, the cost of capital, and risk-adjusted discounting.

The thesis contains a case study on the valuation of loss of a lending opportunity, being a particular type of loss of commercial opportunity. The case study is used to demonstrate the utility of the valuation framework developed in Parts one and two of the thesis, and to exhibit the use of financial concepts and logic and in a legally practical and important context.

Damages

In general terms, damages may be defined as 'an award in money for a civil wrong.'[2] The thesis is concerned with compensatory damages at common law and under s 236 of the ACL. An award of compensatory damages is given as compensation for loss or damage caused by a civil wrong.

The specific loss considered by this thesis is loss of a commercial opportunity. The specific wrongs considered by this thesis are breach of contract, negligence and the statutory prohibition on misleading or deceptive conduct contained in s 18(1) of the ACL.

Commercial opportunity

A claim for damages for loss of a commercial opportunity is a type of claim for loss of a chance. A commercial opportunity, in the sense used in the thesis, is a chance to

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[2] Harvey McGregor, *McGregor on Damages* (Sweet & Maxwell, 19th ed, 2014) [1–001]. See also, Djakhongir Saidov and Ralph Cunnington, 'Current Themes in the Law of Contract Damages: Introductory Remarks', in Djakhongir Saidov and Ralph Cunnington (eds), *Contract Damages: Domestic and International Perspectives* (Hart Publishing, 2008) 9 ('a monetary award given for a wrong').

obtain a pecuniary benefit,[3] or to avoid a pecuniary loss or liability,[4] in a commercial context. Loss of a commercial opportunity is a form of economic loss.[5] Economic loss means 'loss other than physical injury to person or property.'[6]

It follows that the thesis does not consider the doctrine of loss of a chance more generally. Accordingly, the thesis does not consider loss of a chance to obtain a non-pecuniary benefit, or to avoid a non-pecuniary loss or liability, such as the chance of a better medical outcome.[7] Further, the thesis does not consider loss of a chance to obtain a pecuniary benefit, or to avoid a pecuniary loss or liability, in a non-commercial context, such as the loss of the chance to earn future income in consequence of personal injury or death.[8]

The case study concerns the valuation of loss of a lending opportunity, being a particular type of loss of commercial opportunity. This type of loss arises where a lender lends money to a defaulting borrower in reliance on a valuation of the mortgage security negligently prepared by a valuer, and as a result the lender loses the opportunity to lend that money to an alternative (performing) borrower.

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[3] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 92–4 (Mason CJ and Dawson J), 104 (Brennan J), 118–19 (Deane J); *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 348 (Mason CJ, Dawson, Toohey and Gaudron JJ); *Badenach v Calvert* (2016) 331 ALR 48, 56 [39] (French CJ, Kiefel and Keane JJ). The relevant benefit may include the chance to make an even greater return than the claimant made in fact: *Professional Services of Australia Pty Ltd v Computer Accounting and Tax Pty Ltd (No 2)* (2009) 261 ALR 179, 202 [104], 205 [119] (Martin CJ; Buss and Newnes JJA agreeing).

[4] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 119 (Deane J); *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 363 (Brennan J); *Badenach v Calvert* (2016) 331 ALR 48, 56 [39] (French CJ, Kiefel and Keane JJ); *Daniels v Anderson* (1995) 37 NSWLR 438, 526, 529, 538–9 (Clarke and Sheller JJA; Powell JA agreeing generally); *QBE Insurance Ltd v Moltoni Corporation Pty Ltd* (2000) 22 WAR 148, 151 [7] (Ipp J), reversed, but reasoning approved, sub nom *Moltoni Corporation Pty Ltd v QBE Insurance Ltd* (2001) 205 CLR 149, 163 [24] (Full Court); *Unit 11 Pty Ltd v Sharpe Partners Pty Ltd* (2006) 150 FCR 405, 413 [34] (Lee J); *Doolan v Renkon Pty Ltd* (2011) 21 Tas R 156, 173 [57] (Full Court); *Australian Special Opportunity Fund LP v Equity Trustees Wealth Services Ltd* [2015] NSWCA 225 (11 August 2015), [161]-[163] (Bathurst CJ; Macfarlan JA agreeing), [190] (Emmett JA); *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1611 (Stuart-Smith LJ; Hobhouse LJ agreeing).

[5] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 348 (Mason CJ, Dawson, Toohey and Gaudron JJ).

[6] *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514, 525 (Mason CJ, Dawson, Gaudron and McHugh JJ).

[7] For the recovery of damages for this type of loss under Australian law, see *Tabet v Gett* (2010) 240 CLR 537; under English law, see *Gregg v Scott* [2005] 2 AC 176; *Barker v Corus UK Ltd* [2006] 2 AC 572.

[8] See generally Harold Luntz, *Assessment of Damages for Personal Injury and Death* (LexisNexis Butterworths, 4th ed, 2002).

Valuation of commercial opportunity

The thesis examines the valuation of loss of a commercial opportunity. Valuation of loss involves identifying and measuring, in money terms, the loss suffered by a claimant as a result of the defendant's wrong.

Valuation of loss is part of, but distinct from, the task of assessing a claimant's loss for the purpose of awarding damages. It is distinct from the task of assessment of loss in two key respects. First, the task of valuing loss involves the process of computing loss for the purpose of assessing damages. The task of assessing loss, on the other hand, is a broader concept. It encompasses all legal principles relevant to the determination of an award of damages, including the principles of remoteness of damage and mitigation.

Secondly, in principle, the task of valuing loss is done without hindsight; the task of assessing loss, on the other hand, is often done with the benefit of hindsight.[9] Courts therefore 'frequently assess value or damages on the basis that "where facts are available they are to be preferred to prophecies" even though those facts occur after the date at which the value or damages will be assessed.'[10]

The issue of the timing of loss or loss recognition is critical. Finance theory places great importance of the timing of cash flows, and also recognises explicitly that the value of an asset (say a commercial opportunity) depends inevitably on the point in time from which it is considered. For example, an asset may have great apparent value when looking forward from the moment of its formation (e.g. when a loan is first made), but in hindsight that forward-looking valuation – which would have been apparent at that time in its commercial market value – may have completely disappeared, as is the case when the cash flows expected by the lender (at the time of lending) failed to ever materialise. This is one of the key points on which legal and financial logic or reasoning can benefit from cross-comparison. As mentioned above, legal reasoning has much to gain from a full understanding of the time-and-timing perspectives that are explicit foundations of financial theory.

[9] *HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd* (2004) 217 CLR 640, 661 [44] (Full Court).
[10] *Kizbeau Pty Ltd v WG & B Pty Ltd* (1995) 184 CLR 281, 293 (Full Court) (citations omitted).

While the focus of the thesis is on the valuation of loss, the thesis will necessarily examine aspects of the assessment of loss in order to provide the context for the valuation framework developed in the thesis.

Financial theory of value

The valuation of loss is ultimately a legal question, however it is necessarily informed by financial valuation theory. Financial valuation theory offers a coherent set of normative models by which to ascribe monetary values to assets at a particular point in time (generally the present time, but hypothetically from any point in time at which some asset value remains).

In finance theory, an asset is conceived as a 'lottery' or source of uncertain or risky future cash flows. This definition is adopted in the thesis. The current valuation of an asset, such as a market value, is therefore a single number that is meant to capture the expected amount and the perceived uncertainty of that future cash flow, all in one measure.

Valuation theory is built on the fundamental principal that the value of any asset is equal to the expected value of the future cash flows generated by the asset, discounted back to a present value at a theoretically appropriate discount rate.[11] The appropriate rate at which the expected value of the future cash flow is discounted to present value reflects both the 'time value of money' and the probability distribution (and thus the risk or uncertainty)[12] of those expected cash flows. The main mathematical model used in finance theory to value risky future cash flows or 'payoffs' is the Sharpe-Lintner-Mossin capital asset pricing model. This model is known as the CAPM.

[11] Wayne Lonergan, *The Valuation of Businesses, Shares and Other Equity* (Allen & Unwin, 4th ed, 2003) 22; Shannon P Pratt and Alina V Niculita, *Valuing a Business: The Analysis and Appraisal of Closely Held Companies* (McGraw Hill, 5th ed, 2008) 56.
[12] This thesis does not draw a distinction between uncertainty and risk. For the distinction in economics, see Frank H Knight, *Risk, Uncertainty and Profit* (Houghton Mifflin, 1921) 233–4.

Justification

Selection of topic

Claims for damages for loss of a commercial opportunity arise frequently in commercial disputes and litigation. They have the potential to significantly increase the scope of recovery of damages. Indeed, it has been suggested, 'such claims have become part of the standard armoury in formulating statements of case to achieve maximum liability.'[13]

The legal principles relating to liability for loss of a commercial opportunity, and the general principles relating to the assessment of that loss, are reasonably well settled. However, little explicit attention or fundamental research has been paid to the principles by which that loss is valued, either from a legal or a finance theory perspective. This is for two reasons. First, relative to the long history of law, finance theory is a very recent creation. Although there have been ways of thinking about money and investment for centuries, it is only since the development of modern portfolio theory by Markowitz in the 1950s, the capital asset pricing model by Sharpe and Lintner in the 1960s and derivative pricing by Black and Scholes in the 1970s, that finance has existed as a distinct discipline.[14]

Secondly, lawyers are typically not trained in finance logic, as evidenced by the general absence of such training in undergraduate legal education and the absence of finance theory in legal textbooks. Finance theorists, on the other hand, only become involved valuing of loss on an *ad hoc* basis in the capacity of a consultant or expert, and their role in the legal process is generally limited to submitting a technical report to lawyers to incorporate into the formal legal argument. The established and often intricate case law, legal concepts and language relied upon by lawyers in arguments over damages, loss of opportunity and the like, are foreign to finance practitioners, in much the same way as finance is to law.

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[13] Jill Poole, 'Loss of chance and the evaluation of hypotheticals in contractual claims' [2007] *Lloyd's Maritime and Commercial Law Quarterly* 63, 64.
[14] The history of the development of modern finance theory is set out in Peter L Bernstein, *Capital Ideas: The Improbable Origins of Modern Wall Street* (Free Press, 1991).

The valuation of loss of a commercial opportunity almost always involves some application of financial valuation theory in a legal context. In general, courts, tribunals and other decision makers have limited formal training in finance and economics, and therefore they rely heavily on expert valuation evidence in determining the amount of damages to award for this type of loss. Typically, both parties to a dispute will adduce complicated and conflicting expert evidence as to the value of the claimant's alleged loss, often with the distortions that the adversarial process entails. Ultimately, however, it is the court or other decision maker who is charged with the responsibility for determining the value of this loss. It is therefore essential that courts, tribunals and other decision makers, as well as practising lawyers, understand, and explicitly recognise, the economic principles of financial valuation, and how they can be applied correctly to the valuation of loss.

While case law does contain some limited examination of the principles of valuation of loss, this is normally done by *ad hoc* references to expert's reports and without reference to any coherent logical framework or body of principles rooted in legal or finance theory. This thesis attempts to develop a general legal framework, which is also in effect a financial framework, for the valuation of a particular type of loss, and to contribute to the critical use of finance theory in law.

Choice of case study

There are three reasons for analysing loss of a lending opportunity. First, a claim for loss of a lending opportunity represents a claim for loss of a chance to make a profit from the use of money. Following *Hungerfords v Walker*,[15] claims for loss of the use of money, and loss of a chance to make a profit from the use of money, have become an important feature of commercial disputes and litigation. Secondly, claims for loss of a lending opportunity invariably involve claims for two different types of alleged loss – 'capital' and 'income' – that is relevant to the thesis argument. Thirdly, the quantum of the relevant loss, and the variables and contingencies affecting that loss, can be ascertained with reasonable certainty. This precision enables a general valuation model to be constructed.

[15] *Hungerfords v Walker* (1989) 171 CLR 125.

Contribution

The primary contribution of this thesis is to the legal discipline.

At a general level, the development of a framework for the valuation of loss that is consistent with finance theory makes explicit the economic logic behind the assumptions that are made in legal reasoning. Further, it assists to identify the flaws or gaps in that reasoning. At a more practical level, this framework may assist in the development, preparation and critique of valuation evidence in claims for damages for loss of a commercial opportunity. Finally, the development of a theoretically sound framework, with roots in accepted finance theory, will assist in reducing agency problems associated with expert valuation reports.

The thesis is also an important application of finance theory, and will assist finance practitioners in carrying out the forensic task of valuation of loss of a commercial opportunity. At a very basic level, the thesis will consider deterministic (ie, certain) cash flows.[16] Finance theory proper usually moves quickly from the theory of time value of money under deterministic cash flows to the more difficult problems of investment and asset pricing under uncertain (probabilistic) cash flows. However, in the context of this thesis, deterministic cash flow calculations are important. For example, when applying the compensatory principle in assessing damages, it is natural for a court to consider the sequences of cash flows that should or would have occurred but for the wrong, and those that did occur in practice. These sequences of cash flows can be written down with certainty (ie, they are deterministic).

The second major contribution of the thesis will build on the finance of uncertain cash flows. At present, courts adopt relatively unsophisticated rules by which to allow for the uncertainty of hypothetical events. This will be demonstrated in the case study. In assessing damages for loss of a lending opportunity, courts make judgements, implicitly or explicitly, about the probability of the existence of an alternative borrower, and that borrower repaying the loan in full. Courts therefore need to invoke

[16] See, eg, David G Luenberger, *Investment Science* (Oxford University Press, 2nd ed, 2013) ch 2.

rigorous principles for interpreting and assessing probabilities, and for valuing losses that are in some respects uncertain, in the same way as finance uses statistical thinking to help value uncertain future cash flow streams. The problem of valuing losses is in some ways the mirror image of valuing income streams, although valuing losses is largely or partly backward-looking (*ex-post* loss) rather than forward looking like most financial valuation (eg, valuing shares). Interestingly, finance theory has generally little to say explicitly about valuing losses. This is because the main subject matter in finance is investment decision making, which is by nature a forward-looking task. In general, all losses or past outcomes are of little relevance because they do not make any difference to what is the best action from the current moment onward. Rather, past losses usually mean that there is less money available currently for investment, but they do not have a logical bearing on how that available money should be invested for the future.

State of knowledge

The thesis topic has not been the subject of any extensive legal or financial theory analysis in Australia. A detailed analysis of the doctrine of loss of a commercial opportunity can be found in leading texts on the law of damages.[17] A more limited treatment can be found in generalist works on the law of contract, tort, remedies and misleading or deceptive conduct.[18] However, none of these texts contain any detailed analysis of the valuation of this type of loss. Academic writing has also focused on liability and the general principles of assessment of damages, with little attention paid to the task of valuation.

The valuation of loss of a chance or commercial opportunity has received more attention in the United States. A number of academic articles address this topic, with

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[17] McGregor, above n 2; Adam Kramer, *The Law of Contract Damages* (Hart Publishing, 2014). See also, Robyn Carroll, 'Damages for Loss of a Commercial Opportunity', in Robyn Carroll (ed), *Civil Remedies: Issues and Developments* (Federation Press, 1996) ch 2.

[18] See, eg, H G Beale (ed), *Chitty on Contracts* (Sweet & Maxwell, 31st ed, 2012); J W Carter, *Contract Law in Australia* (LexisNexis, 6th ed, 2013); N C Seddon, R A Bigwood and M P Ellinghaus, *Cheshire & Fifoot Law of Contract* (LexisNexis, 10th Australian ed, 2012); D W Greig and J L R Davis, *The Law of Contract* (Law Book, 1987); Michael A Jones (ed), *Clerk & Lindsell on Torts* (Sweet & Maxwell, 20th ed, 2010); Katy Barnett and Sirko Harder, *Remedies in Australian Private Law* (Cambridge University Press, 2014); Colin Lockhart, *The Law of Misleading or Deceptive Conduct* (LexisNexis, 4th ed, 2015).

a focus on the valuation of loss of a chance of a better medical outcome.[19] A number of articles address the related topic of valuation of the loss of profit.[20] Several valuation texts also address the application of finance theory to the valuation of loss.[21] The thesis incorporates and builds on this material.

The thesis

Overview

Thesis argument

This thesis argues that the loss of a commercial opportunity should be valued by reference to its market value, or the hypothetical exchange price of the asset or claim in question. Such prices are determined routinely in finance either by empirical observation of traded prices in active markets or by theoretical derivation of what such prices would be if there were observable trade in the assets in question.

The thesis will demonstrate that, in a damages context, the value (or loss in value) of an asset is generally determined by reference to its market value. In order to form the subject matter of a compensable loss, a commercial opportunity must have a non-negligible monetary value. A chance with a non-negligible monetary value constitutes an asset, because it represents the chance of an anticipated future cash flow. Loss of a commercial opportunity therefore represents the loss of an asset, being the chance or opportunity of an anticipated future cash flow. It follows that, in principle, the loss of a commercial opportunity should be valued by reference to its theoretical market value, with the timing of that valuation and any adjustments to the quantum of that value being determined by law.

The philosophy underlying this thesis is that the market value approach applies to all types of lost opportunity, including loss of a cause of action.

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[19] See below, Part two, ch 6.
[20] See below, Part one, ch 2.
[21] See, eg, Shannon P Pratt and Roger J Grabowski, *Cost of Capital in Litigation: Applications and Examples* (John Wiley, 2011) ch 6; Pratt and Niculita, above n 11, ch 40.

Valuation framework

The thesis develops a legal framework for the valuation of loss of a commercial opportunity, based on the thesis argument. This framework is constructed in legal terms, and built on the principles of financial valuation theory.

The thesis identifies the simple probability approach as the general approach taken by courts to the valuation of loss of a commercial opportunity. The simple probability approach is applied to construct a framework for determining the market value of the loss of a commercial opportunity. This framework consists of three steps: first, determine the market value of the object of the opportunity; secondly, assess the probability of the opportunity and adjust the market value of the object by that probability; and thirdly, account for any benefits received by the claimant as a result of the defendant's wrong.

Utility of valuation framework

The case study is used to demonstrate the utility of the proposed valuation framework. This is done by applying the framework to expose the errors that are commonly made by courts in valuing the loss of a lending opportunity. Specifically, the case study will demonstrate that the approach adopted by courts to the valuation of this type of loss fails to properly characterise the true nature of the claimant's loss as a single undivided loss of anticipated future cash flow; fails to properly value the contingencies affecting that loss and fails to properly account for the benefits received by the claimant. These failures lead to the misapplication of the loss of commercial opportunity doctrine, and to erroneous damages awards in claims for loss of a lending opportunity.

Structure

The thesis is divided into four parts and eight chapters.

Part one introduces the thesis and provides the foundation for the analysis contained in Parts two and three. Part one contains this chapter, and chapters two and three. Chapters two and three examine two things by way of introduction. Chapter two examines the role of financial valuation theory in the assessment of damages for economic loss in a commercial context. It identifies the meaning of value in a damages context, and examines the use of financial valuation theory in quantifying that value. Chapter three examines the legal doctrine of loss of a commercial opportunity, both at common law and for the purposes of s 236 of the ACL.

Part two develops a legal framework for the valuation of loss of a commercial opportunity, based on the thesis argument. Part two comprises chapters four, five and six. Chapter four examines the fact of loss of a commercial opportunity. This chapter focuses on proof of the existence of a valuable commercial opportunity. It identifies and explores the concept of a non-negligible monetary value. Chapter five examines the economic character of the loss of a commercial opportunity. It identifies such a loss as an asset. Chapter six examines the valuation of the loss of a commercial opportunity. This chapter draws together the analysis contained in Parts one and two of this thesis. It identifies the standard of value by which the loss of a commercial opportunity is valued, and develops a general legal framework for the valuation of such a loss.

Part three, comprising chapter seven, contains a case study on the valuation of loss of a lending opportunity. The case study applies the valuation framework developed in Parts one and two of the thesis to three cases that illustrative the general approach taken by courts in valuing this type of loss. The case study develops a general model for the valuation of loss of a lending opportunity, based on the general valuation framework set out in the body of the thesis.

Part four contains chapter eight, which concludes the thesis.

Approach

Research taxonomy

The thesis adopts the taxonomy of legal research proposed by Arthurs.[22] On that basis, the thesis can be classified as applied legal research, with a predominantly doctrinal focus.[23] The thesis is applied (rather than pure) because it is written for courts, tribunals and other decision makers, and practising lawyers (rather than an academic constituency), and for finance experts giving evidence on the valuation of loss of a commercial opportunity.

To the extent that the thesis expounds the legal principles relevant to the thesis topic, the thesis adopts a traditional doctrinal approach to the topic with an expository research orientation. The thesis also attempts to analyse and apply those principles in the context of financial valuation theory. To that extent, the thesis adopts an inter-disciplinary approach to the topic with a fundamental research orientation.

Within the fundamental research category, this thesis adopts a law and economics analysis.[24] At a general level, the thesis considers the legal doctrine of loss of a commercial opportunity in the context of financial valuation theory. The thesis then develops a legal framework for the valuation of this type of loss that is consistent with, and largely based upon, that theory. The thesis concludes by considering a particular type of loss of commercial opportunity, and proposing a model for the valuation of that type of loss. The thesis therefore adopts both a positive (descriptive), and a normative (prescriptive), law and economics analysis.[25]

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[22] H W Arthurs, *Law and Learning: Report to the Social Sciences and Humanities Research Council of Canada by the Consultative Group on Research and Education in Law* (Information Division, Social Sciences and Humanities Research Council of Canada, Ottowa, 1983) 63–71.

[23] See, Terry Hutchinson and Nigel Duncan, 'Defining and Describing What We Do: Doctrinal Legal Research' (2012) 17(1) *Deakin Law Review* 83.

[24] See, Richard A Posner, *Economic Analysis of Law* (Wolters Kluwer, 8th ed, 2011); Michael J Trebilcock, 'An Introduction to Law and Economics' (1997) 23 *Monash University Law Review* 123.

[25] Trebilcock, above n 24, 125.

Epistemology

The thesis adopts an interpretive, qualitative approach rather than an objective, quantitative or empirical approach. The analytical aspect of the research process, which forms the most substantial part of the research process, is qualitative because it depends on the expertise, experience, skill and views of the individual researcher.[26]

The thesis topic is by nature analytical rather than empirical or statistical, and will involve extensive consideration of case law. It adopts a combination of an internal and an external analysis. To the extent the thesis examines the legal principles relevant to the thesis topic, the thesis adopts an internal, participant-oriented approach to the research. The research material is drawn from the legal system, and is analysed from the subjective viewpoint of the researcher.

To the extent that the thesis examines these legal principles in the context of financial valuation theory, the thesis adopts an external analysis. This aspect of the research involves analysing the legal principles relevant to the thesis topic from an independent viewpoint using the conceptual tools of a non-legal discipline.[27] This thesis looks to finance theory as a foundational non-legal discipline that offers normatively correct ways of analysing the value of loss, and then applies that analysis in a legal context. While finance theory is the theoretical authority on the question of value, the theoretical framework will always remain legal. The task is to reach a forensic conclusion on the question of value.

Methodology

The primary focus of the thesis is doctrinal legal research, and therefore a doctrinal research methodology is the primary research methodology used in the thesis.

At a general level, the thesis seeks to analyse the thesis topic by examining the principles of financial valuation theory and the relevant legal principles and then formulating a framework for the valuation of loss that is consistent with principles of

[26] Hutchinson and Duncan, above n 23, 116.
[27] Ibid 114–15.

financial valuation theory. The principal source of material for analysis is case law, which reflects the legal basis of the subject. The thesis argument, accordingly, is developed by reference to case law principles as they apply to the assessment and valuation of damages.

The thesis analyses the law in Australia and, to a lesser extent, England. The analysis presented in this thesis will be relevant to some extent in other common law jurisdictions such as Canada and New Zealand.

Limitations

This thesis is also subject to the following general limitations. Specific limitations applicable to the case study are identified in chapter seven.

First, the thesis only considers loss of a *commercial opportunity*, as that term is defined in the thesis. Accordingly, the thesis does not consider the broader concept of loss of a chance, except to the extent that case law or commentary in that broader context illuminates the thesis topic.

Secondly, the thesis is principally concerned with the *valuation* of loss of a commercial opportunity. The thesis does not consider liability for loss of a commercial opportunity, except by way of introduction in chapters three, four and seven. Nor does the thesis consider broader aspects of the assessment of damages for such a loss, such as remoteness,[28] mitigation, contributory negligence and proportionate liability.

Thirdly, the thesis is only concerned with claims for damages for loss of a commercial opportunity in contract and the tort of negligence, and under s 236 of the ACL for contravention of section 18(1) of the ACL. This thesis does not consider compensation for this type of loss in other fields of law, such as the law of equity,[29] or

[28] See, eg, *IOOF Building Society Pty Ltd v Foxeden Pty Ltd* [2009] VSCA 138 (19 June 2009); *Triden Properties Ltd v Capita Financial Group Ltd* (Unreported, New South Wales Court of Appeal, 15 November 1995).
[29] On the availability of equitable compensation for loss of a commercial opportunity, see *Ramsay v BigTinCan Pty Ltd* (2014) 101 ACSR 415.

under cognate statutory provisions,[30] except where necessary to illuminate the thesis topic. Furthermore, this thesis is concerned with damages for actual, and not prospective, loss. Accordingly, this thesis does not deal with compensation, under s 237 of the ACL, for contravention of section 18(1) of the ACL.[31]

Fourthly, the thesis assumes, for the purposes of exposition, that the measure of damages for loss of a commercial opportunity is identical, irrespective of whether a claim for such loss is brought in contract, negligence, or for contravention of section 18(1) of the ACL.

Finally, the thesis does not address in any detail the issues of taxation and interest as they apply to the assessment and valuation of the loss of a commercial opportunity.[32]

[30] Eg, *Australian Securities and Investments Commission Act 2001 (Cth)*, ss 12DA(1) and 12GF(1).
[31] Section 237 of the ACL entitles a person who has suffered, or is likely to suffer, 'loss or damage' because of conduct in contravention of s 18(1) to apply for an order to compensate that person in whole or in part for the loss or damage or to prevent or reduce the loss or damage.
[32] For a consideration of these issues, see, eg, *P M Sulcs v Daihatsu Aust – Costs & Interest* [2001] NSWSC 798 (13 September 2001).

Chapter 2

Principles of financial valuation theory in a damages context

Introduction

Purpose and object

Sound and accurate valuation of compensatory damages requires the application of economic and financial valuation theory.[1] This is because the valuation of such damages 'cannot be separated easily from the environment of economic complexity.'[2] In assessing damages, therefore, '[c]ourts have a more demanding and sophisticated task than choosing between the plaintiff's and defendant's damage calculation.'[3] In order to discharge their decision-making function, courts should understand, and apply, economic and financial valuation theory in the assessment process.

This chapter examines the role of financial valuation theory in the assessment of damages for economic loss in a commercial context. The general object of this chapter is to provide a theoretical foundation for the legal framework developed in Part two of the thesis. More particularly, the object of this chapter is to identify the concept of value in a damages context, and to articulate that concept in terms of financial valuation methodology.

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[1] R F Lanzilloti and A K Esquibel, 'Measuring Damages in Commercial Litigation: Present Value of Lost Opportunities' (1990) 5(1) *Journal of Accounting, Auditing & Finance* 125, 143.
[2] John W Bagby, Norman G Miller and Michael E Solt, 'The Determination of Compensatory Damages: A Valuation Framework' (1984) 22 *American Business Law Journal* 1, 34.
[3] Lanzilloti and Esquibel, above n 1, 142.

Structure

This chapter is divided into an introduction and three main sections. The first section examines the concept of value in a damages context, and the role that financial valuation theory plays in determining value in that context. The second section examines the general principles of financial valuation theory relevant to the valuation of loss, and the third section demonstrates how these principles are applied to determine the present value of a claimant's loss.

Value in a damages context

Introduction

An award of compensatory damages is given as compensation for loss or damage caused by a civil wrong. The purpose of this award, both at common law,[4] and under s 236 of the ACL,[5] is to put the claimant in the same position it would have been in if the relevant wrong had not occurred.

An award of damages therefore involves valuing, at the time of assessment, the claimant's relevant actual financial position, having suffered loss; and the claimant's relevant hypothetical financial position, assuming that the loss did not occur. The difference between these two values represents the measure of the claimant's loss. The claimant is awarded by way of damages a sum of money equal to this difference as compensation for its loss.

[4] *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25, 39 (Lord Blackburn); *Butler v The Egg and Egg Pulp Marketing Board* (1966) 114 CLR 185, 191 (Taylor and Owen JJ); *Pennant Hills Restaurants Pty Ltd v Barrell Insurances Pty Ltd* (1981) 145 CLR 625, 637–8 (Gibbs J), 646–7 (Stephen J); *Todorovic v Waller* (1981) 150 CLR 402, 412 (Gibbs CJ and Wilson J; Aickin J agreeing), 427 (Stephen J), 463 (Brennan J); *Johnson v Perez* (1988) 166 CLR 351, 367 (Wilson, Toohey, Gaudron JJ), 371 (Brennan J); *Haines v Bendall* (1991) 172 CLR 60, 63 (Mason CJ, Dawson, Toohey and Gaudron JJ); *Nominal Defendant v Gardikiotis* (1996) 186 CLR 49, 54 (McHugh J); *Husher v Husher* (1999) 197 CLR 138, 142–3 [6] (Gleeson CJ, Gummow, Kirby and Hayne JJ); *Cattanach v Melchior* (2003) 215 CLR 1, 22 [36] (Gleeson CJ), 41–2 [100] (Kirby J); *Clark v Macourt* (2013) 253 CLR 1, 6 [7] (Hayne J), 18–19 [59] (Gageler J).
[5] *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514, 526 (Mason CJ, Dawson, Gaudron and McHugh JJ).

General legal concept of value

In a legal context, the concept of value will depend on the precise legal and factual circumstances. However, in general terms, in the absence of an applicable statutory or contractual provision, the value (or loss in value) of an asset is determined by reference to its 'market' value.[6]

The market value of an asset is the hypothetical price at which a hypothetical seller and a hypothetical buyer, who are both informed and willing but not anxious to trade, would agree as the exchange price of the asset. The dominant notion of market value in Australian, the United Kingdom, Canadian, and United States jurisprudence is the assumption of a hypothetical market in which the particular asset is traded.[7] This market 'presupposes a person willing to give what is being valued in exchange for money and another willing to give money in exchange for what is being valued.'[8]

In Australian jurisprudence, the classic definition of market value was given by the High Court in *Spencer v Commonwealth*,[9] in the context of determining the proper approach to the value of land. Griffith CJ said:[10]

> In my judgment the test of value of land is to be determined, not by inquiring what price a man desiring to sell could actually have obtained for it on a given day, ie, whether there was in fact on that day a willing buyer, but by inquiring 'What would a man desiring to buy the land have had to pay for it on that day to a vendor willing to sell it for a fair price but not desirous to sell?'… The necessary mental process is to put yourself as far as possible in the position of persons conversant with the subject at the relevant time, and from that point of view to ascertain what, according to the then current opinion of land values, a purchaser would have had to offer for the land to induce such a willing vendor to sell it, or, in other words, to inquire at what point a desirous purchaser and a not unwilling vendor would come together.

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6 *Spencer v Commonwealth* (1907) 5 CLR 418; *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 494, 514 [49] (McHugh, Hayne and Callinan JJ); *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 199 CLR 413, 436 [49] (McHugh J).
7 Bernard Marks, 'Valuation Principles in the Income Tax Assessment Act' (1996) 8(2) *Bond Law Review* 114, 118.
8 *Boland v Yates Property Corporation Pty Ltd* (1999) 167 ALR 575, 595 [79] (Gleeson CJ).
9 *Spencer v Commonwealth* (1907) 5 CLR 418.
10 *Spencer v Commonwealth* (1907) 5 CLR 418, 432.

Isaacs J added:[11]

We must further suppose both to be perfectly acquainted with the land, and cognizant of all circumstances which might affect its value, either advantageously or prejudicially, including its situation, character, quality, proximity to conveniences or inconveniences, its surrounding features, the then present demand for land, and the likelihood, as then appearing to persons best capable of forming an opinion, of a rise or fall for what reason soever in the amount which one would otherwise be willing to fix as the value of the property.

In *Walker Corporation Pty Ltd v Sydney Harbour Foreshore Authority*,[12] the Full Court of the High Court approved[13] the following summary given by McHugh J in *Kenny & Good Pty Ltd v MGICA (1992) Ltd*[14] of the principle of value articulated in *Spencer*:[15]

Value is determined by forming an opinion as to what a willing purchaser will pay and a not unwilling vendor will receive for the property. In determining that value, there must be attributed to the parties a knowledge of all matters that affect its value. Those matters will include the predicted impact of future events as well as the experience of the past and the rates of return on other investments… The market for the property is, therefore, assumed to be an efficient market in which buyers and sellers have access to all currently available information that affects the property.

In McHugh J's view, it followed from these principles that '[n]ew information concerning properties becomes reflected in the prices which buyers are willing to pay for those properties', and 'the price will reflect the present value of the future prospects of a property.'[16]

[11] *Spencer v Commonwealth* (1907) 5 CLR 418, 441.
[12] *Walker Corporation Pty Ltd v Sydney Harbour Foreshore Authority* (2008) 233 CLR 259.
[13] *Walker Corporation Pty Ltd v Sydney Harbour Foreshore Authority* (2008) 233 CLR 259, 276–7, [51].
[14] *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 199 CLR 413.
[15] *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 199 CLR 413, 436 [49]–[50].
[16] *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 199 CLR 413, 436 [51].

Value in a damages context

Introduction

In general, in a damages context, a claimant's loss is determined by reference to its market value.[17]

However, in some claims, a distinction is drawn between market value and 'real' or 'true' value for the purpose of assessing damages. Thus, if the purchase of an asset is induced by deceit,[18] or misleading or deceptive conduct,[19] the claimant's prima facie measure of damages is the difference between the price paid for the asset and its 'real' value at the date of acquisition. In this context, in *HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd*,[20] the Full Court of the High Court observed that the claimant is not limited to the difference between the price paid and the market value of the asset because, among other things, there may not be a market, or the market price may be manipulated or otherwise mistaken.[21]

Properly understood, true value is an aspect of market value, and not an independent principle of value in its own right. The true value of an asset at a point in time is simply its market value, assuming that, at that time, the hypothetical buyer and seller had knowledge of subsequent information and events relevant to the inherent value of the asset at that earlier time.

Viewed in that way, market value is the one objective standard of value, and other so-called types or standards of value are merely different aspects of the market value concept, where different assumptions are made in relation to, or where different characteristics are imputed to, the hypothetical sale and purchase transaction underpinning the market value concept.

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[17] *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 494, 514 [49] (McHugh, Hayne and Callinan JJ); *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 199 CLR 413, 436 [49] (McHugh J); *Port Stephens Shire Council v Tellamist Pty Ltd* (2004) 135 LGERA 98, see especially 157 [217] (Santow JA).

[18] *Potts v Miller* (1940) 64 CLR 282, 289 (Starke J), 297 (Dixon J), 307 (Williams J).

[19] *Kizbeau Pty Ltd v WG & B Pty Ltd* (1995) 184 CLR 281, 291 (Full Court).

[20] *HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd* (2004) 217 CLR 640.

[21] *HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd* (2004) 217 CLR 640, 657–8 [37].

Valuation methodology

The concept of value articulated by the High Court in *Spencer* is a not a test, but rather a guiding principle.[22] The method of valuation that best gives effect to the *Spencer* principle will depend on the precise legal and factual context. Thus, in *Boland v Yates Property Corporation Pty Ltd*,[23] Gleeson CJ observed that the application of the exchange theory of value 'involves a factual judgment, and may be made by reference to comparable sales, or a capitalisation of profits formula, or, in certain circumstances, by reference to costs of reinstatement or other criteria.'[24] Similarly, Callinan J observed that '[t]here is no legal principle that purports to, or could, close for all times the categories of methods of valuation which might be acceptable in a particular case.'[25]

In a damages context, the first step in determining the appropriate valuation methodology is to identify the nature and subject matter of the claimant's loss. If the claimant's loss relates to a marketable asset, the value of that loss is often determined by reference to the market price of that asset. For example, under Australian sale of goods legislation, the prima facie measure of damages, where there is an available market, for the non-acceptance or the non-delivery of goods is the difference between the contract price and the market or current price of the relevant goods.[26] Similarly, damages for breach of warranty as to the quality of goods may be measured by reference to the difference between the market price of the goods delivered and the market price of goods that answer the warranty.[27]

However, if the claimant's loss relates to an asset that is not marketable, an alternative methodology must be used. One alternative is to value the claimant's loss using DCF

[22] Steven J Brown, 'Investment Decisions: Discounted Cash Flow and other Valuation Methods in Litigation' (1991) 2 *Journal of Banking and Finance Law and Practice* 4, 6.
[23] *Boland v Yates Property Corporation Pty Ltd* (1999) 167 ALR 575.
[24] *Boland v Yates Property Corporation Pty Ltd* (1999) 167 ALR 575, 596 [79].
[25] *Boland v Yates Property Corporation Pty Ltd* (1999) 167 ALR 575, 652 [280]. See also, *Port Stephens Shire Council v Tellamist Pty Ltd* (2004) 135 LGERA 98, 159 [223] (Santow JA).
[26] *Sale of Goods Act 1954 (ACT)*, ss 53(3), 54(3); *Sale of Goods Act 1923 (NSW)*, ss 52(3), 53(3); *Sale of Goods Act 1972 (NT)*, ss 52(3), 53(3); *Sale of Goods Act 1896 (Qld)*, ss 51(3), 52(3); *Sale of Goods Act 1895 (SA)*, ss 49(3), 50(3); *Sale of Goods Act 1896 (Tas)*, ss 54(3), 55(3); *Sale of Goods Act 1958 (Vic)*, ss 56(3), 57(3); *Sale of Goods Act 1895 (WA)*, s 49(3), 50(3).
[27] See, eg, *Clark v Macourt* (2013) 253 CLR 1. For a criticism of the decision, see JW Carter, Wayne Courtney and GJ Tolhurst, 'Issues of Principle in Assessing Contract Damages' (2014) 31 *Journal of Contract Law* 171.

analysis. Using this approach, the value of the claimant's loss is measured by reference to the present value of the anticipated future cash flow of the asset. This approach is often used when the claimant's loss relates to an income-producing asset.

While DCF analysis has been questioned, it has been accepted as a valid valuation methodology.[28] It has been accepted as a valid foundation by which to value a range of different assets, including land,[29] airspace,[30] shares,[31] and businesses.[32] In a damages context, DCF analysis has been accepted as a valid methodology by which to value claims for loss of profit,[33] and loss of a commercial opportunity.[34] A growing body of academic and professional literature also supports the application of financial valuation theory, and DCF analysis, to the valuation of economic loss in both a commercial,[35] and a non-commercial,[36] context.

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[28] *Albany v Commonwealth* (1976) 12 ALR 201; *Boland v Yates Property Corporation Pty Ltd* (1999) 167 ALR 575, 653 [284] (Callinan J). See also, Brown, above n 22.

[29] See, eg, *Albany v Commonwealth* (1976) 12 ALR 201; *Boland v Yates Property Corporation Pty Ltd* (1999) 167 ALR 575, 653 [284] (Callinan J); *Adelaide City Corporation v City of Port Adelaide Enfield* (2001) 115 LGERA 137.

[30] *Collex Pty Ltd v Roads and Traffic Authority of New South Wales* (2006) 149 LGERA 234, affirmed, without challenge to the methodology, sub nom *Roads and Traffic Authority of New South Wales v Collex Pty Ltd* (2009) 165 LGERA 419.

[31] See, eg, *Bromley Investments Pty Ltd v Elkington* (2003) 47 ACSR 273.

[32] See, eg, *Bell Group Ltd (In liq) v Westpac Banking Corporation (No 9)* (2008) 39 WAR 1, 198 [1416] (Owen J).

[33] See, eg, *Haviv Holdings Pty Ltd v Howards Storage World Pty Ltd* (2009) 254 ALR 273, 294 [66], 298 [87] (Jagot J).

[34] See, eg, *Hungry Jack's Pty Ltd v Burger King Corporation* [1999] NSWSC 1029 (5 November 1999); *P M Sulcs v Daihatsu Australia* [2001] NSWSC 636 (1 August 2001), [813], [913] (Kirby J); *BestCare Foods Ltd v Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd)* [2013] NSWSC 1287 (10 September 2013), [167]–[171] (Stevenson J); *North East Solution Pty Ltd v Masters Home Improvement Australia Pty Ltd* [2016] VSC 1 (28 January 2016); *James Carleton Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 2641 (10 December 2007).

[35] See, eg, Elmer J Schaefer, 'Uncertainty and the Law of Damages' (1978) 19 *William and Mary Law Review* 719; Richard G Schneider, 'Damages for the Termination of a Business Interest' (1980) 49 3(2) *Antitrust Law Journal* 1295; Lanzilloti and Esquibel, above n 1; Franklin M Fisher and R Craig Romaine, 'Janis Joplin's Yearbook and the Theory of Damages' (1990) 5(1) *Journal of Accounting, Auditing & Finance* 145; Brown, above n 22; Allen Michel and Israel Shaked, 'Valuation of Damage Claims: An Application of Corporate Finance' (1992) (19)(3) *Journal of Business Finance & Accounting* 455; James E Meyer, Patrick Fitzgerald and Mostafa Moini, 'Loss of Business Profits, Risk, and the Appropriate Discount Rate' (1994) 4(3) *Journal of Legal Economics* 27; Melvin Aron Eisenberg, 'Probability and Chance in Contract Law' (1998) 45 *University of California at Los Angeles Law Review* 1005; Denis Boudreaux, William Ferguson and Philip Boudreaux, 'Analysis and Valuation of Closely Held Firms Involved in Business Damage Cases and Application of Certainty Equivalence' (1999-2000) 9(3) *Journal of Legal Economics* 1; Robert L Dunn and Everett P Harry, 'Modeling and Discounting Future Damages' (2002) 193(1) *Journal of Accountancy* 49; Robert M Lloyd, 'Discounting Lost Profits in Business Litigation: What Every Lawyer and Judge Needs to Know' (2007) 9(1) *Transactions: The Tennessee Journal of Business Law* 9; Thierry Senechal, 'Dealing with Uncertainty: Discounted Cash Flow (DCF) Versus Adjusted Present Value (APV)' (2007) 4(3) *Transnational Dispute Management* 1.

[36] Bagby, Miller and Solt, above n 2.

A persistent issue in the cases that have questioned the use of DCF analysis is the validity or reliability of the assumptions regarding future cash flow and the appropriate discount rate.[37] It is clear from these cases that, in order for DCF analysis to be used, the assumptions on which the analysis is based 'must be satisfactorily grounded in evidence.'[38]

Financial valuation theory

Introduction

This section of the chapter examines the principles of financial valuation theory relevant to the valuation of economic loss in a damages context.

The foundational principles of modern financial valuation theory were laid in the early twentieth century with the work of the American economist Irving Fisher.[39] In two books, *The Rate of Interest*,[40] and *The Theory of Interest*,[41] Fisher developed a general framework for the theory of investments based on the application of the concept of discounting to present value.

In the second half of the twentieth century, these foundational principles were expanded and greatly refined by scholars such as Harry Markowitz, William Sharpe, Robert Merton, Fischer Black and Myron Scholes. The work of these scholars culminated in the development of portfolio theory, the CAPM, and options pricing theory.[42]

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[37] See, eg, *Roach v Page (No 37)* [2004] NSWSC 1048 (15 November 2004), issue not challenged on appeal sub nom *Winnote Pty Ltd v Page* [2006] NSWCA 287 (31 October 2006); *Downie v Sorell Council* (2005) 141 LGERA 304; *Roads Corporation v Love* (2010) 31 VR 451.
[38] *Roads Corporation v Love* (2010) 31 VR 451, 518 [598] (Osborn J).
[39] Aswath Damodaran, *Valuation Approaches and Metrics: A Survey of the Theory and Evidence* (Now Publishers, 2005) 4–5.
[40] Irving Fisher, *The Rate of Interest: Its Nature, Determination and Relation to Economic Phenomena* (MacMillan, 1907).
[41] Irving Fisher, *The Theory of Interest: As Determined by Impatience To Spend Income and Opportunity To Invest It* (MacMillan, 1930).
[42] Mark Rubinstein, *A History of the Theory of Investments: My Annotated Bibliography* (John Wiley, 2006) 101–307.

The foundational principles of modern financial valuation, which culminate in portfolio theory, the CAPM, and options pricing theory, provide logical and widely accepted normative principles by which assets (or the loss in value of assets) can be valued and equated.

DCF analysis

Introduction

The financial theory of value is concerned with ascribing a monetary value to an asset at a particular point in time (generally the present time). Valuation theory is built on the fundamental principal that the value of any asset is equal to its 'present value', being the expected value of the projected future cash flows generated by the asset, discounted back to the present at a theoretically appropriate discount rate.[43] Thus, in *The Theory of Interest*, Fisher said 'capital value, is simply future income discounted or, in other words, capitalized. The value of any property, or rights to wealth, is its value as a source of income and is found by discounting that expected income.'[44]

In theory, DCF analysis will produce a reasonable approximation of the market or exchange price of an asset.[45] It will capture in a single number both the magnitude of the anticipated cash flows and the risk associated with them (ie, their risk or volatility in the sense that they might be different and either larger or smaller than their expectations or statistical means).

The appropriate rate at which the expected value of the future cash flow is discounted to present value is designed to at once reflect both the 'time value of money' and the probabilistic uncertainty or risk that the cash flow will not materialise as expected.[46] Generally in finance theory, risk is captured by the second moment or variance of the probability distribution associated with a given cash flow. An asset is just a lottery

[43] Wayne Lonergan, *The Valuation of Businesses, Shares and Other Equity* (Allen & Unwin, 4th ed, 2003) 22; Shannon P Pratt and Alina V Niculita, *Valuing a Business: The Analysis and Appraisal of Closely Held Companies* (McGraw Hill, 5th ed, 2008) 56.
[44] Fisher, above n 41, 12.
[45] Schneider, above n 35, 1297–8.
[46] Lonergan, above n 43, 66.

that is totally represented by the probability distribution over its amount, where that distribution is usually subjective.

Mathematically, the basic formula used to calculate the value of an asset using the DCF approach is:

$$PV = \sum \frac{E[C_t]}{(1+r)^t}$$

Where:

PV = present value

$E[C_t]$ = the expected value of the cash flow at time t

r = discount rate (usually assumed to be a constant like say 15%)

As a very simple example, an asset such as a loan that is expected to produce a cash inflow at time t = 1 (ie, the predicted cash flow is t = 1 period away) of either \$100 (with probability p) or \$40 (with probability 1-p), can be valued under this framework at its expected present value:

$$PV = \frac{[100p + 40(1-p)]}{(1+r)t}$$

If p = 0.8, r = 0.10 and t = 1, then the estimated asset value at t = 0 is:

$$PV = 88/1.1=80$$

The theory of financial valuation can thus be seen as a mathematical logic for equating or comparing future cash flows in terms of their times of occurrence, so as to allow for the time value of money, and their probability distributions, to allow for their uncertainty or risk. In principle, \$80 is an estimate of the market value of the uncertain future cash flow, presuming that the market views a discount rate of 10% as appropriate to its risk class. A higher risk assessment would of course mean a lower market value for the same expectation.

Asset

In finance theory, an asset is an anticipated future cash flow (or sequence of cash flows).[47] The probability that the future cash flow will be received may range from (effectively) zero, to (effectively) certainty.

All assets can therefore be thought of as lottery tickets, with the asset (ticket) representing a claim to an uncertain cash flow or 'payoff' at time *t*. The only difference between an asset and a lottery ticket is that the payoff of a lottery ticket has a known (objective) probability distribution, whereas the corresponding probability distribution for an asset is in general much more subjective.

Discounting to present value

The 'present value' of an asset is estimated by discounting the expected value of the future cash flow of the asset at an appropriate discount rate. The present value of an asset can be interpreted as the amount of money that an investor would be willing to pay at the date of valuation for the given stream of future cash flows. Future cash flows are discounted to present values to enable an investor to compare equivalent investments in money units current at the date of valuation.

The expected cash flow of an asset at time *t* represents the probability-weighted average of all possible future cash flows generated by the asset at that time. The discount rate is a rate that reflects the 'required rate of return' or 'opportunity cost' of the asset.[48] Specifically, the discount rate represents the opportunity cost of capital.[49]

[47] For judicial recognition of this concept, see, eg, *Gould v Vaggelas* (1985) 157 CLR 215, 266 (Dawson J); *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 199 CLR 413, 436 [51] (McHugh J); *Professional Services of Australia Pty Ltd v Computer Accounting and Tax Pty Ltd (No 2)* (2009) 261 ALR 179, 201 [102] (Martin CJ; Buss and Newnes JJA agreeing); *Sullavan v Teare* [2011] 1 Qd R 292, 301 [11] (Chesterman JA; Muir JA and Peter Lyons J agreeing).

[48] An opportunity cost is the cost of taking one of two or more mutually exclusive options, measured by the value of the next best alternative forgone. So for example, when an investor chooses investment A it does so because the expected net present value of A exceeds the expected net present value of B, where B is its second best option. The expected opportunity cost of choosing A is the expected net present value of B. In some circumstances an investor will have a zero or near to zero opportunity cost. This is for two reasons. The first is that the investor has no other viable investment possibility at the time of choosing investment A. The second is that the investor has no effective capital constraint, in the sense that if it identifies two or more different acceptable investments, it can raise the capital for both or all. In finance theory, it is sometimes assumed that, theoretically, the capital markets are

In other words, it represents the expected rate of return that an investor would forego by investing in the subject asset, rather than in an asset bearing a similar risk profile to the subject asset.[50] Thus, in *Winnote Pty Ltd v Page*,[51] Mason P (with whom Tobias and Basten JJA agreed) observed that a discount rate 'represents the expected rate of return that an investor would require to commit funds to an investment instead of available alternative investments that are comparable in terms of risk and other investment characteristics.'[52]

Value and risk

The present value of an asset will depend on the perceived risk or uncertainty of the future cash flow associated with that asset. There is no objectively true asset value. Present value is therefore almost always highly subjective. Even calculations of hypothetical market values stand on the subjective opinions and forecasts of the parties involved. Actual observable market values (eg, stock prices) are the results of subjective assessments by market participants, but are objective to the observer (eg, the price of a given stock at market close on a given day is objective).

A fundamental principle of financial economics is that a rational investor will not accept risk without compensation.[53] Accordingly, there is an inverse relationship between risk and the value of an asset: the higher the level of risk, the lower the value of the asset; the lower the risk, the higher the value (all other things being equal).[54] There is therefore a direct relationship between risk and the discount rate:[55] the higher the level of risk associated with an asset, the greater the discount that is applied to the value of that asset; the lower the risk, the less the discount.

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receptive at all times to financing good investments, and therefore if a potential investor has other good potential investments, apart from its most preferred investment, it can raise the money required in the market place and proceed to make all acceptable investments at once.

[49] Richard A Brealey and Stewart C Myers, *Principles of Corporate Finance* (McGraw-Hill, 6th ed, 2000) 17.

[50] Lonergan, above n 43, 66; Pratt and Niculita, above n 43, 181.

[51] *Winnote Pty Ltd v Page* [2006] NSWCA 287 (31 October 2006).

[52] *Winnote Pty Ltd v Page* [2006] NSWCA 287 (31 October 2006), [197].

[53] Lonergan, above n 43, 11.

[54] This relationship is reversed in the case of an option: the higher the level of risk, the greater the value of the option: see, Brealey and Myers, above n 49, 600.

[55] Schneider, above n 35, 1299–1300; Meyer, Fitzgerald and Moini, above n 35, 32.

It follows that, if the future cash flow associated with an asset is certain (or can be estimated with certainty), that asset will have a (much) higher value than an equivalent but uncertain expected payoff. Usually any negative information about an asset alters subjective perceptions about both its expected future payoff and the risk or variance of that payoff, which therefore has a two-fold effect on its present value. Specifically, the numerator or mean is reduced and the denominator or discount rate is increased.

Valuation under conditions of certainty

The value of an asset, represented by a stream of *certain* future cash flows, is determined by discounting the amount of that cash flow to present value at a rate that reflects the opportunity cost of the delay in receiving the money (ie, a return in compensation for deferring consumption). This cost is often referred to as the 'time value' of money.

In order to invest in such an asset, an investor will require recompense for deferring immediate consumption and for the expected rate of inflation. The rate of compensation will at least equal the rate of return available to the investor from assets bearing equivalent (effectively zero) risk, such as government bonds. While no asset provides a return that is completely risk-free, government bonds are considered to be effectively riskless because it is assumed that a government will never default on any of its outstanding financial obligations.[56] The government bond rate is therefore often referred to as the 'risk-free' rate of return.

Valuation under conditions of uncertainty

The value of an asset, represented by a stream of *uncertain* future cash flows, must be discounted to present value at a rate that reflects the cost of the delay in receiving the money, and the subjective risk of non-receipt or partial-receipt.

[56] Bagby, Miller and Solt, above n 2, 14–15.

Theoretically, the receipt of future cash flow may be certain. However, in reality, all future cash flow is inherently uncertain. Money to be received in the future may not be received, and it is therefore less valuable than money received in the present. Accordingly, in order to invest in an asset represented by a stream of uncertain future cash flow, an investor will require, in addition to the risk-free rate of return, a return commensurate with the risk of non-receipt. This additional return is often referred to as the 'risk-premium'. The risk premium represents the rate of return an investor demands in order to compensate the investor for investing in an asset bearing a level of risk higher than that represented by government bonds.

In finance theory, the risk that future cash flow may not be received is commonly measured by the variance from the expected value of that cash flow stream.[57] Variance in turn is defined quantitatively as the '[m]ean squared deviation from the expected value'[58] and is a measure of the perceived dispersion or variation in the future cash payoff.

Risk can also be measured in qualitative terms. In a qualitative sense, risk has been defined as '*the degree of uncertainty as to the realization of expected future economic income*.'[59] When used in this sense, risk is measured in terms of a 'personalistic',[60] or subjective, probability. A personalistic interpretation of probability 'measures the confidence that a particular individual has in the truth of a particular proposition.'[61] In other words, risk is measured by the investor's degree of confidence that the cash flows generated by an asset will equal the expected value of those cash flows.[62]

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[57] Brealey and Myers, above n 49, 163.
[58] Ibid 1073.
[59] Pratt and Niculita, above n 43, 61 (emphasis in original).
[60] Leonard J Savage, *The Foundations of Statistics* (John Wiley, 1954), 3.
[61] Ibid.
[62] The notion of risk is further clarified in finance theory by considering aggregate cash flows (portfolios). Under this more sophisticated approach, the risk attributes of individual cash flows are considered in terms of how they tend to coincide with other cash flows. For example, two loans which each have a 90% chance of being repaid seem fairly safe, but if they have the additional attribute that when one defaults then so does the other, then they are not as safe as they seem, or as safe as they would be if they were more independent. If the two loans are statistically independent, then the chance of both defaulting at once is only 1% (ie, 0.10 × 0.10).

In general terms, there are two types of risk that attach to an asset.[63] The first type of risk is diversifiable or unsystematic risk. This type of risk is local only (ie, unique or idiosyncratic) to the cash flows being estimated. For example, in a loan context, the risk that the borrower will default is at least partly a diversifiable risk. The second type of risk is undiversifiable or systematic risk. This type of risk relates to the variance in returns in the market in general, for example, the risk of increases in interest rates or taxes, or the risk of an adverse change in government policy. The risk of a borrower defaulting on a loan has both unsystematic and systematic components.

Theoretically, unsystematic risk can be reduced or eliminated by diversification.[64] Systematic risk, on the other hand, is risk that is endemic to the whole market or economy and cannot be reduced or eliminated by diversification, and therefore it is a natural index for risk in a diversified portfolio of assets.[65]

Systematic risk is defined technically by the covariance of an asset's payoff with the return or payoff on the market. Assets that tend to increase in value when the whole market increases, and decrease when it decreases, have positive covariance with the market and hence have 'systematic' or 'market' risk. Assets that are completely independent in their values have only 'idiosyncratic' risk, and no market risk.

The difference between risk in terms of payoff variance and covariance is one of the most important points in financial logic. Standard applications of DCF discount only for systematic risk, which might be only a small portion of total risk (variance). In fact, if an asset has negative covariance with the market, meaning that its value tends to go in the opposite direction to the market (gold can be an example), it might even be discounted at a rate lower than the risk-free rate, because it is so attractive in diversifying an investment portfolio. That however is rare, and in most legal contexts the assets involved will have typical positive covariance with the market.

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[63] Brealey and Myers, above n 49, 167.
[64] Ibid.
[65] Ibid 167, 169.

Estimation of risk-adjusted discount rate

Theoretically, the (risk-adjusted) discount rate, or opportunity cost of capital, is equal to the rate of return available on assets bearing a similar level of risk, or market risk, to the asset being valued.

The discount rate may be estimated formally, or informally.[66] In simple cases, the discount rate may be estimated informally, for example, by reference to an interest rate that seems economically appropriate relative to the yields (rates of return) on assets in the market bearing similar risk profiles. In more complex cases, it may be necessary to estimate the discount rate using a formal model that estimates mathematically the risk of the cash flows relating to such assets.

The appropriate formal discount model will depend on the types of capital used by the investor to finance the acquisition of the asset. If the investor only uses equity capital, the CAPM is the model most widely used to estimate the discount rate.[67] Under this model, the discount rate equals the risk free rate of return, plus the risk premium multiplied by the beta of the subject asset. In *Burger King Corporation v Hungry Jack's Pty Ltd*,[68] the Full Court of the New South Wales Court of Appeal described the CAPM as follows:[69]

> CAPM is a method used in the market place for valuing shares or assets which involve a projected income stream. Essentially an attempt is made to work out what return the hypothetical purchaser in the market place would want on the projected income stream. Relevant is the risk free rate, usually a bond rate. To this is added a market premium. There is then applied a factor (beta) chosen by the expert valuer to reflect the relative riskiness of assets in the stock exchange which have a similar profile to the cash flow projected. Beta of one is the market average. Less than one is less risky than the market average, greater than one, more risky. The risk rate obviously varies from time to time.

Under the CAPM, risk is measured in the context of a diversified portfolio.[70] The model assumes, in effect, that the market portfolio is fully (ie, optimally, or as best

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[66] Lonergan, above n 43, 155.
[67] Lonergan, above n 43, 155; Brealey and Myers, above n 49, 203.
[68] *Burger King Corporation v Hungry Jack's Pty Ltd* [2001] NSWCA 187 (21 June 2001).
[69] *Burger King Corporation v Hungry Jack's Pty Ltd* [2001] NSWCA 187 (21 June 2001), [695].
[70] Brealey and Myers, above n 49, 173, 197.

possible) diversified, and therefore the only remaining risk of the market portfolio is unavoidable systematic risk. In that context, the risk of an asset is measured by the extent to which that asset affects the risk of the portfolio as a whole, which is captured technically by its statistical covariance with the market. Put simply, any asset that is highly market dependent has high systematic risk, and hence a high discount rate.

The marginal contribution of an asset to the risk of the portfolio is measured by the beta of the asset.[71] The beta is a measure of how strongly the anticipated future cash flow or payoff of an asset is correlated with general market forces (ie, it is a measure of covariance with the market). The market as a whole is assigned a beta of 1, by mathematical construction. If an asset's future cash flow is largely unaffected by market forces, it will be assigned a beta nearer zero than one, and will be perceived to be less risky than an average investment in the market. If the cash flow is perfectly correlated with movements in the market, it will be assigned a positive beta that can be much higher than one (eg, a beta of three is very high on this scale), and will be perceived to be more risky than an average investment in the market (ie, if the market goes down, it tends to go down by a greater percentage than the market). The higher the beta, the greater the discount rate assigned to the asset. Beta is a mathematically constructed measure of the asset's systematic risk: it is what statisticians call a 'standardised' measure of covariance. It is standardised in the sense that it has a well-defined scale.

If the firm uses debt and equity capital, the after-tax WACC of its assets is the model most commonly used to estimate the discount rate.[72] This model operates as a benchmark estimate of the appropriate discount rate.[73] This is because the model estimates the *firm's* cost of capital, not the *project* cost of capital (ie, the cost of capital of the asset to be acquired).[74] The after-tax WACC model must be adjusted if the project risk or funding mix differs from that of the firm on average across all its asset holdings.

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[71] Ibid.
[72] Ibid 564.
[73] Ibid 247.
[74] Ibid.

The WACC is usually calculated by applying the interest rates or rates of return demanded by its capital providers. Thus, WACC can be found by determining the cost of each of the firm's classes of capital, multiplying the cost of that component by the proportion of the firm's total capital attributable to that component, and then summing the results.[75] The cost of the firm's debt is relatively easy to calculate, and is generally done on the basis of the firm's marginal after-tax cost of debt.[76] The cost of the firm's equity capital may be determined using the CAPM or by observing the percentage dividends paid to shareholders alongside the return paid in the form of capital gains (eg, if the market value of a firm is $100 at the start of the period and $110 at the end, and pays a $5 dividend for the period, then the percentage rate of return to equity holders is 15%).

Terminal value

In DCF analysis, a convenient simplification is to capture the present value of cash flows anticipated late in the asset's life, say after 10 years, by a single number called the terminal value. This is deemed to be the present value of the asset as at that time, and is then discounted back to time zero as part of the DCF valuation of the asset. The point of this exercise is to try to avoid the futility of predicting period-by-period cash flows after 10 years or after the date in question.

A 'terminal value' will be assigned to an asset at the point in time (terminal value date) beyond which it is deemed too difficult to forecast periodic cash flow. The selection of the terminal value date is arbitrary, and will depend on the nature of the asset in question. The terminal value of an asset is simply the present value, at the terminal value date, of the expected future cash flows of the asset over the remainder of its estimated life.

[75] Lloyd, above n 35, 36.
[76] Brealey and Myers, above n 49, 543.

DCF methodology

Overview

In Australia, the DCF methodology is the method most commonly used for determining the value of an asset,[77] and the proxy for its rational market value as at that time. It is also the 'international standard'[78] in the valuation field.

There are two main DCF methods or models: the 'risk-adjusted discount rate' model; and the 'certainty equivalent' model.[79] While each model represents an alternative approach to adjusting for risk, they will (in principle) yield the same result provided that consistent assumptions are made in each case.[80]

The risk-adjusted discount rate model is the most commonly used DCF model.[81] In this model, the expected cash flows relating to the asset are discounted at a risk-adjusted rate that reflects both the risk-free rate and the risk premium.

In contrast to the risk-adjusted discount rate model, the certainty equivalent model considers risk and the time value of money separately.[82] In the certainty equivalent model, the uncertain future cash flows relating to the subject asset are adjusted to reflect the risk of the asset (ie, they are converted into 'certainty equivalents') and then those cash flows are discounted at the risk-free rate of return. It has been suggested that this separation makes the certainty equivalent model 'a more theoretically correct method because including time value of money with the risk premium compounds the risk premium over time.'[83]

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[77] Lonergan, above n 43, 27.
[78] Senechal, above n 35, 4.
[79] Brealey and Myers, above n 49, 242–6. Other models include the 'adjusted present value' model and the 'excess return' model: see, Damodaran, above n 39, 6.
[80] Damodaran, above n 39, 36–8.
[81] Ibid 6. See also Senechal, above n 35.
[82] For an analysis of the use of the certainty equivalence approach in a damages context, see Boudreaux, Ferguson and Boudreaux, above n 35.
[83] Ibid 10.

Limitations

Irrespective of which DCF model is used, the accuracy or validity of a DCF analysis depends *ex ante* on the evidential credibility of the cash flow projections and the assumptions underpinning the discount rate. The method is therefore most useful where the asset being valued has a finite life and the future cash flow generated by the asset can be estimated with reasonable accuracy (eg, contractual payments). *Ex post*, a DCF analysis can be audited when the actual cash flows are known.

Other valuation methodologies

Introduction

Theoretically, DCF is the superior method of valuing an asset. This is because DCF explicitly recognises three things: first, that the worth of an asset depends on its future cash flow; secondly, the time value of money; and thirdly, that the inducement to make an investment in an asset with a higher level of risk is the expected higher return from the higher risk asset.[84]

In some circumstances, DCF analysis may not be useful, for example where projections of future cash flow are unavailable or unreliable. In those situations, other inevitably *ad hoc* methods of valuation may be used.

There are at least three main alternative methodologies: the comparable market price approach; the asset based approach; and the contingent claim approach.[85] Properly understood, each of these alternative methods is based on projected future cash flow, and therefore they act as surrogates for the cash flow approach.[86] In other words, these methodologies do not reflect different concepts of value; rather they reflect 'different *assumptions* about the fundamentals that determine value.'[87]

Each of these alternative methodologies is outlined below.

[84] Lonergan, above n 43, 67.
[85] Damodaran, above n 39, 2.
[86] Lonergan, above n 43, 21–2.
[87] Damodaran, above n 39, 2 (emphasis added).

Comparable market price

Under the comparable market price approach,[88] the value of an asset is determined by reference to the sale prices of comparable assets in the market for the subject asset.[89]

Under this approach, if the subject asset is identical to a comparable asset priced by the market then the value of the subject asset will equal the market value of the comparable asset. However, if the comparable asset is not identical, then the market value of the comparable asset must be scaled to a common variable to generate standardised prices that are comparable. Those prices must then be adjusted for differences across assets when comparing their standardised values.

The comparable market price approach is based on two core assumptions. The first assumption is that the relevant market is efficient. This means that the market price of an asset reflects all available information about the value of the asset.

The second assumption is that participants in the relevant market, buyers and sellers, are economically rational. This means that buyers and sellers in the market will not pay more, or accept less, for an asset than the expected return from the asset, discounted for the time value of money, and risk. Accordingly, the equilibrium price for an asset in the market is equal to the discounted sum of the future cash flow generated by the asset. The combination of these two assumptions means that all purchases and sales in the market are zero sum transactions. In other words, the price at which an asset is traded in the market equals its value.

In general, the comparable market price approach is an extremely useful index of the value of an asset. This is because, in many cases, the best evidence of the value of an asset is the price at which an asset comparable to the subject asset was sold. The main disadvantage of this approach, however, is that in many cases no comparable

[88] See generally, ibid ch 4.
[89] As a practical matter there will rarely be a single price for an asset. This is because there is rarely a single market for an asset. For example, there may be different geographical markets affected by different economic and regulatory factors; there may also be primary or secondary markets for the same asset, in which the asset trades at different prices.

asset exists, or, if it does, the (adjusted) price of that asset is not a reliable indicator of the value of the subject asset.

Asset-based approach

The second approach is the asset-based approach.[90] Under the asset-based approach, the value of the subject asset (usually a business) is determined by separately identifying and valuing all of the assets and liabilities of the business, revaluing them to market if necessary, and then subtracting from the value of the assets the value of the liabilities, and the costs of realising the assets, to arrive at the net realisable asset value of the business.

The asset-based approach is primarily used to value a business in circumstances where the primary value of the business lies in its assets, and not in its capacity as a whole to generate cash flow, or where the business is not profitable and a valuation is sought to determine whether the highest value of the business is in liquidation rather than as a going concern. It is generally not an appropriate method to use where the asset is a going concern because the value of the business as a whole can be much more than the value of its assets separately, and the method often focuses on historic costs of the assets in place and not on their current market values or individual capacities to generate future cash flow (value).[91]

Contingent claim approach

The final approach is the contingent claim approach. This approach uses option-pricing models to measure the value of assets that share the characteristics of options.[92] This approach is elegant theoretically but is not always possible to implement. To find an option value, there has to be an observable or theoretical value of the underlying asset that is the subject matter of the option.

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[90] See generally, Damodaran, above n 39, ch 3.
[91] Brown, above n 22, 10.
[92] Damodaran, above n 39, 2. For an analysis of a legal claim as an option see, eg, Joseph A Grundfest and Peter H Huang, 'The Unexpected Value of Litigation: A Real Options Perspective' (2006) 58 *Stanford Law Review* 1267.

Option valuation is a mathematical technique that yields the true value of the option conditional on the given (assumed) value of the underlying asset. It is therefore just as subjective, or more so, as the process by which the underlying asset value is found.

Present value in a damages context

Introduction

This section of the chapter considers the way in which the present value of the claimant's loss is calculated. The section commences with a brief overview of the legal principles, followed by an examination of two typical scenarios for the calculation of damages. In the first scenario, the claimant's loss is assessed at the date of the wrong (ie, the date of breach or the date the claimant's cause of action arose). In the second scenario, the claimant's loss is assessed at the date of trial. In each scenario, it is assumed that the claimant's loss first arose at the time of the wrong, and that the trial takes places some time after the time of the first loss. In the first scenario, it is also assumed that only those matters known up to the date of the wrong are taken into account for the purposes of valuing the claimant's loss.

General

In general, compensatory damages are awarded 'once and forever, and (in the absence of any statutory exception) must be awarded as a lump sum.'[93] This requires a court to adjust the claimant's damages to present value at the time the claimant's loss is assessed.[94] In the case of future loss, the claimant's damages are discounted to present value; in the case of past loss, the claimant's damages are accumulated to present value.

In *Todorovic v Waller*,[95] Brennan J explained the purpose of discounting damages for future loss:[96]

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[93] *Todorovic v Waller* (1981) 150 CLR 402, 412 (Gibbs CJ and Wilson J; Aickin J agreeing). This rule does not necessarily apply to the assessment of damages under s 236 of the ACL: *Murphy v Overton Investments Pty Ltd* (2004) 216 CLR 388, 409 [52] (Full Court).
[94] *Todorovic v Waller* (1981) 150 CLR 402, 414 (Gibbs CJ and Wilson J; Aickin J agreeing).
[95] *Todorovic v Waller* (1981) 150 CLR 402.

> [T]he award of damages results in the immediate payment of a lump sum which, by some form of investment, may earn increments between the time of that payment and the time when the lost earnings would have been paid in the future. To give the injured party an undiscounted equivalent of future net earnings would over-compensate him because he would be awarded also the increments to the capital sum. Discounting reduces the capital sum so that, with the increments it may earn over time, it could provide no more than the recurrent payments of net earnings which would have been received over the same time if the plaintiff's earning capacity had not been tortiously destroyed or impaired.

The task of discounting involves selecting an interest rate (expressed as a percentage) at which the claimant's damages for future economic loss will be discounted to present value. In *Gray v Richards*,[97] the Full Court of the High Court described the discount rate as 'a conceptual tool deployed for the purpose of arriving at a lump sum reflecting the present value of future losses.'[98] In *Nominal Defendant v Gardikiotis*,[99] McHugh J explained that a discount rate is used to assess the present value of future economic loss and expense 'because it is perceived to be the conceptual tool best suited to determine what is fair and reasonable compensation for that loss or expense.'[100] In *Todorovic*, Brennan J defined the discount rate as 'the rate which, applied to that undiscounted stream, results in a sum which the plaintiff could invest and draw upon from time to time to put himself in the same financial position as he would have been in if his earning capacity had not been tortiously impaired or destroyed.'[101]

The same considerations apply in adjusting a claimant's damages for past loss, except that such a loss is accumulated, rather than discounted, to present value at the date of assessment. Damages for past loss are accumulated to present value to reflect the delayed receipt of money; and the claimant's forgone opportunity to invest that money.

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[96] *Todorovic v Waller* (1981) 150 CLR 402, 466–7; see also, 428–9 (Stephen J), 442–3 (Mason J) and 451–2 (Murphy J).
[97] *Gray v Richards* (2014) 313 ALR 579.
[98] *Gray v Richards* (2014) 313 ALR 579, 590 [64].
[99] *Nominal Defendant v Gardikiotis* (1996) 186 CLR 49.
[100] *Nominal Defendant v Gardikiotis* (1996) 186 CLR 49, 61.
[101] *Todorovic v Waller* (1981) 150 CLR 402, 472.

Assessment at date of wrong

If the claimant's loss is assessed at the date of the wrong, the task of assessing that loss will involve determining the present value of the claimant's future (pre-trial and post-trial) loss.

Certain future cash flow

If the claimant's loss represents the loss of *certain* future net cash flow, that loss is valued by discounting that amount back to the date of the wrong at the risk-free rate for the period in question. The risk-free rate is used because the cash flow is certain or riskless. In general terms, because of the time value of money, a failure to discount any loss of future cash flow (certain or uncertain) at least at the risk-free discount rate will almost certainly give rise to an error of fact, or an error of mixed fact and law.[102]

Uncertain future cash flow

If the claimant's loss represents the loss of *uncertain* future net cash flow, that loss is valued by discounting the expected value of that cash flow back to the date of the wrong at an appropriate (risk-adjusted) discount rate.[103] A risk-adjusted rate is used because the cash flow is uncertain or risky. Thus, in *P M Sulcs v Daihatsu Australia*,[104] Kirby J observed, in the context of assessing damages for loss of a commercial opportunity:[105]

> In considering what discount rate should be used, the overall objective of the discounting exercise must be borne in mind. The overall aim is to convert a stream of projected (but nevertheless hypothetical) net cash flows, occurring over a long period of time, into a single lump sum at a single date. The act of conversion of the net cash flow stream into a single cash lump sum is therefore to ascribe an equivalent

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[102] See, eg, *Batterham v Makeig* (2010) 15 BPR 28,713, 28,729-30 [115] (Young JA; McColl JA and Sackville AJA agreeing). See also, *P M Sulcs v Daihatsu Aust – Costs & Interest* [2001] NSWSC 798 (13 September 2001), [4]–[13] (Kirby J).

[103] *P M Sulcs v Daihatsu Australia* [2001] NSWSC 636 (1 August 2001), [903]. See also, *IOOF Building Society Pty Ltd v Foxeden Pty Ltd* [2009] VSCA 138 (19 June 2009), [216] (Full Court); *North East Solution Pty Ltd v Masters Home Improvement Australia Pty Ltd* [2016] VSC 1 (28 January 2016), [345], 346], [375] (Croft J).

[104] *P M Sulcs v Daihatsu Australia* [2001] NSWSC 636 (1 August 2001).

[105] *P M Sulcs v Daihatsu Australia* [2001] NSWSC 636 (1 August 2001), [903].

value as at 30 June 1989 to those net cash flows, so that the single lump sum reflected all future net cash flows but allowed for the different time periods of receipt and the risks of receipt.

Similarly, in *James Carleton Seventh Earl of Malmesbury v Strutt & Parker (a partnership)*,[106] Jack J observed, in the context of valuing the loss of an opportunity to negotiate a turnover rent provision in a lease:[107]

> The annual sums forecast to be received as turnover rent require to be discounted for two reasons. One is that they are to be received in the future, and so require to be discounted to arrive at a present value. The second is that the income is uncertain: I mean that, although the assessment of the amount represents what the rent is most likely to be, it may turn out to be more, or, more importantly less. Because of that uncertainty, which I can refer to as the commercial risk, a purchaser of the income would require a discount to reflect his assessment of that risk.

In general, a court should assess the probability of the risk relating to uncertain future cash flow on a subjective, or personalistic, basis. This is because meaningful statistical or quantitative measurements of risk are generally unavailable or inapplicable in a legal context.[108]

In a damages context, the appropriate risk-adjusted discount rate should generally equal the claimant's opportunity cost of capital,[109] at the time of the wrong.[110] This is because, in awarding the claimant damages for the loss of an uncertain (ie, risky) future cash flow, the claimant will be relieved of the risk of receiving that cash flow, and therefore the discount rate should *include* the risk-premium.[111] In general, it is not appropriate in a commercial context to adopt the discount rates used in valuing

[106] *James Carleton Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 2641 (10 December 2007).
[107] *James Carleton Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 2641 (10 December 2007), [27].
[108] Robert J Rhee, 'The Effect of Risk on Legal Valuation' (2007) 78 *University of Colorado Law Review* 193, 199.
[109] *P M Sulcs v Daihatsu Australia* [2001] NSWSC 636 (1 August 2001), [904] (Kirby J); *Haviv Holdings Pty Ltd v Howards Storage World Pty Ltd* (2009) 254 ALR 273, 294 [66] (Jagot J). See also, Schneider, above n 35, 1299; Lanzilloti and Esquibel, above n 1, 130; Fisher and Romaine, above n 35, 150; Boudreaux, Ferguson and Boudreaux, above n 35, 2–3; Lloyd, above n 35, 32. For a detailed analysis, see Meyer, Fitzgerald and Moini, above n 35.
[110] Fisher and Romaine, above n 35, 150.
[111] Ibid 154; Lanzilloti and Esquibel, above n 1, 130.

economic loss in a personal injury context because those rates do not incorporate an appropriate risk premium for the loss of uncertain future cash flow.[112]

Effect of post-wrong evidence

In some circumstances, even if damages are assessed as at the date of the wrong, a court may admit evidence of events occurring between the date of the wrong and the date of the trial relevant to the quantum of loss. If this evidence is admitted, it may affect the valuation of the claimant's loss of future cash flow, or the rate at which that cash flow is discounted to the date of assessment. For example, the admission of post-wrong evidence may lead a court to apply the discount rates applicable at the date of the trial, or it may lead the court to apply different discount rates to the claimant's pre-trial and post-trial (future) loss.

In *Haviv Holdings Pty Ltd v Howards Storage World Pty Ltd*,[113] Jagot J was required to determine how to apply a discount rate to ascertain the present value of net lost profits caused by a breach of contract. Her Honour assessed damages at the date of loss (shortly after the date of breach), but adopted different discount rates for the claimant's pre-trial and post-trial loss. Jagot J discounted the pre-trial net lost profits back to the date of loss at 28%, and the claimant's post-trial net lost profits back to the date of loss at 30%. Her Honour explained that the claimant's pre-trial loss was discounted at a lower rate because 'known facts up to the date of judgment are able to be taken into account', and therefore 'the hypothetical past presents fewer risks than the uncertain future because the past took place in a known economic environment.'[114]

Pre-judgment interest

If a claimant's loss is assessed at the date of the wrong, the claimant will require compensation for being deprived of the use of its money between the date of the

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[112] See *Haviv Holdings Pty Ltd v Howards Storage World Pty Ltd* (2009) 254 ALR 273, 293–4 [63]–[66] (Jagot J). See also, Schneider, above n 35, 1300–1. For the principles relevant to discounting damages in a personal injury context, see Harold Luntz, *Assessment of Damages for Personal Injury and Death* (LexisNexis Butterworths, 4th ed, 2002) ch 6, 7.
[113] *Haviv Holdings Pty Ltd v Howards Storage World Pty Ltd* (2009) 254 ALR 273.
[114] *Haviv Holdings Pty Ltd v Howards Storage World Pty Ltd* (2009) 254 ALR 273, 295 [73].

wrong and the time of judgment. In order to obtain compensation, the claimant must prove a claim for the loss of use of its money,[115] or apply for an award of statutory pre-judgment interest on this loss.[116]

Most Australian jurisdictions permit the award of interest on a claimant's loss from the accrual of the cause of action (or commencement of proceedings) to the time of judgment.[117] The award 'is an award of interest in the nature of damages', and is 'compensatory in character.'[118] The purpose of such an award is to compensate a claimant for being 'deprived of the use of his or her money, not because he or she has forgone investment opportunities.'[119] An award of pre-judgment interest, in addition to an award of damages for the claimant's loss, restores the claimant to the position it would have been in if the wrong had not occurred.[120] The disadvantage of such an award, however, is that it is only made on a simple, and not a compound, interest basis.[121]

Alternatively, the claimant could seek damages for the loss of use of money between the date of the wrong and the date of judgment. In general, a claimant would claim compensation for the loss of use of money calculated by reference to the claimant's opportunity cost of capital.[122] The precise rate will depend on the claimant's circumstances. In general, finance theory assumes that a firm can reinvest its cash flows at its WACC.[123] On this basis, compounding the claimant's loss at its WACC puts the claimant in the position it would have been in if the wrong had not occurred and the claimant had reinvested its lost cash flow at its WACC.[124]

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[115] See, *Hungerfords v Walker* (1989) 171 CLR 125.
[116] See, eg, *North East Solution Pty Ltd v Masters Home Improvement Australia Pty Ltd (No 2)* [2016] VSC 87 (18 March 2016), [23]-[30] (Croft J).
[117] See, eg, *Federal Court of Australia Act 1976 (Cth)*, s 51A; *Supreme Court Act 1933 (ACT)*, s 69; *Civil Procedure Act 2005 (NSW)*, s 100; *Supreme Court Act 1979 (NT)*, s 84; *Supreme Court Act 1995 (Qld)*, s 47; *Supreme Court Act 1935 (SA)*, s 30C; *Supreme Court Act 1986 (Vic)*, s 60; *Supreme Court Act 1935 (WA)*, s 32. See also, *Supreme Court Civil Procedure Act 1932 (Tas)*, s 34.
[118] *Haines v Bendall* (1991) 172 CLR 60, 66 (Mason CJ, Dawson, Toohey and Gaudron JJ).
[119] *MBP (SA) Pty Ltd v Gogic* (1991) 171 CLR 657, 666 (Full Court). See also, *Grincelis v House* (2000) 201 CLR 321, 328 [16] (Gleeson CJ, Gaudron, McHugh, Gummow and Hayne JJ).
[120] *Haines v Bendall* (1991) 172 CLR 60, 66 (Mason CJ, Dawson, Toohey and Gaudron JJ).
[121] See, eg, *Civil Procedure Act 2005 (NSW)*, s 100(3)(a).
[122] Thierry Senechal, 'Time Value of Money: A Case Study' (2007) 4(6) *Transnational Dispute Management* 1, 9.
[123] Meyer, Fitzgerald and Moini, above n 35, 37.
[124] Ibid. See also, Michel and Shaked, above n 35, 461–2; Boudreaux, Ferguson and Boudreaux, above n 35, 3.

The advantage of this approach is that the claimant's loss is calculated on a compound, rather than a simple, interest basis. However, a claimant must prove the loss of use of money, and except perhaps where the claimant seeks to prove its loss by reference to a risk-free compound rate,[125] the claimant's loss may be discounted significantly to reflect the chances or contingencies affecting its realisation.

Assessment at date of trial

If the claimant's loss is assessed at the date of trial, the task of assessing that loss will involve determining the present value of the claimant's pre-trial (past) loss, and may also involve determining the present value of the claimant's post-trial (future) loss.

Post-trial loss

The simplest part involves valuing the claimant's post-trial (future) loss. If the claimant's loss is assessed at the date of trial, the claimant's post-trial loss of future net cash flow is valued in the manner described above, depending on whether it is certain or uncertain.

Pre-trial loss

Certain past cash flow

The valuation of the claimant's pre-trial (past) loss is more complicated. If the claimant's pre-trial loss represents the loss of *certain* past net cash flow, the value of that loss is computed simply by accumulating that loss forward to the date of trial at an appropriate accumulation rate for the relevant period.

[125] See, Lanzilloti and Esquibel, above n 1, 134; Fisher and Romaine, above n 35.

Uncertain past cash flow

More difficult is valuing the claimant's pre-trial loss of *uncertain* past net cash flow. There are two methods for valuing this loss.[126] Under the first method the claimant's loss is computed by reference to the claimant's actual *known* pre-trial loss. Under the second method, the claimant's loss is computed by reference to the claimant's *expected* pre-trial loss.

The first method is similar to the approach used to compute the claimant's pre-trial loss of certain past net cash flow. If the claimant's loss of pre-trial uncertain past net cash flow is known by the time of the trial, the value of that loss can be computed by accumulating that amount to the date of trial at an appropriate accumulation rate for the relevant period.

The second method involves calculating, at the time of the wrong, the expected value of the claimant's pre-trial uncertain (future) net cash flow, and then discounting that amount back to the date of the wrong at the claimant's opportunity cost of capital at the date of the wrong. The resulting figure is then accumulated to the date of trial at an appropriate accumulation rate for the relevant period. In contrast to the first method, the court ignores the claimant's actual known pre-trial net cash flow loss.

The first method is based on the view that the best evidence of the value of the claimant's loss is the claimant's actual known loss of net cash flow. The second method, on the other hand, is based on the view that the most precise estimate of the value of the claimant's loss is the pre-wrong expected value of the claimant's net cash flow, which reflects the specific risks and returns associated with those cash flows (and the price at which the relevant asset could have been sold at that time), and that estimate is to be preferred to actual (arbitrary) cash flows.

In Australia, general support for the first method can be found in the judgment of Aickin J in *Todorovic*. His Honour observed, *obiter*, that in assessing damages in a personal injury context for lost wages up to the date of trial, '[i]t is no doubt realistic

[126] For a detailed analysis of each method, see Lanzilloti and Esquibel, above n 1, 132–8; Fisher and Romaine, above n 35.

and sensible to take an actual figure, where one is known, especially when it represents a highly probable loss to the plaintiff, capable of calculation with reasonable certainty, and to confine estimates and guesses to the uncertain, unknown and unknowable.'[127]

More direct support can be found in *Australian Naturalcare Products Pty Ltd v McGrath; in the matter of Pan Pharmaceuticals Limited (in liq)*.[128] Gyles J held that the defendant's contravention of s 18(1) of the ACL had caused the claimant to suffer a pre-trial loss of net profit. His Honour held that the claimant's damages under s 236(1) were to be assessed by reference to the claimant's actual known pre-trial losses, accumulated to the date of trial at the rate of interest applicable to an award of statutory pre-judgment interest:[129]

> I do not see the necessity for any discount back to a present value at the date of breach. The time has now elapsed. The amounts in question reflect the dollar values at the time during the period of loss. On that basis, interest would not run from the date of breach but should be calculated to reflect the progressive occurrence of loss.

Ultimately, the appropriate approach for a court to adopt will depend on the precise legal and factual circumstances. The touchstone for the court will be the approach 'best adapted to giving an injured plaintiff that amount in damages which will most fairly compensate him for the wrong he has suffered.'[130]

Accumulation rate

Subject to double counting, in order to make the claimant whole at the date of trial, the claimant's pre-trial loss should be accumulated from the date of the wrong to the date of judgment. This can be achieved by an award of statutory pre-judgment interest, or by an award of damages for the loss of the use of money, as described

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[127] *Todorovic v Waller* (1981) 150 CLR 402, 457.
[128] *Australian Naturalcare Products Pty Ltd v McGrath; in the matter of Pan Pharmaceuticals Limited (in liq)* (2006) 237 ALR 389; affirmed, without reference to the issue, sub nom *McGrath v Australian Naturalcare Products Pty Ltd* (2008) 165 FCR 230.
[129] *Australian Naturalcare Products Pty Ltd v McGrath; in the matter of Pan Pharmaceuticals Limited (in liq)* (2006) 237 ALR 389, 419 [105].
[130] *Johnson v Perez* (1988) 166 CLR 351, 355–6 (Mason CJ); 367 (Wilson, Toohey and Gaudron JJ); 380 (Deane J); 386 (Dawson J).

above in relation to pre-judgment interest on damages assessed at the date of the wrong.

Conclusion

This chapter examined the methods and role of financial valuation theory in the assessment of damages for economic loss in a commercial context.

This chapter demonstrated that, in a damages context, the value (or loss in value) of an asset is generally determined by reference to a present value of cash flows or hypothetical market value. Market value, in this context, means the hypothetical exchange price of an asset based on its future cash flows and perceived risk-return characteristics. This chapter explained that the particular methodology used to determine the market value of an asset will depend on the precise legal and factual circumstances, and demonstrated that financial valuation theory is an accepted methodology for determining market value in this context.

This chapter also described how financial valuation theory is used to determine the value of loss in a damages context. The chapter outlined the major principles of financial valuation theory relevant to the valuation of loss, and demonstrated how they can be used to determine the present value of a claimant's loss in two common scenarios: first, where the claimant's loss is assessed at the date of the wrong; and secondly, where the claimant's loss is assessed at the date of the trial.

Chapter 3

Loss of a commercial opportunity

Introduction

Purpose and object

This chapter provides an introduction to the legal doctrine of loss of a commercial opportunity. The object of this chapter is to provide the legal foundation for the analysis that follows in Part two of the thesis.

This chapter will also assist finance experts by introducing the legal framework within which their expert analysis and evidence will be considered. For expert evidence to be admissible, and useful, it must relate to the legal principles in question and the legal environment in which it is used. A sound understanding of this environment will assist finance experts in preparing relevant and persuasive evidence on the value of loss of a commercial opportunity, and ultimately assist courts in determining the value of that loss.

This chapter will focus on three particular areas: first, the meaning and legal character of the loss; secondly, the circumstances when liability for such a loss will arise in contract, tort, and under s 18(1) of the ACL; and thirdly, the general principles relevant to compensation for such a loss.

Structure

This chapter is divided into an introduction, and two main sections. The first section provides an introduction to the legal doctrine of loss of a commercial opportunity. It is divided into two parts. The first part identifies the meaning and legal character of the loss of a commercial opportunity. The second part outlines, by reference to decided cases, the circumstances when liability for such a loss will arise in contract, tort, and under s 18(1) of the ACL.

The second section of this chapter examines the general principles relating to compensation for loss of a commercial opportunity. It is divided into two parts. The first part outlines the compensatory principle, which underpins the award of damages for loss of a commercial opportunity. The second part demonstrates how the compensatory principle applies to the loss of a commercial opportunity.

Loss of a commercial opportunity

Introduction

Meaning

A commercial opportunity is a chance to obtain a pecuniary benefit,[1] or to avoid a pecuniary loss or liability,[2] in a commercial context.

In general terms, a claim for loss of a commercial opportunity involves a claim for compensation for the loss of a chance or opportunity to take an alternative available course of action. The object of this course of action is to obtain a pecuniary benefit or to avoid a pecuniary loss or liability. This course of action may include entering into a profitable contract, making an alternative investment, or avoiding some type of financial loss.

[1] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 92–4 (Mason CJ and Dawson J), 104 (Brennan J), 118–19 (Deane J); *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 348 (Mason CJ, Dawson, Toohey and Gaudron JJ); *Badenach v Calvert* (2016) 331 ALR 48, 56 [39] (French CJ, Kiefel and Keane JJ). The relevant benefit may include the chance to make an even greater return than the claimant made in fact: *Professional Services of Australia Pty Ltd v Computer Accounting and Tax Pty Ltd (No 2)* (2009) 261 ALR 179, 202 [104], 205 [119] (Martin CJ; Buss and Newnes JJA agreeing).
[2] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 119 (Deane J); *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 363 (Brennan J); *Badenach v Calvert* (2016) 331 ALR 48, 56 [39] (French CJ, Kiefel and Keane JJ); *Daniels v Anderson* (1995) 37 NSWLR 438, 526, 529, 538–9 (Clarke and Sheller JJA; Powell JA agreeing generally); *QBE Insurance Ltd v Moltoni Corporation Pty Ltd* (2000) 22 WAR 148, 151 [7] (Ipp J), reversed, but reasoning approved, sub nom *Moltoni Corporation Pty Ltd v QBE Insurance Ltd* (2001) 205 CLR 149, 163 [24] (Full Court); *Unit 11 Pty Ltd v Sharpe Partners Pty Ltd* (2006) 150 FCR 405, 413 [34] (Lee J); *Doolan v Renkon Pty Ltd* (2011) 21 Tas R 156, 173 [57] (Full Court); *Australian Special Opportunity Fund LP v Equity Trustees Wealth Services Ltd* [2015] NSWCA 225 (11 August 2015), [161]-[163] (Bathurst CJ; Macfarlan JA agreeing), [190] (Emmett JA); *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1611 (Stuart-Smith LJ; Hobhouse LJ agreeing).

This type of claim represents a claim for the value of the *chance* or *opportunity* of receiving an expected benefit or avoiding an expected loss or liability; not a claim for the value of the expected benefit or loss or liability itself.[3] The opportunity of receiving the expected benefit or avoiding the expected loss or liability is the probability that the benefit would accrue in the manner expected or the probability that the loss or liability could have been avoided.

Economic loss

The loss of a commercial opportunity is a form of economic loss.[4] Economic loss means 'loss other than physical injury to person or property.'[5]

In *Wardley Australia Ltd v State of Western Australia*,[6] Brennan J observed that a claimant 'may suffer economic loss or damage in a number of ways: by payment of money, by transfer of property, by diminution in the value of an asset or by the incurring of a liability.'[7] It follows that economic loss involves an actual loss or diminution in value of an asset. At a very general level, that asset is the claimant's relevant financial position. More specifically, that asset may be a particular item of real or personal property, such as a contractual right, or a commercial opportunity.

At common law, a claimant is entitled to damages for any economic loss it suffers as a result of breach of contract or the commission of a tort, subject to the rules relating to remoteness and mitigation of damage.[8] Under section 236 of the ACL, a person who has suffered 'loss or damage'[9] because of conduct that is misleading or

[3] *Howe v Teefy* (1927) 27 SR (NSW) 301, 307 (Street CJ; Gordon and Campbell JJ agreeing); *Waribay Pty Ltd v Minter Ellison* [1991] 2 VR 391, 397 (Young CJ and Kaye J); *Darvall McCutcheon v HK Frost Holdings Pty Ltd* (2002) 4 VR 570, 590 [72] (Chernov JA; Ormiston and Callaway JJA agreeing); *Berryman v Hames Sharley (WA) Pty Ltd* (2008) 38 WAR 1, 86 [536] (Hasluck J).
[4] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 348 (Mason CJ, Dawson, Toohey and Gaudron JJ).
[5] *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514, 525 (Mason CJ, Dawson, Gaudron and McHugh JJ).
[6] *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514.
[7] *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514, 536.
[8] *Hungerfords v Walker* (1989) 171 CLR 125, 143 (Mason CJ and Wilson J).
[9] Section 4K of the CCA provides that, in the Act:
(a) a reference to loss or damage, other than a reference to the amount of any loss or damage, includes a reference to injury; and
(b) a reference to the amount of any loss or damage includes a reference to damages in respect of an injury.

deceptive, or likely to mislead or deceive, in contravention of s 18(1) of the ACL, may recover the amount of the loss or damage. The term 'loss or damage' includes,[10] but is not limited to,[11] economic loss.

Actual damage

The loss of a (valuable) commercial opportunity constitutes actual damage.[12]

At common law, and under s 236 of the ACL, a claimant 'can only recover compensation for actual loss or damage incurred, as distinct from potential or likely damage.'[13] Thus, in *Wardley*, a majority of the High Court held that risk of loss is not a category of loss,[14] and that if a claimant enters into a contract which exposes it to a contingent loss or liability, the claimant 'sustains no actual damage until the contingency is fulfilled and the loss becomes actual.'[15] Actual loss or damage means 'any detriment, liability or loss capable of assessment in money terms',[16] provided that the loss sustained falls 'within the measure of damage applicable to the wrong in question.'[17]

Where the relevant opportunity is promised by contract, there will be little difficulty in establishing that the loss of that opportunity constitutes actual damage.[18] This is because, as pointed out by Brennan J in *Sellars v Adelaide Petroleum NL*:[19]

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[10] *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514, 526 (Mason CJ, Dawson, Gaudron and McHugh JJ).
[11] *Murphy v Overton Investments Pty Ltd* (2004) 216 CLR 388, 407 [45] (Full Court).
[12] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 348, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ), 364 (Brennan J); *Gregg v Scott* [2005] 2 AC 176, 183 [17] (Nicholls LJ), 195 [72] (Hoffmann LJ); *Barker v Corus UK Ltd* [2006] 2 AC 572, 590 [36] (Hoffmann LJ).
[13] *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514, 526 (Mason CJ, Dawson, Gaudron and McHugh JJ) (citations omitted).
[14] *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514, 526–7 (Mason CJ, Dawson, Gaudron and McHugh JJ).
[15] *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514, 532 (Mason CJ, Dawson, Gaudron and McHugh JJ). See also *Law Society v Sephton & Co (a firm)* [2006] 2 AC 543. *Contra* Hugh Evans, 'Contingent liability and "damage"' (2007) 23(1) *Professional Negligence* 2 (contingent loss should be construed as damage).
[16] *Forster v Outred & Co* [1982] 1 WLR 86, 94 (Stephenson LJ; Dunn LJ and Sir David Cairns agreeing generally).
[17] *Nykredit Mortgage Bank plc v Edward Erdman Group Ltd (No 2)* [1997] 1 WLR 1627, 1630 (Nicholls LJ; Goff, Jauncey, Slynn and Hoffmann LJJ agreeing).
[18] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 349 (Mason CJ, Dawson, Toohey and Gaudron JJ), 359 (Brennan J). See also, *QBE Insurance Ltd v Moltoni Corporation Pty Ltd* (2000) 22

> [T]he relevant loss is identified by the contractual promise to afford the plaintiff an opportunity to acquire a benefit or to avoid a detriment. A breach of the promise to afford that opportunity necessarily establishes that the loss flows from the breach. In contract cases, a plaintiff may be entitled to nominal damages for loss of the opportunity promised even though the plaintiff fails to prove what, if any, value performance of the unfulfilled promise would have had.

However, in the tort of negligence,[20] and under s 236 of the ACL,[21] damage is the 'gist of the action'. In those cases, loss of a commercial opportunity 'cannot be proved by reference to an antecedent promise to afford an opportunity.'[22] Accordingly, in tort, and under s 236, the threshold issue is whether, as a matter of law, a lost commercial opportunity itself constitutes actual damage.[23]

In *Wardley*, Deane J addressed the question of whether loss of a commercial opportunity constitutes actual damage. The majority held that risk of loss is not a category of loss,[24] and that if a claimant enters into a contract which exposes it to a contingent loss or liability, the claimant 'sustains no actual damage until the contingency is fulfilled and the loss becomes actual.'[25] Deane J, who was in the minority, reached the same conclusion. His Honour stressed, however, that the fact that a risk of future economic loss does not, of itself, suffice to found a cause of action was not to deny that the loss of a commercial opportunity could constitute actual damage:[26]

WAR 148, 154 [22] (Ipp J), reversed, but reasoning approved, sub nom *Moltoni Corporation Pty Ltd v QBE Insurance Ltd* (2001) 205 CLR 149, 162–3 [24] (Full Court).

[19] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 359 (citations omitted). See also *Law Society v Sephton & Co (a firm)* [2006] 2 AC 543, 569 (Mance LJ).

[20] *Williams v Milotin* (1957) 97 CLR 465, 474 (Full Court); *John Pfeiffer Pty Ltd v Canny* (1981) 148 CLR 218, 241 (Brennan J); *Tame v New South Wales* (2002) 211 CLR 317, 388 [208] (Gummow and Kirby JJ); *Harriton v Stephens* (2006) 226 CLR 52, 102 [161] (Hayne J), 115 [218], 126 [251] (Crennan J; Gleeson CJ and Gummow and Heydon JJ agreeing); *Tabet v Gett* (2010) 240 CLR 537, 560 [50] (Gummow ACJ); 577 [109] (Kiefel J; Hayne, Crennan and Bell JJ agreeing); *Gregg v Scott* [2005] 2 AC 176, 201 [99] (Hope LJ), 226 [193] (Baroness Hale).

[21] *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514, 525 (Mason CJ, Dawson, Gaudron and McHugh JJ); *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 348 (Mason CJ, Dawson, Toohey and Gaudron JJ).

[22] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 359 (Brennan J).

[23] *Tabet v Gett* (2010) 240 CLR 537, 560 [50] (Gummow ACJ).

[24] *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514, 526–527 (Mason CJ, Dawson, Gaudron and McHugh JJ).

[25] *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514, 532 (Mason CJ, Dawson, Gaudron and McHugh JJ). See also, *Law Society v Sephton & Co (a firm)* [2006] 2 AC 543.

[26] *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514, 544 (citations omitted).

> [T]he loss of a mere chance of some future economic benefit may itself constitute loss or damage for the purpose of completing a common law cause of action. The loss of a chance of an economic benefit is not merely a risk of some future loss. The loss of the chance is itself a loss which has actually been sustained and which is, in an appropriate case, capable of sounding in damages.

Deane J's statement was, however, merely *obiter*. Moreover, the cases relied upon by his Honour all involved claims in contract, or concurrent claims in tort and contract.[27] Subsequently, in *Sellars*, the issue arose squarely for determination in the context of a claim for damages under s 236 of the ACL. The High Court unanimously accepted that the loss of the opportunity of entering into, and deriving benefits under, a commercial contract constituted 'loss or damage' for the purposes of s 236 of the ACL.

It follows from *Wardley* and *Sellars* that a distinction must be drawn between *loss of a chance*, which constitutes actual damage, and the *chance of a loss*, which may, in the future, mature into actual damage.[28]

Basis of liability

Introduction

Loss of a commercial opportunity is a well-recognised head of damage at common law, and under statute.[29] The modern law of loss of a commercial opportunity can be traced to the decision of the English Court of Appeal in *Chaplin v Hicks*.[30] The claimant entered into a contract to participate in a beauty competition. The prize was one of 12 theatrical engagements. By the terms of the competition the claimant became one of 50 entrants eligible for selection by the defendant for one of the engagements. In breach of contract, the defendant failed to give the claimant a reasonable opportunity to attend a selection interview, and the claimant was not

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[27] *Chaplin v Hicks* [1911] 2 KB 786; *Hall v Meyrick* [1957] 2 QB 455; *Kitchen v Royal Air Force Association* [1958] 1 WLR 563; *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64.

[28] *Segal v Fleming* [2002] NSWCA 262 (14 August 2002), [24]–[26] (Hodgson JA; Handley JA and Young CJ in Eq agreeing). See also, *Cassis v Kalfus* [2001] NSWCA 460 (11 December 2001), [74]–[76] (Hodgson JA; Powell and Heydon JJA agreeing).

[29] See generally Robyn Carroll, 'Damages for Loss of a Commercial Opportunity', in Robyn Carroll (ed), *Civil Remedies: Issues and Developments* (Federation Press, 1996) ch 2. But see Richard Bronaugh, 'Lost Opportunities in Contract Damages' [1983] 17 *Valparaiso University Law Review* 735 (lost opportunities not relevant to the assessment of damages for breach of contract).

[30] *Chaplin v Hicks* [1911] 2 KB 786.

selected for an engagement. At trial, the jury awarded the claimant £100 as damages for loss of the chance of selection.

Vaughan Williams LJ (with whom Fletcher Moulton and Farwell LJJ agreed) dismissed an appeal by the defendant. His Lordship rejected the defendant's contention that it was impossible to assess the value of the claimant's loss because it turned on such a number of contingencies.[31] Vaughan Williams LJ observed that, as a matter of principle, 'the fact that damages cannot be assessed with certainty does not relieve the wrong-doer of the necessity of paying damages for his breach of contract.'[32] Furthermore, the instant case was not one where 'the loss is so dependent on the mere unrestricted volition of another that it is impossible to say that there is any assessable loss resulting from the breach.'[33] His Lordship concluded 'the taking away from the plaintiff of the opportunity of competition, as one of a body of fifty, when twelve prizes were to be distributed, deprived the plaintiff of something which had a monetary value.'[34] The fact that a market for the opportunity did not exist was not relevant; what was relevant was that 'a jury might well take the view that such a right, if it could have been transferred, would have been of such a value that every one would recognize that a good price could be obtained for it.'[35]

Chaplin has subsequently been approved by the High Court on several occasions.[36]

Contract

Damages for loss of a commercial opportunity may be awarded in contract,[37] in three broad circumstances.[38] First, where the contract contains an express[39] or implied[40]

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[31] *Chaplin v Hicks* [1911] 2 KB 786, 791.
[32] *Chaplin v Hicks* [1911] 2 KB 786, 792.
[33] *Chaplin v Hicks* [1911] 2 KB 786, 792–3.
[34] *Chaplin v Hicks* [1911] 2 KB 786, 793.
[35] *Chaplin v Hicks* [1911] 2 KB 786, 793.
[36] *Fink v Fink* (1946) 74 CLR 127, 135 (Latham CJ and Williams J), 143 (Dixon and McTiernan JJ); *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377, 411–12 (Dixon and Fullagar JJ; McTiernan J agreeing); *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 349 (Mason CJ, Dawson, Toohey and Gaudron JJ).
[37] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 118–19 (Deane J); *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ).
[38] *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010), [2] (Allsop P; Beazley JA agreeing).

promise to confer the opportunity on the claimant. Secondly, where the object of the contract provides a particular opportunity to the claimant.[41] Thirdly, where the loss of the opportunity is the consequence of a breach of contract and the loss of the opportunity falls within the rules of remoteness in contract.[42]

Express promise

Chaplin is an example of the first category of case. The Court of Appeal appeared to infer an express promise by the defendant to give the claimant a reasonable opportunity to attend the selection interview. In *McRae v Commonwealth Disposals Commission*,[43] Dixon and Fullagar JJ (with whom McTiernan J agreed) noted that the broken promise 'was, in effect, "to give the plaintiff a chance".'[44]

A more recent example is the decision of the majority of the New South Wales Court of Appeal in *Silverbrook Research Pty Ltd v Lindley*.[45] The defendant had employed the claimant under a written service agreement. Under the terms of the agreement, the claimant was entitled to an annual performance bonus of $40,000, subject to satisfying certain objectives set by the defendant, and subject to the defendant exercising its discretion to pay the bonus. The defendant did not at any time set the objectives, with the result that the claimant's performance was never assessed against the objectives and no bonus was paid.

Allsop P (with whom Beazley JA agreed) dismissed an appeal by the defendant from the decision of the trial judge that the defendant had breached the agreement, and that

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[39] *Chaplin v Hicks* [1911] 2 KB 786; *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010).

[40] See, eg, *White v Australian & New Zealand Theatres Ltd* (1943) 67 CLR 266; *Fink v Fink* (1946) 74 CLR 127, 135 (Latham CJ and Williams J); *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 111–12 (Brennan J); *QBE Insurance Ltd v Moltoni Corporation Pty Ltd* (2000) 22 WAR 148, 154 [22] (Ipp J), reversed, but reasoning approved, sub nom *Moltoni Corporation Pty Ltd v QBE Insurance Ltd* (2001) 205 CLR 149, 162–3 [24] (Full Court); *Manubens v Leon* [1919] 1 KB 208.

[41] *Howe v Teefy* (1927) 27 SR (NSW) 301. See also, *Chaplin v Hicks* [1911] 2 KB 786, 795 (Fletcher Moulton LJ): 'The very object and scope of the contract were to give the plaintiff the chance of being selected as a prize-winner.'

[42] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 92 (Mason CJ and Dawson J), 130 (Deane J), 144 (Toohey J), 152 (Gaudron J).

[43] *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377.

[44] *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377, 412.

[45] *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010).

the breach had, on the balance of probabilities, caused the claimant to lose a valuable opportunity to be paid the bonus over a three-year period. His Honour considered that the defendant had promised to the claimant 'the contractual opportunity or chance of obtaining bonuses should the results of the process be favourable and subject to the exercise of any discretion'[46] and that '[t]he opportunity or chance that was agreed and to which the respondent was entitled, without more, was denied to her.'[47]

Implied promise

White v Australian & New Zealand Theatres Ltd[48] provides an early example of an implied promise to confer an opportunity. The claimants, who were revue and pantomime artists, entered into a contract with the defendant under which the claimants agreed to provide their 'sole professional services' to the defendant, as required and directed by it, for a fixed term. The claimants produced and performed in a revue until the defendant insisted on a new producer. The claimants refused to perform, and commenced proceedings against the defendant, claiming damages for breach of contract. The trial judge held that the defendant had breached the contract by refusing to allow the claimants to produce the revue, and awarded damages of £400. The Full Court of the New South Wales Supreme Court allowed an appeal by the defendant.

The High Court unanimously restored the decision of the trial judge. Latham CJ (with whom Rich J agreed) held that, properly construed, the term 'professional services' included the production of the revue, and that the defendant had breached that term by refusing to allow the claimants to perform that role.[49] His Honour held that the defendant's conduct also constituted a breach of an implied term that the defendant 'afford an opportunity to the persons employed to exercise and display their talents'[50] and, on that basis, in addition to damages for the agreed remuneration under

[46] *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010), [3].
[47] *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010), [4].
[48] *White v Australian & New Zealand Theatres Ltd* (1943) 67 CLR 266.
[49] *White v Australian & New Zealand Theatres Ltd* (1943) 67 CLR 266, 271–2; 281, 283 (Williams J).
[50] *White v Australian & New Zealand Theatres Ltd* (1943) 67 CLR 266, 271.

the contract, the claimant was entitled to damages for loss of an opportunity to gain publicity by producing the revue.[51]

In *Fink v Fink*,[52] a minority of the High Court held that an agreement between a husband and wife contained an implied promise to confer an opportunity. The claimant and the defendant entered into a contract containing an express promise by the defendant to allow the claimant and their children to remain in the matrimonial home, and to maintain them, for one year following the execution of the agreement. The defendant also promised not to institute divorce proceedings during this time. The recitals to the agreement disclosed that the purpose of the agreement was for the claimant and the defendant to attempt to reconcile. Six months after the agreement was executed the claimant left the home and the defendant filed a petition for divorce. The claimant instituted proceedings against the defendant. Allegations in the statement of claim of an implied promise of quiet occupation, and the loss by the claimant of the opportunity or chance of reconciliation were struck out. The relevant issue before the High Court was whether the claimant could plead that she had suffered such a loss.

Latham CJ and Williams J considered that the defendant had 'contracted to provide'[53] the opportunity for reconciliation. Their Honours observed that this opportunity could not reasonably be said to be 'valueless',[54] and while the contingencies to which it was subject might make it 'impossible to set any high value upon the opportunity', the loss of that opportunity was 'a matter for which damages can be given if a breach of the contract is proved.'[55] Accordingly, their Honours held that the claimant should be allowed to amend her statement of claim 'so as to state the implied term in a supportable form.'[56]

Starke J, on the other hand, held that the statement of claim did not allege an implied promise to confer the opportunity of reconciliation, and nor could such a promise be

[51] *White v Australian & New Zealand Theatres Ltd* (1943) 67 CLR 266, 271–2; 273, 275–6 (Starke J); 281–3 (Williams J).
[52] *Fink v Fink* (1946) 74 CLR 127.
[53] *Fink v Fink* (1946) 74 CLR 127, 135.
[54] *Fink v Fink* (1946) 74 CLR 127, 134.
[55] *Fink v Fink* (1946) 74 CLR 127, 135.
[56] *Fink v Fink* (1946) 74 CLR 127, 135.

implied in the agreement.[57] Furthermore, the alleged loss of opportunity did not flow from any breach of the express promise to allow the claimant to remain in the home.[58] Dixon and McTiernan JJ, who with Starke J made up the majority, confined their analysis to the question whether any loss of opportunity could be said to flow from breach of the express promises in the agreement. Their Honours held that the claimant's loss of opportunity was not capable of assessment. First, because that loss was not 'capable of monetary expression' or the 'proper subject for pecuniary assessment however speculative.'[59] Secondly, because, in the words of Vaughan Williams LJ in *Chaplin*, 'the loss is so dependent on the mere unrestricted volition of another that it is impossible to say that there is any assessable loss resulting from the breach.'[60] This conclusion made it unnecessary to consider whether the agreement contained an implied term promising the opportunity of reconciliation.

Object of contract

Howe v Teefy[61] provides an example of the second category of case. The defendant leased a racehorse to the claimant for a period of three years. In breach of that lease, the defendant removed the horse from the claimant. The claimant claimed damages from the defendant for the loss of the opportunity to make a profit from winning prize money on the horse, betting on him, and by supplying betting information to others. The Court upheld the decision of the jury to award damages of £250. Street CJ (with whom Gordon and Campbell JJ agreed), considered that '[t]he sole object of the agreement was to give him a chance of making money by training and racing the horse',[62] and that, by having the horse wrongfully taken out of his possession, the claimant had been deprived of something of monetary value, being the claimant's 'right under his agreement to train and race the horse, and to make what profit he could out of doing so.'[63]

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[57] *Fink v Fink* (1946) 74 CLR 127, 137–8.
[58] *Fink v Fink* (1946) 74 CLR 127, 138–9.
[59] *Fink v Fink* (1946) 74 CLR 127, 143.
[60] *Fink v Fink* (1946) 74 CLR 127, 143.
[61] *Howe v Teefy* (1927) 27 SR (NSW) 301.
[62] *Howe v Teefy* (1927) 27 SR (NSW) 301, 304.
[63] *Howe v Teefy* (1927) 27 SR (NSW) 301, 307.

Consequential loss

Commonwealth v Amann Aviation Pty Ltd,[64] provides an example of both the first and third categories of case. The claimant and the defendant entered into a contract under which the claimant agreed to provide aerial surveillance services to the defendant for an initial period of three years. In order to perform the contract, the claimant incurred heavy expenses in purchasing and fitting out specially equipped long distance surveillance aircraft. The claimant's prospects of profiting from the contract depended on the prospect of securing a renewal of the contract at the expiry of its initial term. The defendant repudiated the contract shortly after it commenced. The claimant commenced proceedings against the defendant for breach of contract, claiming damages for the expenses it had incurred in reliance on the contract and equipping itself for performance.

The principle issue for determination by the High Court was whether the defendant was able to discharge its onus of proving that the claimant's expenditure would not have been recouped in any event. This required the Court to consider whether, in discharging that onus, account should be taken of the prospect that the claimant would have secured a renewal of the contract, or the prospect that, if the claimant did not secure a renewal, it would have sold its business or aircraft to a new operator at a price which reflected the value of the planes' special equipment.

A majority of the Court held that it was proper for one or both of these opportunities to be taken into account,[65] however different views were expressed on the basis for this conclusion. Mason CJ and Dawson J focused on the prospect of renewal. Their Honours considered that this prospect should be taken into account because it was a distinct commercial benefit created by performance of the contract, the loss of which the parties necessarily contemplated as a probable result of the defendant's breach.[66] Gaudron J focused on the prospect of selling the aircraft at a price that reflected their

[64] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64.
[65] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 92–4 (Mason CJ and Dawson J); 112 (Brennan J); 130–1 (Deane J); 144 (Toohey J); 152 (Gaudron J).
[66] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 92; see also, 130 (Deane J); 144 (Toohey J).

special value. Her Honour considered that this prospect should be taken into account because it was a benefit that flowed from performance of the contract.[67]

Brennan J, on the other hand, considered that the prospect of renewal should be taken into account because, in his Honour's view, the defendant had impliedly promised that, the claimant, 'by performing the contract, could work itself into a secure position as an equipped and established provider of the service and could thereby acquire a most substantial advantage in tendering for any succeeding contract.'[68]

Tort

Damages for loss of a commercial opportunity are also available in the tort of negligence.[69] Like other types of loss, damages for loss of a commercial opportunity will be awarded where the loss is caused by the defendant's breach of duty, and that loss falls within the rules of remoteness of damage.

The majority of cases in this area involve claims for professional negligence,[70] where the defendant owes concurrent duties of care in contract and in negligence.[71] An early example is the decision of the English Court of Appeal in *Kitchen v Royal Air Force Association*.[72] That case concerned an action by the claimant for damages against the Royal Air Force Association and a firm of solicitors for negligently failing to prosecute a claim against an electricity company arising out of the death of the claimant's husband. The claimant's action against the solicitors was successful, and she was awarded £2000 in damages, representing two-thirds of the agreed maximum liability of the electricity company.

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[67] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 152; see also 130 (Deane J).

[68] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 111–12.

[69] *Johnson v Perez* (1988) 166 CLR 351; *Nikolaou v Papasavas Phillips & Co* (1989) 166 CLR 394; *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ); *Naxakis v Western General Hospital* (1999) 197 CLR 269, 278 [29] (Gaudron J); *Badenach v Calvert* (2016) 331 ALR 48, 56 [39] (French CJ, Kiefel and Keane JJ).

[70] See, eg, *Daniels v Anderson* (1995) 37 NSWLR 438; *Kitchen v Royal Air Force Association* [1958] 1 WLR 563; *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602.

[71] For a recent case involving concurrent duties outside a professional negligence context, see *Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd) v BestCare Foods Ltd* [2013] NSWCA 90 (24 April 2013).

[72] *Kitchen v Royal Air Force Association* [1958] 1 WLR 563.

An appeal by the solicitors was dismissed. On the question of damages, Lord Evershed MR (with whom Sellers LJ agreed) set out the task of the court as follows:[73]

> In my judgment, what the court has to do (assuming that the plaintiff has established negligence) in such a case as the present, is to determine what the plaintiff has by that negligence lost. The question is, has the plaintiff lost some right of value, some chose in action of reality and substance? In such a case, it may be that its value is not easy to determine, but it is the duty of the court to determine that value as best it can.

Having reviewed the evidence in the matter, Lord Evershed MR concluded 'that the plaintiff established that there was a cause of action and that she had lost something of value.'[74] Parker LJ (with whom Sellers LJ also agreed) reached the same conclusion. In Parker LJ's view, if the claimant could satisfy the court 'that she would have had some prospect of success, then it would be for the court to evaluate those prospects, taking into consideration the difficulties that remained to be surmounted. In other words, unless the court is satisfied that her claim was bound to fail, something more than nominal damages fall to be awarded.'[75]

In *Johnson v Perez*,[76] the High Court recognised the availability of damages in tort for loss of a commercial opportunity in this context. The claimant retained two firms of solicitors to act for him in connection with claims against his previous employers for damages for personal injuries. Each claim was dismissed for want of prosecution due to the negligence of the respective solicitors. The claimant successfully brought proceedings against the solicitors for breach of duty, and damages were assessed as at the date of judgment in the professional negligence claims. The sole issue on appeal to the High Court was the proper date at which to assess the claimant's loss. A majority of the Court held that damages should have been assessed at the date the claimant's loss arose, which in this case was the respective dates the personal injury actions were dismissed.[77] While the Court expressed different views on the proper

[73] *Kitchen v Royal Air Force Association* [1958] 1 WLR 563, 575.
[74] *Kitchen v Royal Air Force Association* [1958] 1 WLR 563, 576.
[75] *Kitchen v Royal Air Force Association* [1958] 1 WLR 563, 576–7.
[76] *Johnson v Perez* (1988) 166 CLR 351.
[77] *Johnson v Perez* (1988) 166 CLR 351, 363, 366–7 (Wilson, Toohey and Gaudron JJ); 389, 391 (Dawson J).

date of assessment, a majority observed that the claimant had suffered 'the loss of a chance to recover on a cause of action.'[78]

Damages for loss of a commercial opportunity may also be awarded in tort in the absence of concurrent liability in contract. In *Spring v Guardian Assurance plc*,[79] Lord Lowry stated, *obiter*, in the context of a claim for damages for failure to exercise reasonable care in preparing an employment reference, that:[80]

> Once the duty of care is held to exist and the defendant's negligence is proved, the plaintiff only has to show that by reason of that negligence he has lost a reasonable chance of employment (which would have to be evaluated) and has thereby sustained loss … He does not have to prove that, but for the negligent reference, Scottish Amicable *would* have employed him.

Similarly, in *Naxakis v Western General Hospital*,[81] Gaudron J observed, *obiter*, that 'there is no reason in principle why loss of a chance or commercial opportunity should not constitute damage for the purposes of the law of tort where no other loss is involved.'[82]

In *Glenmont Investments Pty Ltd v O'Loughlin (No 2)*,[83] the Full Court of the South Australia Supreme Court awarded damages in the tort of negligence for the loss of an opportunity to make profits from an income-producing chattel that was destroyed by fire. The claimant, the owner of a giant mechanical *Tyrannosaurus Rex*, entered into a contract for the sale and dismantling of a steel enclosure used to house the dinosaur, following its exhibition at a show. The buyer engaged a contractor to carry out the dismantling work. While carrying out the work, an employee of the contractor started a fire that completely destroyed the dinosaur. Relevantly, the Full Court upheld the trial judge's decision that the contractor was vicariously liable to the claimant for the employee's negligence. The Full Court also upheld, but varied, an award of damages against the contractor for the claimant's loss of an opportunity to 'pursue the display of the dinosaur in America, the [proposed] film … possible sequels, the sale of video

[78] *Johnson v Perez* (1988) 166 CLR 351, 360 (Mason CJ). See also, 366 (Wilson, Toohey and Gaudron JJ); 389–92 (Dawson J).
[79] *Spring v Guardian Assurance plc* [1995] 2 AC 296.
[80] *Spring v Guardian Assurance plc* [1995] 2 AC 296, 327.
[81] *Naxakis v Western General Hospital* (1999) 197 CLR 269.
[82] *Naxakis v Western General Hospital* (1999) 197 CLR 269, 278 [29].
[83] *Glenmont Investments Pty Ltd v O'Loughlin (No 2)* (2000) 79 SASR 185.

and television rights, and the opportunity to earn fees for appearances by the dinosaur.'[84]

In *Rockdale City Council v Micro Developments Pty Ltd*,[85] the New South Wales Court of Appeal upheld an award of damages for loss of opportunity against a local council that had negligently misrepresented the zoning of a particular property. The claimant purchased for development a property from a third party in reliance on a representation by the defendant that the zoning of the property permitted the development of the property for residential flat buildings. In fact, the zoning of the property did not permit such development, or anything similar. After becoming aware of the correct zoning, the claimant retained the property and several years later carried out the original development following a rezoning of the property. The defendant admitted its representation was negligent. Giles JA (with whom Hodgson and Campbell JJA agreed) upheld the trial judge's award of damages to the claimant for the loss of the opportunity to develop other properties while its funds were tied up in the subject property.

ACL

A contravention of s 18(1) of the ACL may give rise to an entitlement to damages for loss of a commercial opportunity under s 236(1) of the ACL.[86] The loss of a commercial opportunity may constitute 'loss or damage' for the purposes of section 236 of the ACL.[87] A person who has suffered 'loss or damage' because of conduct that is misleading or deceptive, or likely to mislead or deceive, in contravention of s 18(1) of the ACL, may recover the amount of the loss or damage.

In *Sellars*, the directors of the claimant entered into parallel negotiations with two companies, Poseidon Ltd and Pagini Resources NL, with the object of selling the

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[84] *Glenmont Investments Pty Ltd v O'Loughlin (No 2)* (2000) 79 SASR 185, 280 [427].
[85] *Rockdale City Council v Micro Developments Pty Ltd* (2008) Aust Torts Reports 81–954.
[86] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332; *Doppstadt Australia Pty Ltd v Lovick & Son Developments Pty Ltd* [2014] NSWCA 158 (21 May 2014). Damages for loss of a commercial opportunity are also available under analogous statutory provisions: see, eg, *Molinara v Perre Bros Lock 4 Pty Ltd* (2014) 121 SASR 61 (*Australian Securities and Investments Commission Act 2001 (Cth)*, ss 12DA(1) and 12GF(1)).
[87] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332.

directors' shareholdings in the claimant as part of a corporate restructuring. Negotiations with Pagini were advanced, and a draft contract was sent to the claimant for consideration. Ultimately, however, the claimant's directors entered into a Heads of Agreement with the defendant. Subsequently, the defendant notified the claimant that the Heads of Agreement had been prepared and its signing procured by an executive of the defendant who had exceeded his authority and that the Agreement did not reflect the transaction authorised by the defendant's board. The claimant terminated the Heads of Agreement and resumed negotiations with Pagini. Following entry into a contract with Pagini, the claimant commenced proceedings against the defendant and others under s 18(1) of the ACL. The claimant alleged that, as a result of the defendant's misleading or deceptive conduct, the claimant had lost the opportunity of entering into the initial draft contract with Pagini on terms more beneficial to the claimant than the contract in fact executed.

At trial, French J held that the contravention of s 18(1) was made out. On the question of damages, his Honour held that, but for the misleading conduct, it was probable that the claimant would have concluded the initial draft contract with Pagini, however, it was improbable that the contract would have been performed. French J held that the chance of the agreement being concluded and performed (and the benefits under the contract being derived) was more than speculative, and therefore the loss of that chance constituted 'loss or damage' for the purposes of s 236(1) of the ACL.

The High Court dismissed an appeal from the Full Federal Court upholding the decision of French J. Mason CJ, Dawson, Toohey and Gaudron JJ identified the claimant's loss as 'the loss of the opportunity or chance of securing commercial benefits which entry into the Pagini agreement and completion of it would have brought.'[88] Their Honours observed that this loss, 'assuming it to have value, is a form of economic loss'[89] which is ordinarily recoverable under s 236(1).

The majority held that, in order for a claimant to recover damages for loss of a commercial opportunity, it must prove, on the balance of probabilities, that the

[88] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 348.
[89] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 348.

defendant's wrong had caused 'the loss of a commercial opportunity which had *some* value (not being a negligible value)', the value of that loss 'being ascertained by reference to the degree of probabilities or possibilities.'[90]

Brennan J delivered a separate judgment dismissing the appeal for reasons similar to those given by the majority. Brennan J identified the relevant loss suffered by the claimant as 'the loss of an opportunity to continue the negotiations with Pagini',[91] and not 'the financial benefits which it was the ultimate objective of the plaintiffs to acquire.'[92] Brennan J recognised that, in a non-contractual context, '[a]s a matter of common experience, opportunities to acquire commercial benefits are frequently valuable in themselves, not only when they will *probably* fructify in a financial return but also when they offer a *substantial prospect* of a financial return.'[93]

In Brennan J's view, it followed therefore that:[94]

> Provided an opportunity offers a substantial, and not merely speculative, prospect of acquiring a benefit that the plaintiff sought to acquire or of avoiding a detriment that the plaintiff sought to avoid, the opportunity can be held to be valuable. And, if an opportunity is valuable, the loss of that opportunity is truly 'loss' or 'damage' for the purposes of s 82(1) of the Act and for the purposes of the law of torts.

Loss of the use of money

The doctrine of loss of a commercial opportunity is of broad application. It is capable of applying in an almost limitless array of circumstances. However, until the decision of the High Court in *Hungerfords v Walker*,[95] the practical utility of the doctrine was limited somewhat by a claimant's inability to use the doctrine in the context of a claim for the loss of the use of money.

Historically, the common law refused to award interest as damages for the late payment of a debt (or damages), and *semble*, for the loss of the use of money

[90] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355 (emphasis in original).
[91] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 359.
[92] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 358–9.
[93] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 364 (emphasis in original).
[94] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 364.
[95] *Hungerfords v Walker* (1989) 171 CLR 125.

generally.[96] The common law instead adopted an economically simple view that if a party that suffers a pecuniary loss eventually recovers the nominal amount of its loss then there is no loss, and no further compensation is necessary. For example, if, following default by a borrower, a lender sells the property used as security for the loan and the amount realised from the sale of the property along with any other cash already received by the lender exceeds the principal or amount lent, then the lender has not only been repaid (and therefore has suffered no loss), but has indeed made a 'profit'.

In *Hungerfords*, the High Court rejected this simplistic notion of loss. Mason CJ and Wilson J (with whom Brennan and Deane JJ agreed generally) held that when money is paid away or withheld as a result of a wrong, the claimant's full loss includes 'the investment cost of being deprived of money which could have been invested at interest or used to reduce an existing indebtedness' or 'the borrowing cost, ie, interest payable on borrowed money or interest foregone because an existing investment is realized or reduced.'[97]

Following *Hungerfords*, claims for the loss of the use of money, and for loss of a chance to use money (sometimes referred to as a lost investment opportunity), have become commonplace.[98] This type of claim will be analysed further in chapter seven.

[96] See *London, Chatham and Dover Railway Co v South Eastern Railway Co* [1893] AC 429; not followed, *Sempra Metals Ltd v Inland Revenue Commissioners* [2008] 1 AC 561.
[97] *Hungerfords v Walker* (1989) 171 CLR 125, 143.
[98] For an analysis of compensation for the loss of the use of money on an opportunity cost basis generally, see Thierry J Senechal and John Y Gotanda, 'Interest as Damages' (2009) 47(3) *Columbia Journal of Transnational Law* 491.

Compensation for loss

Introduction

This section of the chapter considers the general principles relating to compensation for loss of a commercial opportunity. It outlines the compensatory principle, and shows how that principle applies to the loss of a commercial opportunity.

Compensatory principle

At common law, the primary object of an award of damages is to give the claimant compensation for loss. In *Haines v Bendall*,[99] Mason CJ, Dawson, Toohey and Gaudron JJ stated that, in the assessment of compensatory damages, '[c]ompensation is the cardinal concept.'[100] This object is achieved by awarding the claimant a sum of money designed to put the claimant 'in the same position as he would have been in if he had not sustained the wrong for which he is now getting his compensation or reparation.'[101]

The application of the compensatory principle, whether to the assessment of damages in tort or for breach of contract, is a comparative exercise. In *Commonwealth v Amann Aviation Pty Ltd*,[102] Deane J observed:[103]

> The application of that general principle ordinarily involves a comparison, sometimes implicit, between a hypothetical and an actual state of affairs: what relevantly represents the position in which the plaintiff would have been if the wrongful act (ie the repudiation or breach of contract or the tort) had

[99] *Haines v Bendall* (1991) 172 CLR 60.
[100] *Haines v Bendall* (1991) 172 CLR 60, 63.
[101] *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25, 39 (Lord Blackburn); *Butler v The Egg and Egg Pulp Marketing Board* (1966) 114 CLR 185, 191 (Taylor and Owen JJ); *Pennant Hills Restaurants Pty Ltd v Barrell Insurances Pty Ltd* (1981) 145 CLR 625, 637–8 (Gibbs J), 646–7 (Stephen J); *Todorovic v Waller* (1981) 150 CLR 402, 412 (Gibbs CJ and Wilson J; Aickin J agreeing), 427 (Stephen J), 463 (Brennan J); *Johnson v Perez* (1988) 166 CLR 351, 367 (Wilson, Toohey, Gaudron JJ), 371 (Brennan J); *Haines v Bendall* (1991) 172 CLR 60, 63 (Mason CJ, Dawson, Toohey and Gaudron JJ); *Nominal Defendant v Gardikiotis* (1996) 186 CLR 49, 54 (McHugh J); *Husher v Husher* (1999) 197 CLR 138, 142–3 [6] (Gleeson CJ, Gummow, Kirby and Hayne JJ); *Cattanach v Melchior* (2003) 215 CLR 1, 22 [36] (Gleeson CJ), 41–2 [100] (Kirby J); *Clark v Macourt* (2013) 253 CLR 1, 6 [7] (Hayne J), 18–9 [59] (Gageler J).
[102] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64.
[103] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 116.

not occurred and what relevantly represents the position in which the plaintiff is or will be after the occurrence of the wrongful act.

The compensatory principle applies both to the assessment of damages in tort and in contract, however the hypothetical reference point differs between the two claims. In contract, the hypothetical reference point is the position the claimant would have been in if the contract (promise) had been performed.[104] In tort, the hypothetical reference point is the position the claimant would have been in if the tort had not been committed.[105] In *Marks v GIO Australia Holdings Ltd*,[106] Gaudron J observed that the difference in approach was explicable by reference to the different nature of each wrong:[107]

> In contract … the wrong consists not in the making but in the breaking of the contract and therefore the plaintiff is entitled to be put into the position he would have been in if the contract had never been broken, or in other words, if the contract had been performed. The plaintiff is entitled to recover damages for the loss of his bargain. In tort, on the other hand, no question of loss of bargain can arise: the plaintiff is not complaining of failure to implement a promise but of failure to leave him alone.

In assessing damages under s 236 for contravention of s 18(1), the compensatory principle also applies,[108] but the hypothetical reference point is not fixed like it is in a claim for damages for breach of contract or negligence. In this context, the 'primary task' involves 'construing the relevant provisions of the Act', and not drawing 'some analogy with any particular form of claim under the general law.'[109] The court must therefore select a measure of damages that 'conforms to the remedial purpose of the

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[104] *Robinson v Harman* (1848) 1 Exch 850, 855 (Parke B); *Wenham v Ella* (1972) 127 CLR 454, 460 (Barwick CJ), 471 (Gibbs J); *Gates v City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1, 11–12 (Mason, Wilson and Dawson JJ); *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 80 (Mason CJ and Dawson J), 98 (Brennan J), 117 (Deane J), 134 (Toohey J), 148 (Gaudron J), 161 (McHugh J); *Tabcorp Holdings Ltd v Bowen Investments Pty Ltd* (2009) 236 CLR 272, 286 [13] (Full Court); *Clark v Macourt* (2013) 253 CLR 1, 6 [7] (Hayne J), 11 [26] (Crennan and Bell JJ), 19 [60] (Gageler J), 30 [106] (Keane J).
[105] *State of South Australia v Johnson* (1982) 42 ALR 161, 169–70 (Full Court); *Gates v City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1, 11–12 (Mason, Wilson and Dawson JJ); *MBP (SA) Pty Ltd v Gogic* (1991) 171 CLR 657, 664 (Full Court).
[106] *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 494.
[107] *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 494, 503 [14], quoting Harvey McGregor, *McGregor on Damages* (Sweet & Maxwell, 16th ed, 1997) 543–4 (citations omitted).
[108] *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514, 526 (Mason CJ, Dawson, Gaudron and McHugh JJ).
[109] *Murphy v Overton Investments Pty Ltd* (2004) 216 CLR 388, 407 [44] (Full Court).

statute and to the justice and equity of the case.'[110] Common law principles 'may provide useful guidance', but '[t]hey are not controlling.'[111]

In *Amann*, Deane J observed that any differences between the rules governing the application of the compensatory principle in tort and contract are of 'diminishing significance.'[112] However, in *Astley v Austrust Ltd*,[113] Gleeson CJ, McHugh, Gummow and Hayne JJ confirmed the continued importance of the distinction between the two causes of action:[114]

> [T]he conceptual and practical differences between the two causes of action remain of 'considerable importance.' The two causes of action have different elements, different limitation periods, different tests for remoteness of damage and, as will appear, different apportionment rules.

It follows that the distinctions between the different rules still remain, and in *HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd*,[115] the Full Court of the High Court warned that it 'may not always be sound'[116] to assume that damages for breach of contract, negligence, and contravention of s 18(1) were identical.

Compensation for loss of a commercial opportunity

General

In theory, compensation for loss of a commercial opportunity will differ, depending on whether the claim is brought in tort, contract or under s 18(1) of the ACL.[117] For example, in *Cadoks Pty Ltd v Wallace Westley & Vigar Pty Ltd*,[118] Ashley J held that the loss of a commercial opportunity to resell a farm at a time of the purchaser's choosing was too remote to found a claim for damages for breach of contract, but was not too remote to found a claim in tort.

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[110] *Henville v Walker* (2001) 206 CLR 459, 470 [18] (Gleeson CJ).
[111] *Henville v Walker* (2001) 206 CLR 459, 470 [18] (Gleeson CJ).
[112] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 116.
[113] *Astley v Austrust Ltd* (1999) 197 CLR 1.
[114] *Astley v Austrust Ltd* (1999) 197 CLR 1, 23 [47] (citations omitted).
[115] *HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd* (2004) 217 CLR 640.
[116] *HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd* (2004) 217 CLR 640, 649 [14]. See also *Commonwealth v Cornwell* (2007) 229 CLR 519, 522 [4] (Gleeson CJ, Gummow, Kirby, Hayne, Heydon and Crennan JJ).
[117] *Commonwealth v Cornwell* (2007) 229 CLR 519, 522 [4] (Gleeson CJ, Gummow, Kirby, Hayne, Heydon and Crennan JJ).
[118] *Cadoks Pty Ltd v Wallace Westley & Vigar Pty Ltd* (2000) 2 VR 569.

In some circumstances, however, the application of the compensatory principle will yield similar results irrespective of the basis of the claim. This is because the exercise of putting the claimant in the same position as if the relevant wrong had not occurred involves putting the claimant in a position to pursue the relevant opportunity.

If the relevant commercial opportunity involves the chance to enter into a profitable contract, then the application of the compensatory principle will involve putting the claimant into a position to pursue the opportunity to make that profit. This is so even if the basis of the claim is in tort or for contravention of s 18(1). It is in this sense that it can be said that the measure of damages for loss of a commercial opportunity resembles compensation on an expectation basis. In *Gates v City Mutual Life Assurance Society Ltd*,[119] Mason, Wilson and Dawson JJ explained the position in tort as follows:[120]

> Because the object of damages in tort is to place the plaintiff in the position in which he would have been but for the commission of the tort, it is necessary to determine what the plaintiff would have done had he not relied on the representation. If that reliance has deprived him of the opportunity of entering into a different contract…on which he would have made a profit then he may recover that profit on the footing that it is part of the loss which he has suffered in consequence of altering his position under the inducement of the representation. This may well be so if the plaintiff can establish that he could and would have entered into the different contract and that it would have yielded the benefit claimed…The lost benefit is referable to opportunities foregone by reason of reliance on the misrepresentation. In this respect the measure of damages in tort begins to resemble the expectation element in the measure of damages in contract save that it is for the plaintiff to establish that he could and would have entered into the different contract.

Similarly, in *Sellars*, a majority of the High Court stated, 'damages for deprivation of a commercial opportunity, whether the deprivation occurred by reason of breach of contract, tort or contravention of s 52(1), should be ascertained by reference to the court's assessment of the prospects of success of that opportunity had it been pursued.'[121]

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[119] *Gates v City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1.
[120] *Gates v City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1, 13.
[121] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ). For a discussion of the availability of expectation damages under ss 236 and 237 of the

Temporal issues

In general, damages for loss of a commercial opportunity, like other types of compensatory damage, are awarded 'once and forever, and (in the absence of any statutory exception) must be awarded as a lump sum.'[122] This requires a court to discount (or accumulate) the claimant's damages to present value at the time the claimant's loss is assessed.[123]

In a claim for damages for loss of a commercial opportunity, the compensatory principle, and the once and forever and lump sum rules, require the resolution of three temporal issues. The first issue is the time at which the loss arose. Once that issue is determined, the next issue is the time at which the loss has ceased, or is taken to have ceased. The third issue is the time at which the loss is to be assessed. Each of these issues is considered below.

Time loss arises

A loss of a commercial opportunity will arise at the time the claimant is deprived, by the defendant's wrong, of an opportunity with a non-negligible monetary value.[124] If an opportunity is promised by contract, the loss of that opportunity will arise at the time of breach.[125] If an opportunity is not promised by contract, but is lost as a consequence of breach, the loss may arise on breach[126] or at some later time when the loss can be said to have crystallised.[127] In the tort of negligence, and in a claim for damages for misleading or deceptive conduct, the loss of a commercial opportunity

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ACL, see David D Knoll, 'Assessing commercial losses in private trade practices litigation' (2002) 10 *Competition & Consumer Law Journal* 1.

[122] *Todorovic v Waller* (1981) 150 CLR 402, 412 (Gibbs CJ and Wilson J; Aickin J agreeing). This rule does not necessarily apply to the assessment of damages under s 236 of the ACL: *Murphy v Overton Investments Pty Ltd* (2004) 216 CLR 388, 409 [52] (Full Court).

[123] *Todorovic v Waller* (1981) 150 CLR 402, 412 (Gibbs CJ and Wilson J; Aickin J agreeing).

[124] *Commonwealth v Cornwell* (2007) 229 CLR 519; *Price Higgins & Fidge v Drysdale* [1996] 1 VR 346.

[125] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 359 (Brennan J).

[126] See, eg, *Hendriks v McGeoch* (2008) Aust Torts Reports 81–942, 61,440 [89] (Basten JA; Spigelman CJ and Giles JA agreeing).

[127] See, eg, *Burger King Corporation v Hungry Jack's Pty Ltd* [2001] NSWCA 187 (21 June 2001), [644] (Full Court). See also, *Mallon v Halliwells (in Adminstration)* [2012] EWCA Civ 1212 (9 July 2012).

will arise when the loss can be said to have crystallised and the relevant cause of action accrues.[128] In the tort of negligence, the loss may arise on breach of the duty of care.[129]

The time at which the loss of a non-promissory commercial opportunity arises will depend on the precise legal and factual circumstances of the case. In *Wardley*, the majority observed, in the context of determining when a cause of action in negligence causing economic loss accrues for the purpose of a limitation statute:[130]

> Economic loss may take a variety of forms and, as Gaudron J noted in *Hawkins v Clayton*, the answer to the question when a cause of action for negligence causing economic loss accrues may require consideration of the precise interest infringed by the negligent act or omission. The kind of economic loss which is sustained and the time when it is first sustained depend upon the nature of the interest infringed and, perhaps, the nature of the interference to which it is subjected. With economic loss, as with other forms of damage, there has to be some actual damage. Prospective loss is not enough.

The fact specific nature of the enquiry is demonstrated by the facts in *Mallon v Halliwells (in Adminstration)*.[131] In April 2005, the claimant's solicitors negligently failed to include in a development agreement a clause giving the claimant a conditional right to the proceeds of sale of a property development. The claimant did not discover this omission until July 2008. At that time, the right remained conditional, but there had been a significant decline in the property market and the development was in negative equity.

The claimant brought an action against the solicitors claiming damages for loss of the opportunity to acquire and subsequently sell the right to the proceeds of sale. The claimant asserted that, but for the solicitors' breach of duty, the claimant would have acquired the right in 2005, and would have subsequently sold that right irrespective of whether the conditions attached to the right had been satisfied. The claimant argued that his loss arose, and should be assessed, at the time of the breach in April 2005. The

[128] See, eg, *Adelaide Petroleum NL v Poseidon Ltd* (1990) 98 ALR 431, 529 (French J) (misleading or deceptive conduct).
[129] See, eg, *Hendriks v McGeoch* (2008) Aust Torts Reports 81–942, 61,440 [89] (Basten JA; Spigelman CJ agreeing; Giles JA agreeing on this point).
[130] *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514, 527 (Mason CJ, Dawson, Gaudron and McHugh JJ) (citations omitted).
[131] *Mallon v Halliwells (in Adminstration)* [2012] EWCA Civ 1212 (9 July 2012).

defendant argued that the claimant's loss arose in August 2008, when the claimant first attempted to sell the right, at which time it was of little or no value.

Hooper LJ (with whom Pitchford LJ and Sir Stephen Sedley agreed) dismissed an appeal by the claimant from the trial judge's decision that the claimant's loss arose, and was to be assessed, in August 2008. His Lordship agreed with the defendant's submission that the claimant had not suffered any loss in April 2005 because he had not taken any steps at that time to sell the right.[132]

It follows that it is not useful or practical to attempt to set out any general principles as to the time at which a non-promissory loss of opportunity will arise. It may be observed, however, that it has been held that the loss of an opportunity to negotiate better terms arose at the time when the disadvantageous contract was entered into.[133] Further, in a claim against a solicitor for the loss of an opportunity to bring or prosecute legal proceedings, the loss will arise (and damages will be assessed) at the date the proceedings are dismissed for want of prosecution,[134] or at the date the proceedings become statute-barred.[135]

Time loss ceases

Most commercial opportunities are not perpetual. In those circumstances, a determination must be made as to the time at which the opportunity, had it been pursued, would have ceased in any event. In some cases, the opportunity would have ceased independently of the actions of the parties, and therefore the determination of the time at which the loss would have ceased will be relatively straightforward. However, if the opportunity turns on the actions of the claimant, the determination of

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[132] *Mallon v Halliwells (in Adminstration)* [2012] EWCA Civ 1212 (9 July 2012), [6].
[133] See, eg, *Adelaide Petroleum NL v Poseidon Ltd* (1990) 98 ALR 431, 529 (French J). See also, *Watkins v Jones Maidment Wilson (a firm)* [2008] EWCA Civ 134 (4 March 2008); *Pickthall v Hill Dickinson LLP* [2008] EWHC 3409 (Ch) (13 October 2008).
[134] *Johnson v Perez* (1988) 166 CLR 351, 363, 366–7 (Wilson, Toohey and Gaudron JJ); 389, 391 (Dawson J).
[135] *Nikolaou v Papasavas Phillips & Co* (1989) 166 CLR 394, 403–4 (Wilson, Dawson, Toohey and Gaudron JJ).

the time at which the loss would have ceased may depend on the court's findings on whether the claimant has mitigated its loss.[136]

This importance of this parameter was considered recently in *Professional Services of Australia Pty Ltd v Computer Accounting and Tax Pty Ltd (No 2)*.[137] The claimant was induced by false and misleading misrepresentations made by the defendant to purchase a service station. The claimant sought damages representing the difference between the price paid for the service station and its true value, together with the loss of an opportunity to purchase an alternative property that would have appreciated in value to a greater extent than the service station. At trial, the claimant was awarded damages for this lost opportunity, but the trial judge made no finding as to the period over which the opportunity was lost. It was implicit in the defendant's case (and the trial judge's reasoning) that the period chosen for the purposes of the assessment of damages was the period between the purchase of the service station and the date of the trial.

An appeal by the defendant was successful on the ground that the award of damages for the lost opportunity was based on inadmissible expert evidence. The Court of Appeal refused to make an order for a retrial on this issue, because the Court held that the appeal should have been allowed on the further ground that the defendant failed to establish the facts necessary to sustain the award of damages in respect of the claim for lost opportunity. This conclusion was based, in part, on the Court's view that the proposition implicit in the defendant's case that it had lost the opportunity of making an alternative investment up to the time of trial was 'illogical and unsustained by any evidence.'[138] Martin CJ (with whom Buss and Newnes JJA agreed) observed that, in determining the period over which the commercial opportunity was lost:[139]

> [T]he time at which the party claiming damages became aware of the true position will be relevant. It is also relevant when assessing the extent to which such a party can claim continuing trading losses or

[136] See, eg, *Browning v Brachers* [2005] EWCA Civ 753 (20 June 2005), [247] (Jonathan Parker LJ; Mance LJ and the Vice Chancellor agreeing).
[137] *Professional Services of Australia Pty Ltd v Computer Accounting and Tax Pty Ltd (No 2)* (2009) 261 ALR 179.
[138] *Professional Services of Australia Pty Ltd v Computer Accounting and Tax Pty Ltd (No 2)* (2009) 261 ALR 179, 204 [117] (Martin CJ; Buss and Newnes JJA agreeing).
[139] *Professional Services of Australia Pty Ltd v Computer Accounting and Tax Pty Ltd (No 2)* (2009) 261 ALR 179, 203–4 [113].

reduced profitability after becoming aware of the true position … the question is: at what point of time, after becoming aware of the true position, would it be reasonable for the innocent party to put an end to the suffering of loss by disposition of the business?

Martin CJ observed that the defendant was aware of the true position in relation to the service station shortly after its acquisition, however ‘no evidence was led to establish any reason why it could not have liquidated its investment in the service station and reinvested in another property at any point prior to trial.’[140] There was, therefore, ‘no basis for selecting the date of the commencement of the trial as the date upon which the lost opportunity to make an alternative investment ceased, or as the date upon which the capacity to liquidate the investment in the service station arose.’[141]

Time loss is assessed

In *Perez*, Mason CJ observed that the ‘general rule’ is that ‘damages for torts or breach of contract are assessed as at the date of breach or when the cause of action arises.’[142] His Honour observed, however, that ‘this rule is not universal; it must give way in particular cases to solutions best adapted to giving an injured plaintiff that amount in damages which will most fairly compensate him for the wrong he has suffered.’[143] The general rule also applies to the assessment of damages under s 236 of the ACL, however the width of that section permits damages to be assessed at the date of the trial provided it works no injustice.[144]

In applying the general rule, both at common law,[145] and under s 236 of the ACL,[146] a court may take into account in assessing damages matters known by the date of

[140] *Professional Services of Australia Pty Ltd v Computer Accounting and Tax Pty Ltd (No 2)* (2009) 261 ALR 179, 189 [42].
[141] *Professional Services of Australia Pty Ltd v Computer Accounting and Tax Pty Ltd (No 2)* (2009) 261 ALR 179, 189 [41].
[142] *Johnson v Perez* (1988) 166 CLR 351, 355; 367 (Wilson, Toohey and Gaudron JJ), 380 (Deane J), 386 (Dawson J). See also, *Clark v Macourt* (2013) 253 CLR 1, 31–2 [109]–[110] (Keane J; Hayne, Crennan and Bell JJ agreeing).
[143] *Johnson v Perez* (1988) 166 CLR 351, 355–6; 367 (Wilson, Toohey and Gaudron JJ), 380 (Deane J), 386 (Dawson J).
[144] *HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd* (2004) 217 CLR 640, 656–7 [34]–[35], 666–8 [63]–[65] (Full Court).
[145] *Wenham v Ella* (1972) 127 CLR 454, 464 (Menzies J), 473 (Gibbs J); *Johnson v Perez* (1988) 166 CLR 351, 368–9 (Wilson, Toohey and Gaudron JJ), 392 (Dawson J); *Nikolaou v Papasavas Phillips & Co* (1989) 166 CLR 394, 403–4 (Wilson, Dawson, Toohey and Gaudron JJ). See also, *Golden Strait*

assessment. This is because, when assessing damages, a court prefers facts to speculation or prophecies.[147]

In general, damages for loss of a commercial opportunity are assessed as at the time of loss, although post-loss evidence relevant to the question of damages is admissible in certain circumstances.[148] The time at which the loss of a commercial opportunity arises was considered above.

In *Perez*, the High Court considered the proper date at which to assess damages against two firms of solicitors for the loss of an opportunity to prosecute claims for damages for personal injuries. The claimant contended that damages should be assessed at the date of judgment in the professional negligence claims. The defendant contended that the relevant date was the date when the personal injuries actions would have been determined, but for the solicitors' negligence, or alternatively the date the personal injuries actions were dismissed for want of prosecution.

A majority of the Court held that damages should be assessed at the date the claimant's loss arose, which in this case was the respective dates the personal injury actions were dismissed.[149] Dawson J (who, with Wilson, Toohey and Gaudron JJ, formed the majority) reasoned that, properly understood, the claimant's action against his solicitors was for damages for loss of a chance, not for compensation for personal injury, and therefore the date of loss was the appropriate date for assessment:[150]

> The actions by the respondent against his solicitors are not actions for damages for personal injuries. They are actions for damages for failure to exercise due care; it matters not for present purposes whether they be regarded as actions for breach of contract or tort or both. The loss caused by the

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Corpn v Nippon Yusen Kubishika Kaisha [2007] 2 AC 353, 383 [37] (Scott LJ), 391 [63] (Carswell LJ), 398–9 [83]–[84] (Brown LJ).

146 *Kizbeau Pty Ltd v WG & B Pty Ltd* (1995) 184 CLR 281, 291 (Full Court); *HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd* (2004) 217 CLR 640, 658–9 [39] (Full Court).

147 *Willis v Commonwealth* (1946) 73 CLR 105, 109 (Latham CJ), 116 (Dixon J; Williams J agreeing).

148 *Johnson v Perez* (1988) 166 CLR 351, 366–9 (Wilson, Toohey and Gaudron JJ), 389, 391–2 (Dawson J); *Nikolaou v Papasavas Phillips & Co* (1989) 166 CLR 394, 403–4 (Wilson, Dawson, Toohey and Gaudron JJ); *Moss (aka Miller) v Eaglestone* (2011) 285 ALR 656, 663 [25] (Allsop P; Campbell and Young JJA agreeing). See also, *Berryman v Hames Sharley (WA) Pty Ltd* (2008) 38 WAR 1, 116–17 [760]–[768] (Hasluck J).

149 *Johnson v Perez* (1988) 166 CLR 351, 363, 366–7 (Wilson, Toohey and Gaudron JJ); 389, 391 (Dawson J).

150 *Johnson v Perez* (1988) 166 CLR 351, 389. See also, 367 (Wilson, Toohey and Gaudron JJ).

negligence does not cover events extending over a period of time. It occurred once and for all in each case when the respondent lost his right to prosecute his claim. The quantification of the loss must necessarily take place at that time because it is not referable to an extended condition as is the loss for which compensation is sought in a personal injury claim.

While the majority held that the date of loss was the appropriate date for assessment, their Honours stressed that did not mean that all post-loss evidence relevant to the question of damages was excluded. Wilson, Toohey and Gaudron JJ observed that, in the present context, such evidence could be received in three circumstances: first, to assist the court in placing itself in the position of the trial judge at the notional personal injury trial when assessing the claimant's likely future losses; secondly, where there is a paucity of evidence concerning the condition of the claimant at the time of the notional trial, to assist the court in piecing together the case that could, but for the negligence of the solicitor, have been made out in the notional trial; thirdly, for the purpose of prosecuting a claim of aggravation of injury or other loss directly attributable to the negligence of the solicitor.[151] Dawson J, on the other hand, observed that evidence could be admitted of loss that could have been established as a probable consequence of the injuries received at the time the personal injuries actions were dismissed.[152]

The *extent* to which post-loss evidence of value will be admitted is not, however, unlimited. In *Hughes v St Barbara Mines Ltd (No 4)*,[153] a company by the name of Kingstream Steel Ltd and the defendant executed an option deed under which Kingstream was granted the option to purchase certain mining tenements. Some time after the execution of the deed, extra tenements were added to the option. Those tenements were three applications for mining leases (AMLs) which had been made by a wholly owned subsidiary of the defendant. Kingstream exercised the option and alleged that the sale and purchase contract arising on exercise of the option obliged the defendant to procure its subsidiary to maintain or keep the applications on foot until the relevant authority granted the mining leases. Two years after the exercise of

[151] *Johnson v Perez* (1988) 166 CLR 351, 368–9.
[152] *Johnson v Perez* (1988) 166 CLR 351, 392. See also, *Nikolaou v Papasavas Phillips & Co* (1989) 166 CLR 394, 404 (Wilson, Dawson, Toohey and Gaudron JJ); *Charles v Hugh James Jones & Jenkins (a firm)* [2000] 1 WLR 1278; *Dudarec v Andrews* [2006] 1 WLR 3002; *Whitehead v Searle* [2009] 1 WLR 549.
[153] *Hughes v St Barbara Mines Ltd (No 4)* [2010] WASC 160 (30 June 2010); reversed on other grounds sub nom *Hughes v St Barbara Ltd* [2011] WASCA 234 (1 November 2011).

the option, the subsidiary withdrew the applications. Kingstream commenced proceedings against the defendant and its subsidiary alleging that those entities acted negligently, and in breach of the sale and purchase contract, in withdrawing the AMLs. The causes of action were assigned to the claimant.

The trial judge, Kenneth Martin J, dismissed the liability claim. However, his Honour went on to consider, *obiter*, the damages claim on the hypothesis that the defendant had breached an implied term of the sale and purchase contract in failing to give Kingstream reasonable notice of the withdrawal of the AMLs. Relevantly, the claimant sought damages under three heads. The claimant sought damages under the first head for the value of the AMLs immediately prior to their withdrawal. Under the second and third heads, the claimant sought damages for loss of a commercial opportunity to first obtain, and then profitably exploit 21-year mining leases over the areas the subject of the AMLs. In support of its claim for loss of a commercial opportunity, the claimant sought to adduce extensive evidence relating to the value of the area the subject of the AMLs between the date the AMLs were withdrawn and the date of the trial, a period of some 8 years.

The claimant relied on the High Court's decision in *HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd*,[154] to argue that in assessing damages for the loss of a commercial opportunity to acquire the mining leases, the Court must determine the 'true' value of the chance lost, and that if the Court assessed the value of that chance at the date of breach, it was entitled to have regard to all events post-breach which were relevant to the value of the lost chance. Kenneth Martin J rejected these propositions. His Honour distinguished HTW on the basis that the present case did not concern the purchase of an asset at an overvalue; there was no negative feature in the AMLs destined to fully mature over time; and the evidence disclosed an accurate, reliable market for the AMLs at the time of breach. In those circumstances, Kenneth Martin J concluded that 'nothing has been raised by the plaintiff to detract from the appropriateness of directing the temporal focus in the ascertainment of the worth… of

[154] *HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd* (2004) 217 CLR 640.

the Zygot AMLs, away from their assessed value in the market at… the time of the assumed breach.'[155]

In Kenneth Martin J's view, the case, 'correctly analysed', was not a true loss of chance case: it concerned the loss of the prospect of obtaining AMLs at the time of breach, not the loss of potential mining leases at a future time. Kenneth Martin J considered that, even if it was possible to characterise the case as one for loss of a chance, his Honour did not 'ascertain within the approach used in *Sellars* any utilisation, let alone principled support for, the open-ended evidentiary reception of subsequent events, to show the worth of a 'lost' opportunity.'[156] Kenneth Martin J observed that the admission of extensive post-loss evidence may give rise to a number of practical and policy concerns:[157]

> Evidentiary scrutiny of unlimited post-breach events, under a loss of opportunity case, actually presents as conceptually paradoxical — given that the analysis of subsequent event evidence embarked upon actually diminishes the need to assess the prospects of later contingencies which may come to fruition (since the evidence will reveal precisely what happened). Unrestrained use of post-breach event evidence in fact substitutes 'chance' for 'certainty', using hindsight to take account of subsequent events. Furthermore, this advocated approach, from a policy perspective, would render it strongly in a plaintiff's interest to delay bringing a loss of opportunity case to trial until the latest possible time, in order for an evidentiary hindsight process as to post-breach developments over a long period up to judgment to unfold. In practical terms, that approach at trial leads to an almost 'never ending story'.

Conclusion

This chapter examined the legal doctrine of loss of a commercial opportunity.

This chapter defined a commercial opportunity as a chance to obtain a pecuniary benefit, or to avoid a pecuniary loss or liability, in a commercial context. A claim for damages for such a loss therefore represents a claim for the value of the chance or opportunity of receiving an expected benefit or avoiding an expected loss or liability; not a claim for the value of the expected benefit or loss or liability itself. This chapter

[155] *Hughes v St Barbara Mines Ltd (No 4)* [2010] WASC 160 (30 June 2010), [901].
[156] *Hughes v St Barbara Mines Ltd (No 4)* [2010] WASC 160 (30 June 2010), [908].
[157] *Hughes v St Barbara Mines Ltd (No 4)* [2010] WASC 160 (30 June 2010), [909]–[910].

explained that the loss of a commercial opportunity is a form of economic loss and, when it is suffered, constitutes actual damage. Compensation for such a loss is available in contract, tort and under s 18(1) of the ACL.

This chapter also examined the operation of the compensatory principle in a claim for loss of a commercial opportunity. It demonstrated that, in general, the measure of damages for loss of a commercial opportunity is often the same, irrespective of the basis of the claim, because the application of the compensatory principle involves putting the claimant in the hypothetical position to pursue the relevant opportunity. The chapter concluded by analysing the temporal issues that must be resolved in applying the compensatory principle, and the once and forever and lump sum rules, to a claim for loss of a commercial opportunity.

Part 2

A framework for the valuation of loss of a commercial opportunity

Chapter 4

Fact of loss

Introduction

Purpose and object

This chapter examines the *fact* of loss of a commercial opportunity.

In a claim for damages for loss of a commercial opportunity, the claimant must prove the fact of loss of that opportunity. In order to prove the fact of loss, the claimant must prove both the *existence* of a valuable commercial opportunity, and that the defendant's wrong *caused* the loss of that opportunity.

This chapter will focus on proof of the existence of a valuable commercial opportunity. The principal object of this chapter is to demonstrate that, in order to form the subject matter of a compensable loss, a commercial opportunity must have a non-negligible monetary value.

This chapter extends the analysis of the legal framework set out in chapter three, and also identifies the role performed by finance experts in proving the existence (as opposed to the value) of a commercial opportunity.

Structure

This chapter is divided into an introduction and two main sections. The first section analyses the general principles relating to proof of the fact of loss of a commercial opportunity. It is divided into four parts. The first part contains an introduction to the requirement of proof. The second part considers the identification of loss, while the third and fourth parts examine the burden and standard of proof.

The second section analyses the proof of the existence of a valuable commercial opportunity. This section is divided into four parts.

The first part contains an introduction. The second part examines the nature of the enquiry as to whether a commercial opportunity exists. The third part considers the evidentiary foundation required to prove the existence of a commercial opportunity. The final part examines the requirement for the relevant commercial opportunity to have some non-negligible value.

Proof of loss

Introduction

A claimant must prove the loss of a commercial opportunity.

If the opportunity is promised by contract, proof of breach will entitle the claimant to an award of nominal damages. Such damages are awarded in recognition of the fact that the claimant has suffered a legal wrong, and without the need for proof of loss. However, proof of loss is required for an award of substantial damages.[1]

Proof of loss is also required for an award of damages in negligence, and under s 236 of the ACL. This is because, in negligence,[2] and under s 236,[3] damage is the 'gist of the action'. In other words, proof of loss is required to constitute the relevant cause of action.

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[1] *Luna Park (NSW) Ltd v Tramways Advertising Pty Ltd* (1938) 61 CLR 286, 301, 305 (Latham CJ), 307 (Rich J), 311 (Dixon J), 312 (McTiernan J).

[2] *Williams v Milotin* (1957) 97 CLR 465, 474 (Full Court); *John Pfeiffer Pty Ltd v Canny* (1981) 148 CLR 218, 241 (Brennan J); *Tame v New South Wales* (2002) 211 CLR 317, 388 [208] (Gummow and Kirby JJ); *Harriton v Stephens* (2006) 226 CLR 52, 102 [161] (Hayne J), 115 [218], 126 [251] (Crennan J; Gleeson CJ and Gummow and Heydon JJ agreeing); *Tabet v Gett* (2010) 240 CLR 537, 560 [50] (Gummow ACJ); 577 [109] (Kiefel J; Hayne, Crennan and Bell JJ agreeing); *Gregg v Scott* [2005] 2 AC 176, 201 [99] (Hope LJ), 226 [193] (Baroness Hale).

[3] *Wardley Australia Ltd v Western Australia* (1992) 175 CLR 514, 525 (Mason CJ, Dawson, Gaudron and McHugh JJ); *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 348 (Mason CJ, Dawson, Toohey and Gaudron JJ).

Identification of loss

In proving the loss of a commercial opportunity, the first step for the claimant is to identify its alleged loss.[4]

This requires the claimant to address the 'critical question':[5] what is it that the claimant has lost? Thus, in *Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd) v BestCare Foods Ltd*,[6] Ward JA (with whom Hoeben JA agreed) observed that 'before an assessment could be made of the value of a lost commercial opportunity, it was necessary to identify what was the opportunity that, on the balance of probabilities, was lost'[7] as a result of the defendant's breach. Similarly, in *Silverbrook Research Pty Ltd v Lindley*,[8] Allsop P (with whom Beazley JA agreed) observed that, where it is alleged that a commercial opportunity had been lost by breach of contract, the relevant task was to 'identify and characterise what, in substance, was promised and what has been lost or denied by the breach of contract.'[9]

Burden of proof

A claimant bears the legal burden of proving the fact of loss of a valuable commercial opportunity.[10] This requires the claimant to prove both the existence of a valuable commercial opportunity, and that the defendant's wrong caused the loss of this opportunity.[11]

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[4] *Winky Pop Pty Ltd v Mobil Refining Australia Pty Ltd* [2015] VSC 348 (13 July 2015), [298] (Digby J).
[5] *Waribay Pty Ltd v Minter Ellison* [1991] 2 VR 391, 392, 398 (Young CJ and Kaye J).
[6] *Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd) v BestCare Foods Ltd* [2013] NSWCA 90 (24 April 2013).
[7] *Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd) v BestCare Foods Ltd* [2013] NSWCA 90 (24 April 2013), [97].
[8] *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010).
[9] *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010), [2].
[10] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ); 368 (Brennan J); *Tabet v Gett* (2010) 240 CLR 537, 585 [137] (Kiefel J; Hayne, Crennan and Bell JJ agreeing); *Darvall McCutcheon v HK Frost Holdings Pty Ltd* (2002) 4 VR 570, 578 [29] (Chernov JA; Ormiston and Callaway JJA agreeing); *Lewis v Hillhouse* [2005] QCA 316 (26 August 2005), [22] (Keane JA; McMurdo P and Wilson J agreeing).
[11] *Gates v City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1, 13 (Mason, Wilson and Dawson JJ); *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 88 (Mason CJ and Dawson J); *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ), 359, 362, 364–5 (Brennan J); *Tabet v Gett* (2010) 240 CLR 537, 585 [137] (Kiefel J; Hayne, Crennan and Bell JJ agreeing); *Price Higgins & Fidge v Drysdale* [1996] 1 VR 346, 354 (Winneke P;

A defendant bears an evidential burden of proving that the relevant commercial opportunity did not exist (ie, it was of no value), or, if it did, that the loss of that opportunity was not caused by the defendant's wrongdoing. For example, in a claim for loss of an opportunity to bring or defend legal proceedings, the defendant solicitor will bear the evidential burden of proving that the claim or defence was doomed to inevitable failure.[12]

The importance of proving the fact of loss was illustrated recently by the Victorian Court of Appeal in *St George Bank Ltd v Quinerts Pty Ltd*.[13] The claimant advanced a loan to a borrower in reliance on the defendant's valuation of property to be used as security for the loan. The defendant admitted that the valuation was incompetent. Following the borrower's default, the security was sold but the proceeds of sale were insufficient to repay the amount outstanding under the loan. In proceedings against the defendant, the claimant sought, among other things, damages to compensate it for interest forgone by entering into the transaction. At trial, the claimant led no evidence as to what it would have done with its money if it had not lent it to the defaulting borrower.

Nettle JA (with whom Mandie JA and Beach AJA agreed) upheld the rejection by the trial judge of the claim for forgone interest. His Honour rejected the claimant's submission that it was obvious that it was in the business of lending money on a regular and recurrent basis and, on that basis, the trial judge should have been prepared to assume that, if the claimant had not entered into the loan transaction with the borrower, it would have entered into another comparable transaction at more or

Ormiston J and Charles JA agreeing); *Darvall McCutcheon v HK Frost Holdings Pty Ltd* (2002) 4 VR 570, 578 [29] (Chernov JA; Ormiston and Callaway JJA agreeing); *Lewis v Hillhouse* [2005] QCA 316 (26 August 2005), [22] (Keane JA; McMurdo P and Wilson J agreeing); *Professional Services of Australia Pty Ltd v Computer Accounting and Tax Pty Ltd (No 2)* (2009) 261 ALR 179, 202–3 [105]–[111] (Martin CJ; Buss and Newnes JJA agreeing); *Doolan v Renkon Pty Ltd* (2011) 21 Tas R 156, 173–5 [57]–[61] (Full Court); *Pritchard v DJZ Constructions Pty Ltd* [2012] NSWCA 196 (28 June 2012), [78]–[79] (Bathurst CJ), [291], [454] (Whealy JA; Barrett JA agreeing); *Falkingham v Hoffmans (a firm)* (2014) 46 WAR 510, 522 [38] (Pullin and Murphy JJA). This position is reflected in Australian civil liability legislation: see, eg, *Civil Liability Act 2002 (NSW)*, s 5D.

[12] *Mount v Barker Austin (a firm)* [1998] PNLR 493, 510 (Simon Brown LJ; Ward LJ agreeing); *Sharif v Garrett & Co (a firm)* [2002] 1 WLR 3118, 3128–9 [39] (Simon Brown LJ; Chadwick LJ agreeing).

[13] *St George Bank Ltd v Quinerts Pty Ltd* (2009) 25 VR 666.

less the same contractual rate of return.[14] Nettle JA held that 'the incurrence of such losses must be proved' and that it was 'not enough for a party like the bank simply to assert that, because it is in the business of lending money, it must follow that it has suffered a loss equal to the return on funds which it might have achieved if it had entered into a successful transaction at the same rate of return as the failed transaction.'[15]

Standard of proof

Distinction between fact and value of loss

In a claim for damages for loss of a commercial opportunity, a distinction is drawn, for the purpose of determining the appropriate standard of proof, between the *fact* of loss, and the *value* of loss.[16] A claimant must prove the fact of loss on the balance of probabilities.[17] However, the claimant is not required to prove the value or extent of that loss on the balance of probabilities.[18] The value of the loss involves the evaluation of hypothetical (past and future) events, and is therefore assessed by reference to the court's assessment of the degrees of probabilities and possibilities that the relevant benefit would have been realised, or the relevant loss or liability would have been avoided.[19] On this basis, a claimant may be entitled to damages for

[14] *St George Bank Ltd v Quinerts Pty Ltd* (2009) 25 VR 666, 675 [24]–[25].
[15] *St George Bank Ltd v Quinerts Pty Ltd* (2009) 25 VR 666, 675 [25]. See also, *State Bank of New South Wales v Yee* (1994) 33 NSWLR 618.
[16] *Tabet v Gett* (2010) 240 CLR 537, 585 [136] (Kiefel J; Hayne, Crennan and Bell JJ agreeing).
[17] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ), 367 (Brennan J); *Tabet v Gett* (2010) 240 CLR 537, 585 [136] (Kiefel J; Hayne, Crennan and Bell JJ agreeing); *Badenach v Calvert* (2016) 331 ALR 48, 56–7 [40]–[41] (French CJ, Kiefel and Keane JJ); *Feletti v Kontoulas* [2000] NSWCA 59 (23 March 2000), [27] (Mason P; Sheller JA and Rolfe AJA agreeing); *Darvall McCutcheon v HK Frost Holdings Pty Ltd* (2002) 4 VR 570, 578 [29] (Chernov JA; Ormiston and Callaway JJA agreeing); *Lewis v Hillhouse* [2005] QCA 316 (26 August 2005), [22] (Keane JA; McMurdo P and Wilson J agreeing); *Pritchard v DJZ Constructions Pty Ltd* [2012] NSWCA 196 (28 June 2012), [78]–[79] (Bathurst CJ), [291]–[292], [454] (Whealy JA; Barrett JA agreeing); *Falkingham v Hoffmans (a firm)* (2014) 46 WAR 510, 522 [39] (Pullin and Murphy JJA). This position is reflected in Australian civil liability legislation: see, eg, *Civil Liability Act 2002 (NSW)*, s 5E.
[18] *Price Higgins & Fidge v Drysdale* [1996] 1 VR 346, 354 (Winneke P; Ormiston J and Charles JA agreeing).
[19] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ), 368 (Brennan J); *Tabet v Gett* (2010) 240 CLR 537, 585 [136] (Kiefel J; Hayne, Crennan and Bell JJ agreeing); *Price Higgins & Fidge v Drysdale* [1996] 1 VR 346, 354 (Winneke P; Ormiston J and Charles JA agreeing); *Darvall McCutcheon v HK Frost Holdings Pty Ltd* (2002) 4 VR 570, 578 [29] (Chernov JA; Ormiston and Callaway JJA agreeing).

loss of a commercial opportunity even though it is improbable that the opportunity will be realised.[20]

In *Sellars v Adelaide Petroleum NL*,[21] the High Court considered the relationship between proof of the fact of loss, and proof of the value of loss, in the context of a claim for damages for loss of a commercial opportunity under s 236 of the ACL. The central issue in the case was whether the loss of the opportunity of entering into, and deriving benefits under, a commercial contract constituted 'loss or damage' for the purposes of s 236 of the ACL, in circumstances where the trial judge had held that there was less than a 50% chance that the contract would have been performed and the benefit of that contract conferred on the claimant. The defendant argued that the claimant had suffered no loss because there was no evidence that the performance of the contract (and the consequential derivation of benefits by the claimant) was probable.

The High Court upheld the decision of the trial judge that the loss of an improbable but nonetheless non-speculative chance that the contract would be performed constituted loss or damage for the purpose of s 236. In reaching this conclusion, the Court reasoned by analogy with the approach taken in *Malec v JC Hutton Pty Ltd*[22] to the assessment of damages in tort for personal injuries (where, like under s 236, damage is the 'gist of the action'). In *Malec*, the High Court drew a distinction between historical facts, which are proved on the balance of probabilities, and past hypothetical and future events, which can only be assessed in terms of the degree of probability of those events occurring.[23] In that case, Deane, Gaudron and McHugh JJ observed:[24]

> When liability has been established and a common law court has to assess damages, its approach to events that allegedly would have occurred, but cannot now occur, or that allegedly might occur, is

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[20] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 92–4 (Mason CJ and Dawson J), 104 (Brennan J), 118–19 (Deane J); *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 349–50, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ), 364–5, 368 (Brennan J). See also, *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1612 (Stuart-Smith LJ; Hobhouse LJ agreeing).
[21] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332.
[22] *Malec v JC Hutton Pty Ltd* (1990) 169 CLR 638.
[23] *Malec v JC Hutton Pty Ltd* (1990) 169 CLR 638, 642–3 (Deane, Gaudron and McHugh JJ), 639–40 (Brennan and Dawson JJ).
[24] *Malec v JC Hutton Pty Ltd* (1990) 169 CLR 638, 642–3.

different from its approach to events which allegedly have occurred. A common law court determines on the balance of probabilities whether an event has occurred. If the probability of the event having occurred is greater than it not having occurred, the occurrence of the event is treated as certain; if the probability of it having occurred is less than it not having occurred, it is treated as not having occurred. Hence, in respect of events which have or have not occurred, damages are assessed on an all or nothing approach. But in the case of an event which it is alleged would or would not have occurred, or might or might not yet occur, the approach of the court is different. The future may be predicted and the hypothetical may be conjectured… If the law is to take account of future or hypothetical events in assessing damages, it can only do so in terms of the degree of probability of those events occurring. The probability may be very high – 99.9 per cent – or very low – 0.1 per cent. But unless the chance is so low as to be regarded as speculative – say less than 1 per cent – or so high as to be practically certain – say over 99 per cent – the court will take that chance into account in assessing the damages. Where proof is necessarily unattainable, it would be unfair to treat as certain a prediction which has a 51 per cent probability of occurring, but to ignore altogether a prediction which has a 49 per cent probability of occurring. Thus, the court assesses the degree of probability that an event would have occurred, or might occur, and adjusts its award of damages to reflect the degree of probability. The adjustment may increase or decrease the amount of damages otherwise to be awarded… The approach is the same whether it is alleged that the event would have occurred before or might occur after the assessment of damages takes place.

In *Sellars*, Mason CJ, Dawson, Toohey and Gaudron JJ considered that the reasons for this approach in a personal injuries context applied with 'equal force to the assessment of damages for loss of a commercial opportunity.'[25] On this basis, their Honours concluded that the fact of loss of a commercial opportunity, being an historical fact, must be proved on the balance of probabilities:[26]

[T]he general standard of proof in civil actions will ordinarily govern the issue of causation and the issue whether the applicant has sustained loss or damage. Hence the applicant must prove on the balance of probabilities that he or she has sustained *some* loss or damage. However, in a case such as the present, the applicant shows *some* loss or damage was sustained by demonstrating that the contravening conduct caused the loss of a commercial opportunity which had *some* value (not being a negligible value), the value being ascertained by reference to the degree of probabilities or possibilities.

[25] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 350.
[26] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ) (emphasis in original).

On the other hand, the value of that loss, which depends on hypothetical (past and future) events, 'should be ascertained by reference to the court's assessment of the prospects of success of that opportunity had it been pursued.'[27]

Brennan J delivered a separate judgment dismissing the appeal for reasons similar to those given by the majority. His Honour noted the distinction drawn in *Malec*, and applying it to the facts of the case concluded:[28]

> Where a loss is alleged to be a lost opportunity to acquire a benefit, a plaintiff who bears the onus of proving that a loss was caused by the conduct of the defendant discharges that onus by establishing a chain of causation that continues up to the point when there is a substantial prospect of acquiring the benefit sought by the plaintiff. Up to that point, the plaintiff must establish both the historical facts and any necessary hypothesis on the balance of probabilities. A constant standard of proof applies to the finding that a loss has been suffered and to the finding that that loss was caused by the defendant's conduct, whether those findings depend on evidence of historical facts or on evidence giving rise to competing hypotheses. In any event, the standard is proof on the balance of probabilities. Although the issue of *a* loss caused by the defendant's conduct must be established on the balance of probabilities, hypotheses and possibilities the fulfilment of which cannot be proved must be evaluated to determine the amount or value of the loss suffered. Proof on the balance of probabilities has no part to play in the evaluation of such hypotheses or possibilities: evaluation is a matter of informed estimation.

Hypothetical acts of claimant and other parties

A claim for loss of a commercial opportunity will necessarily raise the question: what would the claimant, or another party, have done if the relevant wrong had not occurred? For the purpose of determining the appropriate standard of proof, a distinction is drawn between the hypothetical acts of the claimant, on the one hand, and the hypothetical acts of third parties, on the other hand.

The hypothetical acts of the claimant,[29] and *semble*, those closely related to the claimant,[30] are treated as part of the fact of loss and must therefore be proved on the

[27] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ).
[28] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 368 (emphasis in original) (citations omitted).

balance of probabilities. On the other hand, the hypothetical acts of third parties, to the extent that they are relevant to the *fact* of loss, must be proved on the balance of probabilities; however, to the extent that they are relevant to the *value* of loss, they are ascertained by reference to the degree of probabilities or possibilities.[31] Accordingly, the claimant is required to prove, on the balance of probabilities, that but for the relevant wrong, the claimant would have acted (or refrained from acting) so as to obtain the relevant benefit or avoid the relevant loss or liability.[32] Once that is

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[29] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 353 (Mason CJ, Dawson, Toohey and Gaudron JJ), 362, 368 (Brennan J); *Daniels v Anderson* (1995) 37 NSWLR 438, 529 (Clarke and Sheller JJA); *Price Higgins & Fidge v Drysdale* [1996] 1 VR 346, 355 (Winneke P; Ormiston J and Charles JA agreeing); *Feletti v Kontoulas* [2000] NSWCA 59 (23 March 2000), [27]–[32] (Mason P; Sheller JA and Rolfe AJA agreeing); *G W Sinclair & Co Pty Ltd v Cocks* [2001] VSCA 47 (26 April 2001), [29] (Charles JA; Brooking and Buchanan JJA agreeing); *Hammond Worthington v Da Silva* [2006] WASCA 180 (7 September 2006), [118] (Buss JA; McLure and Pullin JJA agreeing); *Heenan v De Sisto* (2008) Aust Torts Reports 81–941, 61,420–21 [31]–[33] (Giles JA; Mason P and Mathews AJA agreeing); *Castel Electronics Pty Ltd v Toshiba Singapore Pte Ltd* (2011) 192 FCR 445, 472 [166] (Full Court); *Doolan v Renkon Pty Ltd* (2011) 21 Tas R 156, 175 [60] (Full Court); *Pritchard v DJZ Constructions Pty Ltd* [2012] NSWCA 196 (28 June 2012), [79] (Bathurst CJ), [297], [454] (Whealy JA; Barrett JA agreeing); *Falkingham v Hoffmans (a firm)* (2014) 46 WAR 510, 522 [40] (Pullin and Murphy JJA); *Sykes v Midland Bank Executor and Trustee Co Ltd* [1971] 1 QB 113; *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1610 (Stuart-Smith LJ; Hobhouse LJ agreeing), 1623 (Millett LJ). Cf *Bak v Glenleigh Homes Pty Limited* [2006] NSWCA 10 (15 February 2006), [73]–[74] (Hodgson JA; McColl JA agreeing) (requirement that the claimant establish, on the balance of probabilities, that it would have taken the relevant opportunity is limited to claims in which loss or damage is the gist of the action).

[30] *Doppstadt Australia Pty Ltd v Lovick & Son Developments Pty Ltd* [2014] NSWCA 158 (21 May 2014), [262]–[265] (Gleeson JA; Ward and Emmett JJA agreeing); *Veitch v Avery* [2007] EWCA Civ 711 (12 July 2007), [26] (Auld LJ; Sedley and Leveson LJJ agreeing).

[31] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355–6 (Mason CJ, Dawson, Toohey and Gaudron JJ), 368–9 (Brennan J); *Heenan v De Sisto* (2008) Aust Torts Reports 81–941, 61,421 [33]–[34] (Giles JA; Mason P and Mathews AJA agreeing); *Pritchard v DJZ Constructions Pty Ltd* [2012] NSWCA 196 (28 June 2012), [85]–[88] (Bathurst CJ), [297], [457]–[459] (Whealy JA; Barrett JA agreeing); *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1611 (Stuart-Smith LJ; Hobhouse LJ agreeing), 1623 (Millett LJ). But see, *Stone Heritage Developments Ltd v Davis Blank Furniss (a firm)* (Unreported, High Court of England & Wales, Hodge J, 1 June 2006) (claimant must prove, on the balance of probabilities, the hypothetical acts of a third party where that party is before the court); affirmed, without reference to the issue, [2007] EWCA Civ 765 (24 July 2007). For a criticism of the decision of Hodge J, see Harvey McGregor, *McGregor on Damages* (Sweet & Maxwell, 19th ed, 2014), [10–064]–[10–065]. See also, *Aercap Partners 1 Ltd v Avia Asset Management AB* [2010] EWHC 2431 (Comm) (7 October 2010), [76(v)] (Gross LJ) (*obiter*) (claimant adducing evidence from the third party proving, on the balance of probabilities, the fact of loss is entitled to recover that loss in full subject only to a discount for contingencies affecting quantum). Cf, *Wellesley Partners LLP v Withers LLP* [2015] EWCA Civ 1146 (11 November 2015), [112]-[122] (Floyd LJ; Roth and Longmore LJJ agreeing).

[32] Under Australian civil liability legislation, the hypothetical acts of the claimant must be determined subjectively and, in general, evidence from the claimant is inadmissible: see, eg, *Civil Liability Act 2002 (NSW)*, s 5D(3); *Civil Liability Act 2003 (QLD)*, s 11(3); *Civil Liability Act 2002 (TAS)*, s 13(3); *Civil Liability Act 2002 (WA)*, s 5C(3). See also, *Rosenberg v Percival* (2001) 205 CLR 434; *McCrohon v Harith* (2010) Aust Torts Reports 82–056, 64,142–3 [102]–[106] (McColl JA; Campbell JA and Handley AJA agreeing); *Pritchard v DJZ Constructions Pty Ltd* [2012] NSWCA 196 (28 June 2012), [456] (Whealy JA; Barrett JA agreeing). In some circumstances, a claimant's failure to lead evidence of what it would have done will be fatal to its claim: see *OXS Pty Ltd v Sydney Harbour*

established, the claimant must prove, 'by evidence or inference',[33] that, on the balance of probabilities, there was a 'substantial, and not merely a speculative'[34] chance that the third party would have acted (or refrained from acting) in this way. Once those two matters are established, the court will assess the value of the chance 'by reference to the degree of probabilities or possibilities.'[35]

Thus, in *Sellars*, the claimant was required to prove that, on the balance of probabilities, it would have entered into the Pagini contract.[36] However, the claimant was not required to prove, on the balance of probabilities, that the counterparty would have entered into the contract, only that there was some chance that the counterparty would have done so. That chance was then reflected in the value of the Pagini contract.

The appropriate standard of proof to apply to the hypothetical acts of the defendant, or a person closely related to the defendant,[37] will depend on whether those acts go to the *fact* or *value* of the claimant's loss. In principle, if the hypothetical acts go to the fact of the claimant's loss, the claimant must prove those acts on the balance of probabilities, despite the fact that they are hypothetical.[38]

Foreshore Authority [2016] NSWCA 120 (23 May 2016), [260]-[262] (Gleeson JA; Macfarlan and Leeming JJA agreeing).

[33] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1623 (Millett LJ).

[34] *Prosperity Advisers Pty Ltd v Secure Enterprises Pty Ltd t/a Strathearn Insurance Brokers* [2012] NSWCA 192 (25 June 2012), [73] (Tobias AJA; Macfarlan and Barrett JJA agreeing).

[35] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ).

[36] See *Adelaide Petroleum NL v Poseidon Ltd* (1990) 98 ALR 431, 531 (French J) (the 'probability' of the claimant entering into the Pagini contract was 'high').

[37] But see, *Jones v IOS (RUK) Ltd* [2012] EWHC 348 (Ch) (2 March 2012), [86] (Hodge QC) (obiter) (related company of defendant treated as a third party for the purpose of determining the appropriate standard of proof).

[38] *QCoal Pty Ltd v Cliffs Australia Coal Pty Ltd* [2009] QCA 358 (20 November 2009), [42], [44] (Fraser JA; Holmes JA and White J agreeing) (*obiter*); *North Sea Energy Holdings NV v Petroleum Authority of Thailand* [1999] 1 Lloyd's Rep 483, 493–6 (Waller LJ; Ward and Roch LJJ agreeing); *Aercap Partners 1 Ltd v Avia Asset Management AB* [2010] EWHC 2431 (Comm) (7 October 2010), [76(iii)] (Gross LJ). See also, *Gregg v Scott* [2005] 2 AC 176, 197 [83] (Lord Hoffmann); *Transport for London v Spirerose Ltd (in administration)* [2009] 1 WLR 1797, 1813 [44] (Walker LJ; Scott, Mance, Neuberger and Collins LJJ agreeing); McGregor, above n 31, [10–061]; Adam Kramer, *The Law of Contract Damages* (Hart Publishing, 2014) [13.3A(iv)], [13.3B]; Jill Poole, 'Loss of chance and the evaluation of hypotheticals in contractual claims' [2007] *Lloyd's Maritime and Commercial Law Quarterly* 63, 68–9; Andrew Burrows, 'Uncertainty about uncertainty: damages for loss of a chance' (2008) 1 *Journal of Personal Injury Law* 31, 41. *Contra Tasmania Development & Resources v Martin* (2000) 97 IR 66, 74–5 [38] (Kiefel J; Lee and Cooper JJ agreeing); *Guthrie v News Ltd* (2010) 27 VR 196, 227–8 [168], 229 [173] (Kaye J) (question whether the defendant would have renewed a fixed term employment contract assessed by reference to the degrees of probability).

One reason for requiring proof on the balance of probabilities is that a defendant, like the claimant, can be expected to give evidence of its hypothetical acts in a self-serving manner.[39] It has been suggested that this position, in so far as it relates to the hypothetical acts of the defendant in a claim for breach of contract, is consistent with the operation of the 'minimum' or 'least onerous' obligation rule.[40] If the minimum obligation rule applies, it is presumed that the defendant would have performed the contract in the manner most beneficial to it; no question arises as to the possibilities of whether the defendant would have performed in this way.

On the other hand, if the hypothetical acts of the defendant, or a person closely related to the defendant, go to the value of the claimant's loss, those acts are assessed by reference to the degree of probabilities or possibilities.[41] This is illustrated by the decision of the majority of the New South Wales Court of Appeal in *Silverbrook Research Pty Ltd v Lindley*.[42] The defendant had employed the claimant under a written service agreement. Under the terms of the agreement, the claimant was entitled to an annual performance bonus of $40,000, subject to satisfying certain objectives set by the defendant, and subject to the defendant exercising its discretion to pay the bonus. The defendant did not at any time set the objectives, with the result that the claimant's performance was never assessed against the objectives and no bonus was paid. The trial judge held that the defendant had breached the agreement, and that the breach had, on the balance of probabilities, caused the claimant to lose a valuable opportunity to be paid the bonus over a three-year period. The trial judge assessed the value of that opportunity at $74,000, on the basis that the likelihood of the defendant paying the bonus was 75% in the first year; 60% in the second year; and 50% in the third year.

Allsop P (with whom Beazley JA agreed) dismissed an appeal by the defendant. His Honour rejected the defendant's contentions that the trial judge had erroneously characterised the claimant's action as a claim for loss of a commercial opportunity. Allsop P considered that the defendant had promised to the claimant 'the contractual

[39] Poole, above n 38, 67–9.
[40] Ibid 68–9. See below, Part two, ch 6.
[41] See, eg, *Chaplin v Hicks* [1911] 2 KB 786.
[42] *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010).

opportunity or chance of obtaining bonuses should the results of the process be favourable and subject to the exercise of any discretion'[43] and that '[t]he opportunity or chance that was agreed and to which the respondent was entitled, without more, was denied to her.'[44] The value of the claimant's opportunity or chance was then 'to be measured by the probabilities and possibilities', including 'how the appellant would or might act.'[45]

Hammerschlag J dissented. His Honour agreed with the defendant's submission that the trial judge erred in characterising the claimant's action as a claim for loss of a commercial opportunity and in dealing with damages on that footing. Hammerschlag J considered that, in the present case, the claimant's loss turned on the hypothetical acts of the defendant, and therefore in order to discharge its onus of proof, the claimant was required to prove those acts on the balance of probabilities:[46]

> An opportunity may be lost because a party fails, in breach of its contractual obligations, to take steps which it is obliged to take. In such a case, in order to discharge its onus on the issue of causation, the plaintiff must establish (on the probabilities) that had there been no breach, the steps concerned would have been taken and it must also establish that the opportunity to gain a financial benefit (or avoid a financial detriment) was thereby lost.

His Honour considered that, '[p]roperly analysed the chance identified and valued by the primary judge was no more than the chance that the appellant would perform its obligations under the Agreement in a particular way'[47] and that framing this chance as a commercial opportunity 'displaced the requirement on the respondent alleging breach, of establishing on the balance of probabilities that she suffered damage from the breach.'[48] Hammerschlag J concluded that, in relation to the third bonus year, the trial judge's error in characterising the claim had the effect that the defendant 'recovered damages for a breach which may or may not have led to the Bonus being

[43] *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010), [3].
[44] *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010), [4].
[45] *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010), [9].
[46] *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010), [50].
[47] *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010), [53].
[48] *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010), [54].

paid and where she failed to establish that it was more probable than not that she would have received anything.'[49]

The difference between the majority and minority judgments in *Silverbrook* can be explained by the fact that the majority considered that, properly construed, the agreement contained an express promise by the defendant to confer the opportunity on the claimant. Breach of this promise inevitably caused the loss of the opportunity, and therefore the hypothetical acts of the defendant were only relevant to the question of the value of the claimant's loss. On the other hand, Hammerschlag J considered that the claimant's alleged loss was a consequential loss, which depended on the hypothetical acts of the defendant, and therefore in order to prove the fact of loss the claimant was required to prove the hypothetical acts of the defendant on the balance of probabilities.

It follows from the above analysis that, properly understood, a claim for loss of a commercial opportunity arises where the fact of loss turns, wholly or partly, on the hypothetical acts of a third party.[50] However, if the fact of loss turns solely on the hypothetical acts of the claimant or the defendant, proof of those acts on the balance of probabilities is required, and will entitle the claimant to its loss in full (subject to any contingencies affecting quantum), and no occasion will arise for assessing the claimant's loss on the probabilities or possibilities.

Difficulties of distinction between fact and value of loss

In a claim for damages for loss of a commercial opportunity, the distinction between the fact of loss, and the value of loss is critical, both to the proper determination of liability and quantum. Unfortunately, 'sometimes trial judges have not separated from the question, what has the plaintiff lost, the question what is the value of that which he is satisfied has been lost.'[51]

[49] *Silverbrook Research Pty Ltd v Lindley* [2010] NSWCA 357 (17 December 2010), [56].
[50] See Poole, above n 38, 68.
[51] *Waribay Pty Ltd v Minter Ellison* [1991] 2 VR 391, 398 (Young CJ and Kaye J).

The importance, and difficulty, of making this distinction was illustrated in *Daniels v Anderson*.[52] An employee of the claimant caused the claimant to suffer substantial foreign exchange losses. These losses were undetected because of gross deficiencies in the claimant's internal reporting system. The claimant alleged that its auditor, the defendant, had repeatedly failed to warn the claimant of those deficiencies and that as a result the claimant had been deprived of the opportunity to avoid some or all of the losses it suffered.

Both at trial and on appeal, the claimant proved, on the balance of probabilities, that if the defendant had complied with its duty to warn, the claimant would have taken remedial action to stem its losses by reverting to trading in accordance with its then current trading policy. On that premise (and assuming no change in that policy), it was agreed by the parties that the claimant would have reduced its foreign exchange losses by $6 million. However, in the course of assessing damages, the trial judge concluded that it was *probable* that, at some point in the relevant time, the claimant would have changed its trading policy. The trial judge then treated this finding as a certain fact and assessed damages on the basis that the change in policy would, not might, have taken place.

The New South Wales Court of Appeal set aside the trial judge's finding and reassessed the claimant's damages. Clarke and Sheller JJA pointed out that, having found on the balance of probabilities that the claimant would have reverted to in-policy trading, the trial judge was required to treat that fact as certain and to assess damages accordingly. Clarke and Sheller JJA then addressed the likelihood of a change in policy:[53]

> To the extent that the financial consequences of the directors acting in this way did not flow inevitably but depended upon chances and events… the trial judge was required to consider possibilities as well as probabilities and to reach a broad determination in the light of those considerations… There were, in theory a number of conclusions open. First, the judge could have concluded that it was unlikely that there would have been any change of policy. Secondly, he could have thought that the question was so speculative that it was impossible for him to reach any conclusion upon it. Thirdly, he could have thought that there were some possible changes which may have been made and, acting on evidence,

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[52] *Daniels v Anderson* (1995) 37 NSWLR 438.
[53] *Daniels v Anderson* (1995) 37 NSWLR 438, 560-1.

made some allowance for those changes. What he could not do was to determine that a change was more likely than not and then treat the fact that that damage would have taken place as certain and award damages upon the basis that it would have taken place.

A similar error occurred in *Allied Maples Group Ltd v Simmons & Simmons (a firm)*.[54] The claimant instructed its solicitors, the defendant, to act for the claimant in the purchase of certain assets from the vendor, including four department stores leased by a subsidiary of the vendor. Following the discovery that the leases were personal and non-transferable, the transaction was restructured as a share sale under which the claimant would acquire the issued share capital of the subsidiary. The defendants prepared a sale agreement that contained a warranty by the vendor that the subsidiary had no existing or contingent liabilities in respect of previously leased properties. Following negotiation, that warranty was replaced by a clause which required the vendor to make a payment to the purchaser in respect of any liability of the subsidiary that was not, but should have been, reflected in the completion accounts.

After completion of the sale, it was discovered that the subsidiary had significant 'first tenant' liabilities, which were not required by accountancy practice to be reflected in the completion accounts and therefore were not subject to a compensating payment by the vendor. The claimant brought proceedings against the defendants claiming that the claimant had been insufficiently advised of, and protected from, the first tenant liabilities. The claimant alleged, among other things, that they had lost the chance, if properly advised, to successfully renegotiate the sale agreement and obtain total or partial protection against the risk of first tenant liability.

At the trial of a preliminary issue on the question of liability, the trial judge held that the defendants were in breach of their duty, and that, if the claimant had been properly advised it would have sought to renegotiate the sale agreement to obtain protection against the contingent liability. The trial judge also held that it was *probable* that the claimant would have successfully renegotiated the sale agreement, in circumstances where neither the claimant nor the defendant called evidence from the vendor as to its attitude to the renegotiation.

[54] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602.

Stuart-Smith LJ (with whom Hobhouse LJ agreed) dismissed an appeal by the defendant, but nonetheless held that the trial judge had applied the wrong test in determining whether the claimant would have successfully renegotiated the sale agreement. His Lordship considered that, in the present case, the claimant's loss depended on the hypothetical actions of the claimant, and a third party. In those circumstances, the claimant was required to establish on the balance of probability that it would have taken action to obtain the relevant benefit or to avoid the risk,[55] and that there was a 'substantial', rather than 'speculative', chance that the third party would have acted to confer the benefit or to avoid the risk, the evaluation of that chance being a question of quantification of damages.[56]

The trial judge was therefore required to assess two things as a matter of *causation*: first, whether, on the balance of probability, the claimant would, if given correct advice, have sought to renegotiate; secondly, whether the claimant had a substantial chance of successfully renegotiating some protection against the contingent liability. Stuart-Smith LJ held that there was ample evidence to support the trial judge's affirmative conclusion on each issue.[57] However, his Lordship held that the trial judge, in finding that the claimant would *probably* have succeeded in obtaining some protection against the contingent liability, had gone further than was necessary and made a determination on *quantum*.[58] This finding was not required at a preliminary trial on the question of liability, and involved the application of the wrong test, particularly in circumstances where the vendor or its solicitor may have given evidence going to this issue at the quantum hearing.[59]

Existence of loss

Introduction

This section of the chapter explores the principles relevant to proof of the existence of a commercial opportunity. In order to prove the existence of a commercial

[55] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1610.
[56] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1611.
[57] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1610, 1615.
[58] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1614.
[59] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1614.

opportunity, the claimant must prove, on the balance of probabilities, that the opportunity itself 'had *some* value (not being a negligible value).'[60]

This section will examine three things: first, the nature of the enquiry as to whether a commercial opportunity exists; secondly, the evidentiary foundation required to prove the existence of a commercial opportunity; and thirdly, the requirement for the relevant commercial opportunity to have some non-negligible value.

Subjective or personalistic probability

In general, the question whether a commercial opportunity has some value, and the extent of that value, requires the relevant court, tribunal or other decision maker to make a subjective or personalistic probability assessment.[61]

In the former case, the court must form a belief as to the existence of a valuable opportunity, with the strength of that belief satisfying the balance of probabilities.[62] In the latter case, the court must simply form a belief as to the extent of the value of the opportunity.

An assessment of the existence and extent of value must, however, be based on evidence. The evidentiary foundation required to prove the existence of a valuable opportunity is addressed in the next section. The evidentiary foundation required to prove the extent of that value is addressed in chapter six.

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[60] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ) (emphasis in original); *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003), [32], [34] (Chernov JA; Buchanan JA agreeing).

[61] Note, 'Damages Contingent Upon Chance' [1964] 18 *Rutgers Law Review* 875. On the importance of subjective probability in legal assessment, see, eg, John Kaplan, 'Decision Theory and the Factfinding Process' (1968) 20 *Stanford Law Review* 1065, 1066–7; Justice D H Hodgson, 'The Scales of Justice: Probability and Proof in Legal Fact-finding' (1995) 69 *Australian Law Journal* 731; Robert J Rhee 'A Price Theory of Legal Bargaining: An Inquiry into the Selection of Settlement and Litigation Under Uncertainty' (2006) 56 *Emory Law Journal* 619, 646–53.

[62] See, Hodgson, above n 61, 732.

Evidentiary foundation

Requirement for evidence

The existence of a commercial opportunity 'must be proven by evidence.'[63] This evidence will include evidence of the claimant's 'objectives and the contingencies in the way of their achievement.'[64] Importantly, the claimant must adduce evidence on which a rational assessment could be made that the relevant opportunity had some value. Thus, in *Prosperity Advisers Pty Ltd v Secure Enterprises Pty Ltd t/a Strathearn Insurance Brokers*,[65] Tobias AJA (with whom Macfarlan and Barrett JJA agreed) observed '[w]hether or not a lost chance has *some* value which is more than just speculative involves an evaluative judgment based on all the circumstances and, in particular, the evidence elicited to support the proposition that the prospects of the chance coming to fruition was sufficient to enable a positive rational assessment of it to be made.'[66] A claimant must therefore adduce evidence that the relevant opportunity has some value, and not simply rely on 'guess-work or conjecture.'[67]

Nature of evidence

A mixture of subjective and objective evidence may be adduced to prove the existence of a commercial opportunity. For example, in a claim for the loss of an opportunity to purchase an alternative asset, the claimant may itself give evidence of its readiness and willingness to buy the alternative asset. The claimant may also lead objective evidence of the availability of the asset, and the claimant's ability to buy it. This evidence may enable the court to draw inferences about the likelihood that the claimant would have bought the alternative asset, but for the defendant's wrong.

In some cases, evidence of the terms of a contract under which an opportunity is promised will constitute prima facie evidence of the existence of a valuable

[63] *Price Higgins & Fidge v Drysdale* [1996] 1 VR 346, 355 (Winneke P; Ormiston J and Charles JA agreeing).
[64] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 365 (Brennan J).
[65] *Prosperity Advisers Pty Ltd v Secure Enterprises Pty Ltd t/a Strathearn Insurance Brokers* [2012] NSWCA 192 (25 June 2012).
[66] *Prosperity Advisers Pty Ltd v Secure Enterprises Pty Ltd t/a Strathearn Insurance Brokers* [2012] NSWCA 192 (25 June 2012), [88] (emphasis in original).
[67] *Prosperity Advisers Pty Ltd v Secure Enterprises Pty Ltd t/a Strathearn Insurance Brokers* [2012] NSWCA 192 (25 June 2012), [98] (Tobias AJA; Macfarlan and Barrett JJA agreeing).

opportunity. However, as discussed in the next section of this chapter, the fact that an opportunity is promised is not conclusive evidence that the opportunity is valuable.

Expert evidence

In many claims for loss of a commercial opportunity, the existence and valuation of the alleged lost opportunity will be the subject of expert valuation evidence. However, it has been suggested that determining the existence of the loss of a commercial opportunity is 'largely a matter of gut instinct rather than mathematics' and that '[a]ny temptation to adopt too detailed, or mathematical, an approach to the determination of the causation question needs to be resisted.'[68]

This does not mean, however, that financial valuation evidence has no role to play in proving the existence of a commercial opportunity, and that such evidence should be confined to proving the value of an established loss. As Brennan J observed in *Sellars v Adelaide Petroleum NL*:[69]

> Although the loss of a valuable opportunity and the assessment of its amount are concepts that can be logically separated, in practice it will usually be the same body of evidence that tends to establish both the existence of a loss and the amount to be recovered. That evidence may establish the loss of a valuable opportunity more clearly than the value of the opportunity lost.

Furthermore, in complex commercial cases, adducing valuation evidence at the liability stage of a hearing may not only assist a court in understanding the financial dynamics of the claim, but it may also assist in its early resolution or settlement.

Non-negligible value

Introduction

A claim for loss of a commercial opportunity represents a claim for the value of a *chance* or *opportunity* to receive an expected benefit or to avoid an expected loss or

[68] Poole, above n 38, 74. See generally, Hodgson, above n 61, 736–7.
[69] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 364. See also, *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003), [13] (Buchanan JA).

liability; not a claim for the value of the expected benefit or loss or liability itself.[70] The opportunity to receive an expected benefit or to avoid an expected loss or liability is the probability that the benefit would accrue in the manner expected or the probability that the loss or liability could have been avoided.

It follows that in order for a commercial opportunity to have some value the opportunity itself must have a non-negligible value. Thus, it has been said that the opportunity must be 'real'[71] or 'substantial';[72] and not 'negligible',[73] 'speculative',[74] 'fanciful'[75] or, in the words of Vaughan Williams LJ (with whom Fletcher Moulton and Farwell LJJ agreed), 'so dependent on the mere unrestricted volition of another that it is impossible to say that there is any assessable loss resulting from the breach.'[76]

In this context, value means monetary value.[77] For an opportunity to have a non-negligible monetary value, two inter-related things are required: first, the *object* of the opportunity (the relevant benefit, or loss or liability) must have a non-negligible monetary value; secondly, the *probability* of successfully obtaining or realising that object must be non-negligible.[78]

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[70] *Howe v Teefy* (1927) 27 SR (NSW) 301, 307 (Street CJ; Gordon and Campbell JJ agreeing); *Waribay Pty Ltd v Minter Ellison* [1991] 2 VR 391, 397 (Young CJ and Kaye J); *Darvall McCutcheon v HK Frost Holdings Pty Ltd* (2002) 4 VR 570, 590 [72] (Chernov JA; Ormiston and Callaway JJA agreeing); *Berryman v Hames Sharley (WA) Pty Ltd* (2008) 38 WAR 1, 83 [536] (Hasluck J).
[71] *Fink v Fink* (1946) 74 CLR 127, 135 (Latham CJ and Williams J); *Price Higgins & Fidge v Drysdale* [1996] 1 VR 346, 355 (Winneke P; Ormiston J and Charles JA agreeing); *Darvall McCutcheon v HK Frost Holdings Pty Ltd* (2002) 4 VR 570, 578 [29] (Chernov JA; Ormiston and Callaway JJA agreeing); *Falkingham v Hoffmans (a firm)* (2014) 46 WAR 510, 522 [39] (Pullin and Murphy JJA).
[72] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 364 (Brennan J); *Badenach v Calvert* (2016) 331 ALR 48, 56 [40] (French CJ, Kiefel and Keane JJ).
[73] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ).
[74] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 364 (Brennan J); *Badenach v Calvert* (2016) 331 ALR 48, 56 [40] (French CJ, Kiefel and Keane JJ).
[75] *Darvall McCutcheon v HK Frost Holdings Pty Ltd* (2002) 4 VR 570, 578 [29] (Chernov JA; Ormiston and Callaway JJA agreeing); *Falkingham v Hoffmans (a firm)* (2014) 46 WAR 510, 522 [39] (Pullin and Murphy JJA).
[76] *Chaplin v Hicks* [1911] 2 KB 786, 792–3.
[77] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 364 (Brennan J); *Howe v Teefy* (1927) 27 SR (NSW) 301, 307 (Street CJ; Gordon and Campbell JJ agreeing); *Chaplin v Hicks* [1911] 2 KB 786, 793 (Vaughan Williams LJ; Fletcher Moulton and Farwell LJJ agreeing).
[78] *Glenmont Investments Pty Ltd v O'Loughlin (No 2)* (2000) 79 SASR 185, 281 [430] (Full Court) (a court must ignore 'opportunities which have negligible prospects of occurring or would be of negligible value should they occur.')

These two elements are not independent criteria. In some cases, such as those involving a lost cause of action, it is not possible to consider whether the object of the opportunity (a damages award or settlement payment) has a non-negligible monetary value without understanding whether the probability of successfully realising that object (the prospect of success) is more than negligible. Thus, in *Lewis v Hillhouse*,[79] Keane JA (with whom McMurdo P and Wilson J agreed) observed, in the course of considering whether the opportunity to have a criminal conviction quashed was something of value:[80]

> An opportunity to litigate, considered in the abstract and without regard for the prospects of a favourable outcome, is not something of value. Rather, it is an occasion of confrontation, conflict and expense. No litigant suffers any real loss by losing the opportunity to run up dry gullies. It cannot sensibly be said that the loss of 'a right to an appeal' or 'a right to a trial', without more, is a loss of something valuable. In the context of a claim for substantial damages, the loss of a right to an appeal or trial of criminal charges is, of itself, nothing more than the loss of the opportunity to be in peril of a conviction and to spend money to avoid that peril. It is only if the result of the appeal or trial was likely to be favourable in some sense that anything of value has been lost by the litigant.

Each of these criteria is examined below.

Non-negligible monetary value

The object of an opportunity may have a non-negligible monetary value in two senses. First it may represent an expected benefit. This benefit may take the form of a prize or reward;[81] the payment of a sum of money, such as a tip,[82] a commission,[83] or a debt;[84] rights under a guarantee;[85] a cause of action (with some prospects of a favourable outcome);[86] the sale,[87] or exploitation,[88] of an asset; or the ability to tender

[79] *Lewis v Hillhouse* [2005] QCA 316 (26 August 2005).
[80] *Lewis v Hillhouse* [2005] QCA 316 (26 August 2005), [24].
[81] *Chaplin v Hicks* [1911] 2 KB 786.
[82] *Manubens v Leon* [1919] 1 KB 208.
[83] *IOOF Building Society Pty Ltd v Foxeden Pty Ltd* [2009] VSCA 138 (19 June 2009); *Nicholas Prestige Homes v Neal* [2010] EWCA Civ 1552 (1 December 2010).
[84] *Domine v Grimsdall* [1937] 2 All ER 119 (judgment debt); *Molinara v Perre Bros Lock 4 Pty Ltd* (2014) 121 SASR 61 (commercial debt).
[85] *Pritchard v DJZ Constructions Pty Ltd* [2012] NSWCA 196 (28 June 2012).
[86] *Johnson v Perez* (1988) 166 CLR 351; *Lewis v Hillhouse* [2005] QCA 316 (26 August 2005), [24] (Keane JA; McMurdo P and Wilson J agreeing); *Falkingham v Hoffmans (a firm)* (2014) 46 WAR 510.

for,[89] negotiate,[90] enter into,[91] or renegotiate,[92] a contract. Secondly, the object of an opportunity may represent avoiding, reducing or deferring a detriment, such as a cost,[93] a loss,[94] or a liability.[95]

In this context, however, it is important to note two things. First, it is not necessary that there be an actual market for the object of the opportunity in order for that object to have a monetary value. In *Chaplin v Hicks*,[96] Vaughan Williams LJ observed that the claimant's right to participate in the competition according to its terms was incapable of transfer and could not be sold in a market, however, 'a jury might well take the view that such a right, if it could have been transferred, would have been of such a value that every one would recognise that a good price could be obtained for it.'[97] Similarly, while there is no actual market in legal claims, the right to bring (or defend) legal proceedings (with some prospects of a favourable outcome) is an 'asset',[98] of 'real value.'[99]

The second thing to note is that the mere fact that the claimant contracts for an opportunity does not necessarily mean that the object of the opportunity has a

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[87] *G W Sinclair & Co Pty Ltd v Cocks* [2001] VSCA 47 (26 April 2001); *Williams v Pagliuca* [2009] NSWCA 250 (19 August 2009); *First Interstate Bank of California v Cohen Arnold (a firm)* [1996] PNLR 17; *Stovold v Barlows (a firm)* [1996] PNLR 91.
[88] *Howe v Teefy* (1927) 27 SR (NSW) 301 (racehorse); *Glenmont Investments Pty Ltd v O'Loughlin* (No 2) (2000) 79 SASR 185 (mechanical dinosaur).
[89] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64.
[90] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332.
[91] *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377, 416–17 (Dixon and Fullagar JJ; McTiernan J agreeing); *Gates v City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1, 13 (Mason, Wilson and Dawson JJ).
[92] *Heenan v De Sisto* (2008) Aust Torts Reports 81–941; *Jacfun Pty Limited v Sydney Harbour Foreshore Authority* [2012] NSWCA 218 (25 July 2012); *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602; *Watkins v Jones Maidment Wilson (a firm)* [2008] EWCA Civ 134 (4 March 2008). See also, Craig Smith, 'Recognising a Valuable Lost Opportunity to Bargain when a Contract is Breached' (2005) 21 *Journal of Contract Law* 250.
[93] *Lewis v Hillhouse* [2005] QCA 316 (26 August 2005), [24] (Keane JA; McMurdo P and Wilson J agreeing).
[94] *Daniels v Anderson* (1995) 37 NSWLR 438.
[95] *QBE Insurance Ltd v Moltoni Corporation Pty Ltd* (2000) 22 WAR 148, 151 [7] (Ipp J), reversed, but reasoning approved, sub nom *Moltoni Corporation Pty Ltd v QBE Insurance Ltd* (2001) 205 CLR 149, 163 [24] (Full Court).
[96] *Chaplin v Hicks* [1911] 2 KB 786.
[97] *Chaplin v Hicks* [1911] 2 KB 786, 793.
[98] *Rosa v Galbally & O'Bryan (No 2)* [2013] VSCA 154 (20 June 2013), [27] (Tate JA; Harper JA and Kyrou AJA agreeing). See also, Robert J Rhee, 'The Effect of Risk on Legal Valuation' (2007) 78 *University of Colorado Law Review* 193, 196.
[99] S M Waddams, 'Damages: Assessment of Uncertainties', (1998) 13 *Journal of Contract Law* 55, 60.

monetary value.[100] The fact that a contractual promise is itself an asset,[101] in the sense that nominal damages are available for breach, does not necessarily mean that the promised opportunity itself has a monetary value. Properly understood, an award of nominal damages for breach of a promise to confer an opportunity represents compensation for the infringement of a legal right, and not compensation for the loss of a valuable opportunity as such. Thus, in *Sellars*, Brennan J observed that, '[i]n contract cases, a plaintiff may be entitled to nominal damages for loss of the opportunity promised even though the plaintiff fails to prove what, if any, value performance of the unfulfilled promise would have had.'[102]

Support for this view can also be found in the decision of Dixon and McTiernan JJ in *Fink v Fink*.[103] Latham CJ and Williams J held that an implied contractual promise to provide an opportunity for marital reconciliation was valuable. In reaching this decision, their Honours appeared to attach considerable significance to the fact that the defendant 'contracted to provide'[104] the relevant opportunity. However, Dixon and McTiernan JJ took a different view. Their Honours considered that the fact that the claimant 'was prepared to accept so slender a chance as the chief benefit which the agreement secured to her, apart from the postponement of divorce proceedings, hardly affects the question whether, as a matter of law, it is possible to treat the premature determination of the chance or opportunity as a loss for which a pecuniary compensation may be assessed.'[105]

There are two circumstances where the object of an opportunity will not have a monetary value: first, where the object does not have *any* objective monetary value;[106]

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[100] *Contra* Brian Coote, 'Chance and the Burden of Proof in Contract and Tort', (1988) 62 *Australian Law Journal* 761, 768: 'If someone is prepared to contract for a chance and a fortiori to give consideration for it, it would be inconsistent for the law to treat it as being of no value, particularly since "value" in this context does not depend exclusively on profitability' (citations omitted).
[101] *Marks v GIO Australia Holdings Ltd* (1998) 196 CLR 494, 502 [13] (Gaudron J).
[102] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 359 (citations omitted).
[103] *Fink v Fink* (1946) 74 CLR 127.
[104] *Fink v Fink* (1946) 74 CLR 127, 135.
[105] *Fink v Fink* (1946) 74 CLR 127, 142.
[106] See, eg, *Fink v Fink* (1946) 74 CLR 127, 143 (Dixon and McTiernan JJ); *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377; *Radosavljevic v Radin* [2003] NSWCA 217 (13 August 2003) (work accident claim not viable); *Elobadi v Royal Australasian College of Surgeons* [2014] WASCA 117 (9 June 2014).

secondly, where the claimant fails to *prove* that the object has an objective monetary value.[107] Each of these categories is illustrated below.

No monetary value

The clearest example of this category is an object that simply does not exist. In *McRae v Commonwealth Disposals Commission*,[108] the High Court refused to award damages for the loss of the opportunity of making a profit from the salvage of an oil tanker, which did not in fact exist. The claimant tendered to buy the tanker that the defendant said was lying on 'Journaund Reef', approximately 100 miles north of Samarai. The claimant's tender was accepted. The defendant supplied the claimant with the geographical co-ordinates at which the tanker was alleged to be lying, and the claimant proceeded to spend a considerable sum of money equipping a vessel to salvage the wreck. The claimant was unable to find the tanker. In fact, there was no tanker in the locality at any material time.

Dixon and Fullagar JJ (with whom McTiernan J agreed) allowed an appeal by the claimant from the decision of the trial judge that the contract between the claimant and the defendant was void. Their Honours held that there was a contract, and that the defendant had breached a promise that there was a tanker in the position specified.[109] On the question of damages, Dixon and Fullagar JJ refused to allow the claimant damages for the loss of the opportunity of making a profit from the salvage of the tanker.[110] Their Honours distinguished *Chaplin* on the basis that, in that case, the object of the opportunity (a prize) would have had a monetary value, whereas in the instant case the outcome was itself unknown:[111]

[107] See, eg, *Commonwealth v Cornwell* (2007) 229 CLR 519; *Waribay Pty Ltd v Minter Ellison* [1991] 2 VR 391; *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003); *St George Bank Ltd v Quinerts Pty Ltd* (2009) 25 VR 666; *Elobadi v Royal Australasian College of Surgeons* [2014] WASCA 117 (9 June 2014); *Mallon v Halliwells (in Adminstration)* [2012] EWCA Civ 1212 (9 July 2012).
[108] *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377.
[109] *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377, 410.
[110] Dixon and Fullagar JJ did, however, award the claimant damages for the loss of the opportunity of earning a profit from the deployment of the salvage ship on an alternative contract: see, *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377, 416–17.
[111] *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377, 412 (citations omitted).

> In *Chaplin v Hicks*, if the contract had been performed, the plaintiff would have had a real chance of winning the prize, and it seems proper enough to say that that chance was worth something. It is only in another and quite different sense that it could be said here that, if the contract had been performed, the plaintiffs would have had a chance of making a profit. The broken promise itself in *Chaplin v Hicks* was, in effect, 'to give the plaintiff a chance': here the element of chance lay in the nature of the thing contracted for itself. Here we seem to have something which cannot be assessed. If there were nothing more in this case than a promise to deliver a stranded tanker and a failure to deliver a stranded tanker, the plaintiffs would, of course, be entitled to recover the price paid by them, but beyond that, in our opinion, only nominal damages.

A more recent example is *Elobadi v Royal Australasian College of Surgeons*.[112] The claimant, a foreign trained cardiothoracic surgeon, applied four times to the defendant for specialist admission as a Fellow. On each occasion, the claimant was assessed as 'not comparable' and denied admission. Following the determination of his fourth application, the claimant requested the defendant, by its Chief Executive Officer, to convene an Appeals Committee in respect of the fourth application. An Appeals Mechanism Policy, which had contractual force between the claimant and the defendant, prevented the CEO from convening the Committee unless he was satisfied that, on the basis of the supporting documented material submitted, there were valid grounds of appeal. The CEO considered that there were no valid grounds of appeal and refused to convene the Committee. The claimant asserted that the failure to convene the Committee constituted a breach of contract, and commenced proceedings against the defendant seeking, among other things, damages for the loss of an opportunity to be assessed as 'partially comparable'.

The Full Court of the Western Australia Court of Appeal upheld the trial judge's decision to dismiss the claimant's action. Central to the trial judge's decision were two findings of fact: first, the inevitable result of an appeal to the Committee would have been a dismissal; secondly, the claimant had not completed a comparable specialist training programme and he would never be regarded as 'partially comparable' until he did. The claimant did not challenge either of these findings on appeal. Those findings of fact meant that, but for any breach of contract by the defendant in failing to convene the Committee, the appeal would inevitably have been dismissed, or an ultimate assessment of 'not comparable' would have been made, in

[112] *Elobadi v Royal Australasian College of Surgeons* [2014] WASCA 117 (9 June 2014).

any event. Accordingly, even if there had been a breach of contract, no damages could be awarded because the relevant loss, being the loss of an opportunity to be assessed as 'partially comparable', 'did not exist'[113] or 'had no value.'[114]

The object of an opportunity will also have no monetary value where that object is incapable of monetary assessment. In *Fink*, Dixon and McTiernan JJ reached this conclusion in relation to an alleged opportunity for marital reconciliation. The claimant and her husband, the defendant, entered into an agreement under which the defendant promised, among other things, to allow the claimant and their children to remain in the matrimonial home, and to maintain them, for one year following the execution of the agreement. The purpose of the agreement was for the claimant and the defendant to attempt to reconcile. The relationship broke down and after the claimant left the home she instituted proceedings alleging the defendant had breached the contract and claiming damages for loss of the opportunity to reconcile.

Dixon and McTiernan JJ dismissed an appeal by the claimant from an order that her pleaded loss be struck out. Their Honours considered that the claimant's loss of opportunity was not capable of monetary assessment:[115]

> The chance of a reconciliation… is one depending on all the fortuitous elements upon which the healing or the exacerbation of domestic differences depends… They are not like contingencies or conditions which are recognized for some commercial purpose, such as the chances which are made the subject of insurance; they are not aleatory, such as are habitually made the subject of the calculation of odds, or, at all events, of the giving and taking of odds; they bear no resemblance to the claim of one of a very limited number of competitors to receive the consideration to which he is contractually entitled in the distributive award of definite and material benefits… There is no actual relation in human affairs between the tolerance or intolerance of one spouse for another and the material considerations which we are accustomed to estimate in money, and there is no common understanding or convention under which any such relation is presumed to exist… The intangible chance of success in the remainder of the stipulated period cannot be compared with any of the contingencies which in the decided cases have been regarded as capable of monetary expression or as a proper subject for pecuniary assessment however speculative.

[113] *Elobadi v Royal Australasian College of Surgeons* [2014] WASCA 117 (9 June 2014), [39], [43].
[114] *Elobadi v Royal Australasian College of Surgeons* [2014] WASCA 117 (9 June 2014), [39].
[115] *Fink v Fink* (1946) 74 CLR 127, 143.

In contrast, Latham CJ and Williams J would have allowed the appeal. Their Honours considered that the agreement contained an implied promise by the defendant to confer on the claimant the opportunity for reconciliation.[116] On that basis, Latham CJ and Williams J observed that this opportunity could not reasonably be said to be 'valueless',[117] and while the contingencies to which it was subject might make it 'impossible to set any high value upon the opportunity', the loss of that opportunity was 'a matter for which damages can be given if a breach of the contract is proved.'[118]

No proof of monetary value

The object of an opportunity will not have any monetary value if the claimant fails to adduce evidence of that fact. In *Longden v Kenalda Nominees Pty Ltd*,[119] the claimant and the defendant entered into a lease of premises to be used by the claimant to conduct a business. The defendant repudiated the lease before the claimant took possession and the business was never commenced. The claimant sought damages for the loss of the opportunity to earn profits from the conduct of the business at the premises. At trial the claimant sought to prove its loss, not by adducing evidence of how profits would have been earned in the proposed business, but by leading evidence of the profitability of another, allegedly comparable, business. The trial judge rejected this evidence, and in the absence of any other evidence of the value of the proposed business, held that the claimant had failed to prove any loss.

Chernov JA (with whom Buchanan JA agreed) dismissed an appeal by the claimant. His Honour observed that the claimant bore the onus of establishing, on the balance of probabilities, that the alleged opportunity had some non-negligible value; and that the loss of the chance to conduct the business, by itself, could not amount to a relevant loss because the proposed business may not have generated sufficient revenue to cover its outgoings, including the rent payable under the lease.[120] Chernov JA observed that the claimant could have established its loss by 'showing that there was a

[116] *Fink v Fink* (1946) 74 CLR 127, 135.
[117] *Fink v Fink* (1946) 74 CLR 127, 134.
[118] *Fink v Fink* (1946) 74 CLR 127, 135.
[119] *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003).
[120] *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003), [34].

reasonable, as distinct from a speculative, possibility that the… business would or might have produced a profit',[121] but the trial judge rejected the claimant's evidence, and there was therefore no evidentiary basis on which the trial judge could have found that the alleged opportunity had any value.[122] Buchanan JA accepted that there was a 'real possibility' that the business would have been profitable, but in order to attribute a value to the loss of that opportunity to make a profit, 'the trial judge needed evidence to found an estimate of the likelihood of the prospect of profitability becoming a reality.'[123] Without this evidence, '[t]he possibility that the business would make a profit could not be valued, for it was not known whether it was a remote possibility, a strong possibility or something in between.'[124]

In other cases, a claimant may adduce direct evidence of value, but that evidence may not be accepted. In *Waribay Pty Ltd v Minter Ellison*,[125] the claimant engaged the defendant, a firm of solicitors, to advise on, and to prepare the documents necessary for, the acquisition of a controlling interest in a company. The acquisition failed due to the negligence of the defendants. The claimants sued the defendants claiming damages for the loss of the opportunity to acquire the company and derive a financial advantage from it.

Young CJ and Kaye J dismissed an appeal by the claimant from the decision of the trial judge, refusing to award substantial damages. Their Honours held that '[t]he promise involved in the retainer of the respondents could not be described as a promise to give the appellants a chance'[126] and therefore the alleged opportunity could not be said to have value on that account. Furthermore, Young CJ and Kaye J considered that the trial judge was justified in accepting the defendant's expert accounting evidence that, at the time of the alleged loss, the shares in the company had no value.[127]

[121] *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003), [34].
[122] *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003), [37].
[123] *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003), [11].
[124] *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003), [11].
[125] *Waribay Pty Ltd v Minter Ellison* [1991] 2 VR 391.
[126] *Waribay Pty Ltd v Minter Ellison* [1991] 2 VR 391, 400.
[127] *Waribay Pty Ltd v Minter Ellison* [1991] 2 VR 391, 401.

Murphy J, in dissent, considered that the shares in Linacre did have some value. His Honour considered that the claimants lost 'whatever opportunity' control of Linacre would have given the claimants to achieve financial rewards; and that control of Linacre 'presented opportunities which lack of control did not present.'[128] The failure to gain control was therefore 'itself some damage.'[129]

A more recent example is *Commonwealth v Cornwell*.[130] The claimant, a former employee of the defendant, alleged that the defendant had, in 1965, negligently advised the claimant that he was ineligible to join a Commonwealth superannuation fund that had been established in 1922 (1922 Fund). It was not until 1987 that the claimant joined a successor fund that had been established in 1976 (1976 Fund). The claimant retired in 1994 and commenced proceedings against the defendant, alleging that he lost the opportunity to join the 1922 Fund in 1965, and in consequence upon his retirement in 1994 received a lesser benefit than he would have received had he joined that fund in 1965.

The relevant issue before the High Court was whether the defendant could rely on a statutory time-bar to defeat the claim. The defendant argued that the claimant had first suffered a loss in 1976, when the 1922 Fund was replaced by the 1976 Fund. Benefits payable under the 1922 Fund were calculated by reference to contributions for pension units; benefits payable under the 1976 Fund were calculated by reference to years of contributory service. Under the 1922 Fund, the claimant could have paid more for units to top his benefit up to the level at which it would have been had he joined the 1922 Fund in 1965; under the 1976 Fund, the claimant could not make up the quantum of his benefits to allow for his 11 years of service since 1965. On this basis, the claim was time-barred. The claimant argued that the defendant breached its duty in 1965, however the claimant's loss remained contingent until his retirement in 1994 when the various statutory contingencies relating to the calculation of his benefit fell in. On this basis, the claimant's cause of action accrued in 1994 and his claim was within time.

[128] *Waribay Pty Ltd v Minter Ellison* [1991] 2 VR 391, 405.
[129] *Waribay Pty Ltd v Minter Ellison* [1991] 2 VR 391, 405.
[130] *Commonwealth v Cornwell* (2007) 229 CLR 519.

Gleeson CJ, Gummow, Kirby, Hayne, Heydon and Crennan JJ held that the claimant's action was not statute barred. Their Honours identified the nature of the claimant's loss as an 'entitlement'[131] to a statutory benefit under the terms of the Act establishing the 1976 Fund. That benefit was subject to the satisfaction of various contingencies. Before the claimant's retirement, the benefit was 'prospective and contingent upon the falling in at a future time of the statutory criteria.'[132] However, on retirement, the relevant contingencies fell in and the claimant became entitled to a benefit that was limited or diminished and his cause of action accrued.

The majority rejected the defendant's contention that the claimant had lost a valuable commercial opportunity in 1976. In the absence of proof, such a loss was merely speculative:[133]

> [W]hether in 1976 the respondent would have been better or worse off had he invested elsewhere the contributions he otherwise would have placed for units under the 1922 Fund arrangements is a matter of speculation. He could not be said, consistently with remarks in *Sellars v Adelaide Petroleum NL*, in 1976 to have sustained loss of a commercial opportunity which had some value, as a matter of the degree of probabilities and possibilities.

Callinan J delivered a powerful dissent. His Honour considered that the claimant had suffered a 'real loss'[134] in 1977, when regulations made in that year had the effect of making it clear that had the claimant been a contributor from 1965, he would have been eligible for the greatly improved pension benefits available under the 1976 Act.

Callinan J did not accept the proposition that it was only when the relevant statutory contingency of retirement fell in that the claimant's loss could be ascertained.[135] His Honour considered that the statutory contingencies were 'no different in kind from the contingencies with which the courts necessarily deal all the time' and 'no different from other criteria in other cases for financial benefit or loss, for example, capacity to work, or perform a contract, changes in the economic climate, the obtaining of a permit or approval, the state of the market place, or indeed practically any event at all

[131] *Commonwealth v Cornwell* (2007) 229 CLR 519, 526 [18].
[132] *Commonwealth v Cornwell* (2007) 229 CLR 519, 531 [37].
[133] *Commonwealth v Cornwell* (2007) 229 CLR 519, 531–2 [38] (citations omitted).
[134] *Commonwealth v Cornwell* (2007) 229 CLR 519, 536 [54].
[135] *Commonwealth v Cornwell* (2007) 229 CLR 519, 537 [59].

that might influence a monetary outcome.'[136] Accordingly, '[i]t was always open to the respondent from at least 1977 to prove the likelihood or otherwise of each of the relevant statutory contingencies.'[137]

Callinan J pointed out that the defendant, by reference to its actuarial evidence, 'demonstrated beyond contradiction how, between 1976 or 1977, and 1982, the respondent's right and entitlement could have been calculated, and, in consequence, the monetary value of the diminution of it.'[138] Based on this evidence:[139]

> In 1983, that is, on the expiration of a limitation period beginning in 1977, it would have been possible to measure in money, the difference, in dollars of the day, between the lump sum value of the respondent's entitlement or interest on notional participation, and the lesser value by reason of his actual non-participation consequent upon the misstatement.

Callinan J concluded that, '[e]ven if, as is not the case here, a court could not have calculated the damages with reasonable accuracy from 1977 onwards, by reference to the present value of a likely pension on notional retirement, it would at least have been obvious then that a substantial opportunity had been lost, and, therefore… damage suffered, to which a sum of money could be attributed.'[140]

Non-negligible probability

In order for an opportunity to have a non-negligible monetary value, the probability of successfully obtaining or realising the object of the opportunity must be non-negligible.

In this context, the mere fact that the object of the opportunity is subject to a number of contingencies does not mean that the object has a negligible probability of success, and that the opportunity therefore has no monetary value.[141] In *Chaplin*, the English Court of Appeal rejected the defendant's argument that the claimant's opportunity of

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[136] *Commonwealth v Cornwell* (2007) 229 CLR 519, 540 [65]–[66].
[137] *Commonwealth v Cornwell* (2007) 229 CLR 519, 540 [66].
[138] *Commonwealth v Cornwell* (2007) 229 CLR 519, 538 [62].
[139] *Commonwealth v Cornwell* (2007) 229 CLR 519, 538 [62].
[140] *Commonwealth v Cornwell* (2007) 229 CLR 519, 543 [71].
[141] *Fink v Fink* (1946) 74 CLR 127, 135 (Latham CJ and Williams J); *Howe v Teefy* (1927) 27 SR (NSW) 301, 304 (Street CJ; Gordon and Campbell JJ agreeing); *Chaplin v Hicks* [1911] 2 KB 786.

winning a prize had no assessable value because it turned on a number of contingencies, including the volition of a third party.[142] In *Fink*, Latham CJ and Williams J applied this reasoning to hold that the claimant's alleged opportunity for reconciliation had value, despite the fact that it was subject to a number of contingencies. Their Honours observed that 'since the case of *Chaplin v Hicks* it cannot be said that the fact that a benefit under a contract depends upon a contingency, and the fact that an element in the contingency is the exercise of the will of a particular person or persons, are sufficient to make damages for the deprivation of such a benefit irrecoverable because too remote.'[143]

However, if the relevant opportunity is subject a very large number of contingencies, or the contingencies involve the exercise by a third party of some considerable discretion, the probability of the opportunity may be negligible or unassessable.[144] In *Chaplin*, this point was acknowledged by Vaughan Williams LJ who said '[t]here are cases, no doubt, where the loss is so dependent on the mere unrestricted volition of another that it is impossible to say that there is any assessable loss resulting from the breach.'[145] In *Fink*, Dixon and McTiernan JJ applied this reasoning to hold that the claimant's opportunity for reconciliation, which depended almost exclusively on the discretion of the defendant, did not constitute an assessable loss.[146]

In order to prove that the object of the opportunity has a non-negligible probability of success, the claimant must adduce evidence of some objective criteria or circumstances that enable the court to form such a view. The strength of this evidence will dictate the court's assessment of the probability. In some cases the evidence will enable the court to make a finding that the probability is certain;[147] in

[142] *Chaplin v Hicks* [1911] 2 KB 786, 791 (Vaughan Williams LJ), 795–6 (Fletcher Moulton LJ), 799 (Farwell LJ).
[143] *Fink v Fink* (1946) 74 CLR 127, 135.
[144] *Fink v Fink* (1946) 74 CLR 127, 134 (Latham CJ and Williams J), 143 (Dixon and McTiernan JJ).
[145] *Chaplin v Hicks* [1911] 2 KB 786, 792–3.
[146] *Fink v Fink* (1946) 74 CLR 127, 143.
[147] See, eg, *Nicholas Prestige Homes v Neal* [2010] EWCA Civ 1552 (1 December 2010), [32]–[33] (Ward LJ; Patten and Black LJJ agreeing) (loss of an opportunity to earn a commission on the sale of residential premises).

other cases, the evidence will be such that the court is driven to conclude that the probability is speculative, and therefore that the opportunity is of no value.[148]

The importance of adducing objective evidence is illustrated by the decision of the English Court of Appeal in *Allied Maples Group Ltd v Simmons & Simmons (a firm)*,[149] considered earlier in this chapter. The relevant issue before the Court was whether the claimant had established that it had a realistic chance of successfully renegotiating the sale agreement to obtain total or partial protection against the first-tenant liabilities. The defendant advanced two arguments. First, the claimant was unable to prove anything beyond a speculative chance in the absence of evidence from the vendor or its solicitor as to what their hypothetical reaction would have been to any request to reopen negotiations on the point. Secondly, the finding of a substantial chance was against the weight of evidence.

Stuart-Smith LJ (with whom Hobhouse LJ agreed) rejected both arguments. His Lordship observed that '[t]he prospect of success depends on all the circumstances of the case and the third parties' attitude must be a matter of inference.'[150] Further, Stuart-Smith LJ held that there was 'ample evidence' to support the conclusion that the claimant had a substantial chance of successfully renegotiating the sale agreement.[151] That evidence included the trial judge's finding that the transaction was only restructured as a share sale at the last minute to enable the claimant to acquire the leases, and that even in those circumstances it was the intention of the parties that the claimants should get a 'clean' deal.

Hobhouse LJ observed that the absence of evidence from the vendor was not fatal to the claimant's case.[152] His Lordship considered that the objective evidence before the court enabled the inference to be drawn that the probability of successful renegotiation was non-negligible:[153]

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[148] See, eg, *ICT Pty Ltd v Sea Containers Ltd* (1995) 39 NSWLR 640, 659–60 (Full Court) (loss of an opportunity to purchase a catamaran). See also, *Shahid v Australasian College of Dermatologists* (2008) 248 ALR 267, 332–3 [219] (Jessup J; Branson and Stone JJ agreeing generally on this point) (loss of an opportunity to participate in a meaningful appeal process).
[149] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602.
[150] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1614.
[151] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1615.
[152] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1620.
[153] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1620.

Where parties are engaged in negotiations on the detailed terms of a commercial deal upon which they are both agreed in principle and from which both are expecting to gain, it is in no way unrealistic to conclude that meaningful negotiation are possible within the framework of the deal when a difficulty of this kind arises. The judge has found that it was clearly the shared intention of the parties that Kingsbury should be acquired clean and that all reasonable efforts would therefore be made to achieve that objective. This is not a case where the plaintiffs are having to submit that they would have been the recipient of some gratuitous favour or that the vendors would be persuaded to act contrary to their commercial interests. It is the case of the plaintiffs, supported by evidence, that effective negotiations would have taken place and there was a basis for believing that further negotiation would have led to a worthwhile amelioration of the plaintiffs' position.

Millett LJ dissented on this point. His Lordship held that the claimant's chance of negotiating better terms with the vendor was purely speculative in the absence of evidence from the vendor.[154]

Millett LJ grouped the reported cases on loss of a commercial opportunity into three categories:[155] first, where the outcome is not dependent on the unrestricted volition of a third party, since the third party's decision must be justifiable by objective criteria; secondly, where the outcome depends upon whether a third party who had been properly advised would have acted in accordance with its own best interests; thirdly, where the outcome appears to depend on the unrestricted volition of a third party but there are objective considerations which make it possible to predicate how it would have acted.

Millett LJ considered that the present case did not fall within any of those categories. His Lordship identified the claimant's loss as the loss of a chance of persuading the vendor 'to act against their own interests by reinstating a warranty which their own solicitors had already struck out or to give some other protection against a risk for which their own solicitors had not thought fit to provide.'[156] Millett LJ observed, however, that there was 'no objective criteria' by which such a chance could be evaluated:[157]

[154] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1625.
[155] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1623–4.
[156] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1624.
[157] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1624.

[T]he decision whether to accommodate the plaintiffs was a commercial one for Gillow to make. The outcome would then have depended on Gillow's perception of the relative strength of the parties' bargaining positions, the extent of the risk which they were being asked to assume and the effect on the deal if they refused. These are all subjective matters; none of them is known and none can be inferred.

In the result, Millett LJ concluded that the present case fell into the altogether different category of case described by Vaughan Williams LJ in *Chaplin*, 'where the loss is so dependent on the mere unrestricted volition of another that it is impossible to say that there is any assessable loss resulting from the breach.'[158]

Conclusion

This chapter examined the fact of loss of a commercial opportunity. In particular, this chapter focused on proof of the existence of such a loss.

The first part of this chapter described the general principles relating to proof of the fact of loss of a commercial opportunity. In order to prove the fact of loss, the claimant must first identify its loss, and then prove, on the balance of probabilities, both the existence of a valuable commercial opportunity, and that the defendant's wrong caused the loss of this opportunity. Once the claimant has proved the fact of loss, the value of that loss is then assessed by reference to the degrees of probabilities and possibilities.

The second part of this chapter focused on proof of the existence of a commercial opportunity. It demonstrated that, in order to form the subject matter of a compensable loss, a commercial opportunity must have some value. The question whether a commercial opportunity has some value (and the extent of that value) requires the court to make a subjective probability assessment, based on a proper evidentiary foundation.

More specifically, the chapter demonstrated that a commercial opportunity must have a non-negligible monetary value. This comprises two inter-related elements. First,

[158] *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1625.

the object of the opportunity must have a non-negligible monetary value. This may represent an expected benefit, or avoiding, reducing or deferring a detriment. The object of an opportunity will not have a monetary value if the object does not have any objective monetary value, for example if the object does not exist or if it is incapable of monetary assessment, or if the claimant fails to prove that fact. Secondly, the probability of successfully obtaining or realising that object must be non-negligible. In order to prove that the object of the opportunity has a non-negligible probability of success, the claimant must adduce evidence of some objective criteria or circumstances that enable the court to form such a view. The strength of this evidence will dictate the court's assessment of the probability.

Chapter 5

Character of loss

Introduction

Purpose and object

This chapter examines the economic character of the loss of a commercial opportunity.

Chapter four demonstrated that, if a commercial opportunity is to form the subject matter of a compensable loss, it must have a non-negligible monetary value. This chapter considers the economic character of that loss.

The object of the chapter is twofold. First it will demonstrate that a commercial opportunity is an asset, representing an opportunity of an anticipated future cash flow. The loss of such an opportunity therefore represents the loss of an opportunity of an anticipated future cash flow. This conclusion follows from the analysis in chapter four. The second objective of this chapter is to demonstrate that the loss of a commercial opportunity is an indivisible loss, and cannot be separated into a loss of 'capital' and a loss of 'income'.

Structure

This chapter is divided into an introduction and three main sections. The first section identifies the essential economic character of a loss of commercial opportunity. This section draws on the analysis contained in chapters two and four of the thesis. The second section examines the indivisibility of such a loss. The final section considers the utility of the practice of separating a loss of a commercial opportunity into two types of loss: a loss of capital, and a loss of income. This section is divided into five parts. The first part contains an introduction. The second part examines the origins of the distinction between capital and income, and the modern understanding of these concepts in economics. This section will then consider the distinction drawn between these concepts in law. The final two parts of this section outline the practical problems that arise from that distinction, and suggest a principled approach to the resolution of those problems.

Character of loss

Commercial opportunity as an asset

Opportunity as an asset

A commercial opportunity is an *asset*.[1] This follows from the analysis in chapter four. In order to form the subject matter of a compensable loss, a commercial opportunity must have some non-negligible monetary value. A chance with a non-negligible monetary value constitutes an asset, because it represents the chance of an anticipated future cash flow.

Support for the proposition that a commercial opportunity is an asset can be found in *Gregg v Scott*,[2] in an observation by Lord Hoffmann that was referred to with approval by a majority of the High Court in *Tabet v Gett*.[3] Lord Hoffmann observed, *obiter*, in the course of considering whether the loss of a chance of a better medical outcome was a form of actionable damage, that 'most of the cases in which there has been recovery for loss of a chance have involved financial loss, where the chance can itself plausibly be characterised as an item of *property*, like a lottery ticket.'[4] Despite characterising the loss narrowly as a form of 'property', as distinct from the broader

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[1] See Mark S Mandell and Susan Marcotte Carlin, 'The Value of a Chance: The Evolution and Direction of Chance in Tort Law' (1986) 20 *Suffolk University Law Review* 203; Melvin Aron Eisenberg, 'Probability and Chance in Contract Law' (1998) 45 *Univeristy of California at Los Angeles Law Review* 1005, 1049; Jeremy L Pryor, 'Lost Profit or Lost Chance: Reconsidering the Measure of Recovery for Lost Profits in Breach of Contract Actions' [2007] 19 *Regent University Law Review* 561, 578; Harvey McGregor, *McGregor on Damages* (Sweet & Maxwell, 19th ed, 2014) [10–062]. See also, Harvey McGregor, 'Loss of chance: where has it come from and where is it going?' (2008) 24(1) *Professional Negligence* 2; Lord Neuberger, 'Loss of a chance and causation' (2008) 24(4) *Professional Negligence* 206.
[2] *Gregg v Scott* [2005] 2 AC 176.
[3] *Tabet v Gett* (2010) 240 CLR 537, 581 [124] (Kiefel J; Hayne, Crennan and Bell JJ agreeing).
[4] *Gregg v Scott* [2005] 2 AC 176, 197 [83] (emphasis added).

concept of 'asset', it is clear from the context that his Lordship was using the word property in its later, broader sense.

This interpretation is consistent with Anglo-Australian law, which only requires that the relevant opportunity have some *monetary* value.[5] More specifically, it is also consistent with the approach taken in Anglo-Australian law, both prior, and subsequent, to *Gregg* and *Tabet*, in which the loss of a non-proprietary opportunity, such as the opportunity to renegotiate a contract,[6] has been accepted as a compensable loss of opportunity.[7] For example, in *Watkins v Jones Maidment Wilson (a firm)*,[8] the claimant alleged that, as a result of the defendant's negligent advice, the claimant entered into a building contract with a third party on less favourable terms, and thereby suffered a loss on entry into that transaction, and the loss of a chance of negotiating more favourable terms with the third party. On a preliminary trial of the question whether the claim for loss of a chance was statute barred, Arden LJ (with whom Longmore and Thomas LJJ agreed) agreed with the trial judge that the loss of a chance arose at the time the claimant entered into the contract and therefore the claim was statute barred. Her Ladyship observed that the claimant's chance of negotiating a better agreement was 'an asset with a measurable value',[9] and its absence meant that the claimant has suffered an immediate loss.

Opportunity as cash flow

The loss of a commercial opportunity represents the loss of an asset. This asset represents the *chance* or *opportunity* of an anticipated future cash flow.

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[5] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 364 (Brennan J); *Howe v Teefy* (1927) 27 SR (NSW) 301, 307 (Street CJ; Gordon and Campbell JJ agreeing); *Chaplin v Hicks* [1911] 2 KB 786, 793 (Vaughan Williams LJ; Fletcher Moulton and Farwell LJJ agreeing).

[6] See, eg, *Heenan v De Sisto* (2008) Aust Torts Reports 81–941; *Jacfun Pty Limited v Sydney Harbour Foreshore Authority* [2012] NSWCA 218 (25 July 2012); *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602; *Watkins v Jones Maidment Wilson (a firm)* [2008] EWCA Civ 134 (4 March 2008).

[7] *Contra* Graham Reid, '*Gregg v Scott* and lost chances' (2005) 21(2) *Professional Negligence* 78 (doctrine of loss of a commercial opportunity should be confined to the loss of proprietary rights such as a chose in action).

[8] *Watkins v Jones Maidment Wilson (a firm)* [2008] EWCA Civ 134 (4 March 2008).

[9] *Watkins v Jones Maidment Wilson (a firm)* [2008] EWCA Civ 134 (4 March 2008), [24].

The loss of a commercial opportunity represents the loss of an opportunity of an anticipated future cash flow in two senses. First it may represent the loss of an opportunity to receive an anticipated future net cash inflow. This cash inflow may take the form of an expected benefit, such as a prize or reward;[10] the payment of a sum of money, such as a tip,[11] a commission,[12] or a debt;[13] rights under a guarantee;[14] a cause of action (with some prospects of a favourable outcome);[15] the sale,[16] or exploitation,[17] of an asset; or the ability to tender for,[18] negotiate,[19] enter into,[20] or renegotiate,[21] a contract.

Secondly, it may represent the loss of an opportunity to avoid, reduce or defer an anticipated future net cash outflow. This cash outflow may take the form of an expected detriment, such as a cost,[22] a loss,[23] or a liability.[24]

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[10] *Chaplin v Hicks* [1911] 2 KB 786.
[11] *Manubens v Leon* [1919] 1 KB 208.
[12] *IOOF Building Society Pty Ltd v Foxeden Pty Ltd* [2009] VSCA 138 (19 June 2009); *Nicholas Prestige Homes v Neal* [2010] EWCA Civ 1552 (1 December 2010).
[13] *Domine v Grimsdall* [1937] 2 All ER 119 (judgment debt); *Molinara v Perre Bros Lock 4 Pty Ltd* (2014) 121 SASR 61 (commercial debt).
[14] *Pritchard v DJZ Constructions Pty Ltd* [2012] NSWCA 196 (28 June 2012).
[15] *Johnson v Perez* (1988) 166 CLR 351; *Lewis v Hillhouse* [2005] QCA 316 (26 August 2005), [24] (Keane JA; McMurdo P and Wilson J agreeing); *Falkingham v Hoffmans (a firm)* (2014) 46 WAR 510.
[16] *G W Sinclair & Co Pty Ltd v Cocks* [2001] VSCA 47 (26 April 2001); *Williams v Pagliuca* [2009] NSWCA 250 (19 August 2009); *First Interstate Bank of California v Cohen Arnold (a firm)* [1996] PNLR 17; *Stovold v Barlows (a firm)* [1996] PNLR 91.
[17] *Howe v Teefy* (1927) 27 SR (NSW) 301 (racehorse); *Glenmont Investments Pty Ltd v O'Loughlin* (No 2) (2000) 79 SASR 185 (mechanical dinosaur).
[18] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64.
[19] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332.
[20] *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377, 416–17 (Dixon and Fullagar JJ; McTiernan J agreeing); *Gates v City Mutual Life Assurance Society Ltd* (1986) 160 CLR 1, 13 (Mason, Wilson and Dawson JJ).
[21] *Heenan v De Sisto* (2008) Aust Torts Reports 81–941; *Jacfun Pty Limited v Sydney Harbour Foreshore Authority* [2012] NSWCA 218 (25 July 2012); *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602; *Watkins v Jones Maidment Wilson (a firm)* [2008] EWCA Civ 134 (4 March 2008). See also, Craig Smith, 'Recognising a Valuable Lost Opportunity to Bargain when a Contract is Breached' (2005) 21 *Journal of Contract Law* 250.
[22] *Lewis v Hillhouse* [2005] QCA 316 (26 August 2005), [24] (Keane JA; McMurdo P and Wilson J agreeing).
[23] *Daniels v Anderson* (1995) 37 NSWLR 438.
[24] *QBE Insurance Ltd v Moltoni Corporation Pty Ltd* (2000) 22 WAR 148, 151 [7] (Ipp J), reversed, but reasoning approved, sub nom *Moltoni Corporation Pty Ltd v QBE Insurance Ltd* (2001) 205 CLR 149, 163 [24] (Full Court).

Indivisibility of loss

The loss of a commercial opportunity constitutes a single, indivisible loss.

The indivisibility of such a loss was acknowledged by the High Court in *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd*.[25] The claimant advanced a loan to a borrower in reliance on the defendant's valuation of the security to be provided for the loan. Following the borrower's default, the security was sold but the proceeds of sale were insufficient to repay the amount outstanding under the loan. The borrower went into liquidation and the claimant sought to recover its losses from the defendant. The claimant sought damages for, among other things, its 'capital' loss, represented by the shortfall on the loan principal, and its lost 'interest', represented by the interest the claimant would have earned on the loan principal had it not lent that money to the borrower. At trial, liability for negligence and misleading or deceptive conduct was admitted. The trial judge held that the claimant had proved an entitlement to damages, but reduced the amount of damages by one-third on account of the claimant's own failure to make reasonable enquiries about the borrower's financial position.

The sole issue before the High Court was whether the statutory predecessor to s 236, or s 237, of the ACL (as they then stood and were interpreted) permitted the reduction of the claimant's proved losses in this way. Relevantly, the defendant argued that the lost interest was a separate and discrete component of the claimant's loss that should be regarded as having been caused by its own conduct. A majority of the Court rejected this argument. Gleeson CJ stated that '[t]here is no reason to distinguish between principal and interest in considering the loss to the appellant. The mortgage was taken to secure the totality of the borrower's obligations and the appellant, as a financier, lost both capital and income.'[26] Similarly, Gaudron, Gummow and Hayne JJ stated that there was 'no basis for distinguishing between the loss of the balance of the loan principal not recouped on sale, and loss as a result of the respondent's

[25] *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2002) 210 CLR 109. In *I & L*, the claimant suffered the loss of a commercial opportunity, but the true nature of the claimant's loss was not considered either by the trial judge ([1999] QSC 320 (22 October 1999)) or on appeal ((2000) 179 ALR 89). For an analysis of the nature of the claimant's loss, see below, Part three, ch 7.
[26] *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2002) 210 CLR 109, 122 [34].

contravention of the Act, and the loss of the interest that otherwise would have been earned on that money during the period of the loan. The loss of interest on the principal sum lent in this transaction was part of the loss suffered by the appellant by the respondent's conduct in contravention of the Act.'[27] McHugh J considered that the claimant had suffered 'a single, indivisible loss'[28] and that 'no distinction can or should be drawn between I & L's loss of principal and its loss of income arising from the failure to pay interest on that principal. The lost interest was as much a part of I & L's loss or damage as the lost principal.'[29]

Capital and income distinction

Introduction

This section of the chapter considers the utility of the practice of separating loss of a commercial opportunity into two types of loss: a loss of capital, and a loss of income. The section will commence by identifying this practice in the case law. The section will then examine the origins of the distinction between capital and income, and the modern understanding of these concepts in economics. The section will then consider the distinction drawn between these concepts in law. The final two parts of the section outline the practical problems that arise from that distinction, and suggest a principled approach to the resolution of those problems.

General

The loss of a commercial opportunity constitutes a single, indivisible loss of anticipated future cash flow. From a finance perspective, that cash flow cannot be objectively separated into a loss of 'capital', and a loss of 'income'. This is because money, or cash, is, in general, fungible:[30] it is perfectly substitutable for itself and combines in a way that no dollar is distinguishable from another dollar (just like oil or gold).

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[27] *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2002) 210 CLR 109, 131 [64].
[28] *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2002) 210 CLR 109, 144 [112].
[29] *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2002) 210 CLR 109, 147 [123].
[30] See David Fox, *Property Rights in Money* (Oxford University Press, 2008) [1.78]–[1.86].

Notwithstanding this, claims for damages for loss of a commercial opportunity frequently distinguish between a claimant's capital loss, and a claimant's income loss. In *Browning v Brachers*,[31] the claimants purchased from a third party a herd of goats. In an action by the third party for money's owing under the contract of sale, the claimants counterclaimed that the goats were infected with a disease, and that as a result they had suffered a loss of profit and a loss of goodwill, and a loss in the value of their farm. This counterclaim was lost by the defendant's negligence. In an action against the defendants, the claimants were awarded damages for the loss of an opportunity to pursue the counterclaim and to recover each of these heads of loss.

Jonathan Parker LJ (with whom Mance LJ and the Vice Chancellor agreed) allowed an appeal by the claimants, increasing the amount of damages awarded for loss of profit, and the diminution in value of the farm, but overturned the award of damages for loss of goodwill. His Lordship held that the value of the claimants' business 'lay essentially in its potential to earn profits',[32] and therefore to award damages for loss of goodwill in addition to damages for loss of profits would involve 'double-counting.'[33] However, his Lordship considered that no double-counting was involved in awarding damages in respect of the diminution in the value of the farm. Jonathan Parker LJ reasoned that the claimants 'had two distinct assets, their business and their farm. Each suffered loss of value by reason of the presence of the disease. A combination of compensation for loss of profits (revenue loss) and compensation for loss of value of the farm (capital loss) is in my judgment appropriate in the circumstances of this case.'[34]

In *4 Eng Ltd v Harper*,[35] the claimant was induced, by the deceit of the defendants, to purchase a company by the name of Excel Ltd. At the time of the purchase, the claimant had reached an in-principle agreement to purchase an alternative company Tarvail Ltd, but elected to defer that purchase in favour of acquiring Excel. Ultimately, it was discovered that various frauds practiced by the defendants had rendered Excel worthless, and the plan to acquire Tarvail was abandoned. The

[31] *Browning v Brachers* [2005] EWCA Civ 753 (20 June 2005).
[32] *Browning v Brachers* [2005] EWCA Civ 753 (20 June 2005), [251].
[33] *Browning v Brachers* [2005] EWCA Civ 753 (20 June 2005), [252].
[34] *Browning v Brachers* [2005] EWCA Civ 753 (20 June 2005), [253].
[35] *4 Eng Ltd v Harper* [2009] Ch 91.

claimant brought proceedings against the defendants for deceit, and claimed, among other things, damages for the loss of an opportunity to earn income and capital profits from Tarvail which, the claimant argued, it would have purchased had it not been induced by the defendants' fraudulent misrepresentations to buy Excel.

David Richards J awarded the claimants damages both for the loss of the income profits up to the date of the trial, and for the loss of a capital profit realisable by it from a notional sale of Tarvail at the date of the trial. His Honour rejected the defendants' contention that such an award involved compensating the claimant twice for the same loss. David Richards J held that the income profits and the capital profits were 'cumulative, not alternative, losses.'[36] His Honour explained that:[37]

> The fact that the capital value of Tarvail is estimated by reference to anticipated future earnings is irrelevant. It is not the capital value of past earnings; if it were, there would of course be double recovery. Past earnings are used by the valuer only for the purpose of establishing maintainable earnings for the future, thereby providing the figure to which the p/e ratio can be applied. The income profits assumed to have been extracted by 4 Eng during its period of ownership are not reflected at all in the capital value of Tarvail.

In *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd*,[38] the claimant made a loan to a borrower in reliance on a valuation of the loan security negligently prepared by the defendant. The borrower defaulted and the claimant was unable to recoup the amount owing under the loan. The claimant sought damages for the loss of an opportunity to lend the loan principal to another borrower.

Finkelstein J (with whom Jacobsen and Besanko JJ agreed, save for a difference as to the precise calculation of the claimant's loss of income) identified the true nature of the claim as a claim for 'the loss of the use of money that was lent to Jet which, but for Hay's negligent valuation, would have been employed in a profitable loan.'[39] The Full Court distinguished between the claimant's 'capital loss' (being the difference between the loan principal and the net proceeds of sale); and its loss of income (being

[36] *4 Eng Ltd v Harper* [2009] Ch 91, 106.
[37] *4 Eng Ltd v Harper* [2009] Ch 91, 106.
[38] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299. See also, *Valcorp Australia Pty Ltd v Angas Securities Ltd* [2012] FCAFC 22 (9 March 2012).
[39] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 316 [76].

the net interest the claimant would have earned on a hypothetical alternative loan, adjusted for contingencies), and awarded the claimant damages for each of these heads of loss, less the net interest payments received from the borrower.

Origins of distinction

Meaning

The term 'capital' is derived from the Medieval Latin adjective '*capitalis*', meaning principal or head.[40] This adjective was used to designate the principal sum of a money loan, and was contrasted with the 'usury' – later called interest – the payment made to the lender in addition to the repayment of the principal sum lent.[41]

As first used in commerce, the term capital therefore meant an interest-bearing sum of money.[42] The great Scottish economist Adam Smith acknowledged this use in his classic treatise, *An Inquiry into the Nature and Causes of the Wealth of Nations*:[43]

> The stock which is lent at interest is always considered as a capital by the lender. He expects that in due time it is to be restored to him, and that in the meantime the borrower is to pay him a certain annual rent for the use of it.

Over the ensuing centuries, however, a multitude of derivative meanings have arisen.[44] Frank Fetter observed that these meanings can be grouped into two principal categories:[45]

> [T]he one implying ownership of a valuable source of income, the other the stock of physical goods constituting the income source. The one idea was from the first characteristically individual,

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[40] See Edwin Cannan, 'Early History of the Term Capital' (1921) 35 *Quarterly Journal of Economics* 469; Frank A Fetter, 'Capital', (1930-1935) (3) *Encyclopedia of the Social Sciences* 187, reprinted in Murray N Rothbard (ed), *Capital, Interest, and Rent: Essays in the Theory of Distribution* (Sheed Andrews and McMeel, 1977) 143. See generally, Francesco Boldizzoni, *Means and Ends: The Idea of Capital in the West, 1500–1970* (Palgrave Macmillan, 2008) 10–13.
[41] Frank A Fetter, 'Reformulation of the Concepts of Capital and Income in Economics and Accounting', (1937) (12) *The Accounting Review* 3, 5.
[42] Fetter, 'Capital', above n 40.
[43] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (5th ed first published 1789, 1904 ed: Edwin Cannan, Methuen & Co Ltd) Book II, ch IV, para 1 <http://www.econlib.org/library/Smith/smWN.html>.
[44] See generally Fetter, 'Reformulation', above n 41, 5–9.
[45] Fetter, 'Capital', above n 40.

acquisitive and commercial, that of any financial fund having a monetary expression; the other idea was characteristically impersonal and technological, that of the physical goods used to extract, transport, create or alter goods: ships, stores of merchandise, money, tools, machines, houses and, usually but not always, lands.

The word 'income', on the other hand, was originally used as a verb meaning 'to enter'.[46] In modern commercial use, the word income is used as a noun meaning 'any sort of goods (or valuable rights) coming into the possession of a person',[47] or, more narrowly, '[t]he flow of wages, interest, payments, dividends, and other receipts accruing to an individual or nation during a period of time (usually a year).'[48]

Distinction

The theoretical foundation for the distinction between 'capital' and 'interest' was laid in the work of classical economics scholars. The chief proponent of the classical view of the concepts of capital and income was Adam Smith. In *Wealth of Nations*, Smith expressed his idea of the nature of capital as follows:[49]

When the stock which a man possesses is no more than sufficient to maintain him for a few days or a few weeks, he seldom thinks of deriving any revenue from it. He consumes it as sparingly as he can, and endeavours by his labour to acquire something which may supply its place before it be consumed altogether. His revenue is, in this case, derived from his labour only. This is the state of the greater part of the labouring poor in all countries. But when he possesses stock sufficient to maintain him for months or years, he naturally endeavours to derive a revenue from the greater part of it; reserving only so much for his immediate consumption as may maintain him till this revenue begins to come in. His whole stock, therefore, is distinguished into two parts. That part which, he expects, is to afford him this revenue, is called his capital. The other is that which supplies his immediate consumption; and which consists either, first, in that portion of his whole stock which was originally reserved for this purpose; or, secondly, in his revenue, from whatever source derived, as it gradually comes in; or, thirdly, in such things as had been purchased by either of these in former years, and which are not yet entirely consumed; such as a stock of clothes, household furniture, and the like. In one, or other, or all of these three articles, consists the stock which men commonly reserve for their own immediate consumption.

[46] Fetter, 'Reformulation', above n 41, 10.
[47] Ibid.
[48] Paul A Samuelson and William D Nordhaus, *Economics*, (McGraw-Hill, 19th ed, 2009), [741].
[49] Smith, above n 43, Book II, ch 1, paras 1–2.

In Smith's view, all wealth could be divided into two separate, discrete parts: capital and revenue (income). Capital itself was further divided into productive capital and non-productive capital. Capital was productive if it produced revenue.

Modern approach

Smith's description of capital and income as separate parts of wealth underpinned the understanding of those concepts in economics and law (and accounting) until at least the end of the nineteenth century.[50] However, in the late nineteenth century, Smith's ideas were challenged by the work of the American economist, Irving Fisher.[51] Fisher rejected Smith's idea of capital and income representing different forms of wealth. In Fisher's view, *all* wealth existing at a point in time was capital, and income was simply the flow of wealth over a period of time:[52]

> To call all wealth capital would, by most persons, be pronounced ridiculous at once. What would remain against which capital could be distinguished? This objection, however, is only apparent. It overlooks the fact that all wealth presents a double aspect in reference to *time*. It forms a *stock* of wealth, and it forms a *flow* of wealth. The former is, I venture to maintain, capital, the latter, income and outgo, production and consumption. Stock relates to a *point* in time, flow to a *stretch* of time. Food in the pantry at any instant is capital, the monthly flow of food through the pantry is income. Machinery existing is capital, its annual replacement or increase is income. The total capital in a community at any particular instant consists of all commodities of whatever sort and condition in existence in that community at that instant, and is antithetical to the streams of production, consumption and exchange of *these very same commodities*.

Rather than being separate states of wealth, capital and income were therefore antithetical states of wealth, distinguished by time.[53] Under Fisher's theory, the classic example of the distinction between capital and income – a loan of money at interest – exhibited this antithetical relationship:[54]

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[50] See generally Thomas Rowles, *Capital and Income in Nineteenth Century Financial Reporting: Development of concepts of capital and income in nineteenth century financial reporting: economic, legal and accounting ideas* (VDM Verlag Dr. Muller, 2009) ch 8–10.

[51] See generally, ibid ch 11.

[52] Irving Fisher, 'What is Capital?' (1896) 6(24) *The Economic Journal* 509, 514 (emphasis in original).

[53] Rowles, above n 50, 281.

[54] Fisher, above n 52, 517 (emphasis in original).

> The word capital was originally an abbreviated form of *Capitalis pars debiti*, the principal of a debt. In this sense it was used during the middle ages, and was antithetical to the interest paid. This antithesis, although limited in its application to *money* and to money actually *loaned*, is at bottom identical with the antithesis between stock and flow, the sum lent being a stock, and the succession of interest payments constituting a flow.

However, while Fisher agreed with the classic understanding that the loan principal was capital, and the interest earned on that principal was income, under Fisher's theory they did not represent different types of wealth.

Fisher's theory, that capital and income are antithetical states of wealth, is the basis of the modern understanding in economics of the relationship between capital and income.[55] It is also the basis of modern finance theory, which sees capital simply as the sum of the present value of future income. Fetter defined this modern concept of capital as follows:[56]

> [W]e may define capital as the market value expression of individual claims to incomes, whether they have their sources in the technical uses of wealth or elsewhere. This is essentially an individual acquisitive, financial, investment, ownership concept. It is a 'fund' only in the financial sense, not a stock of wealth. It is the sum, in terms of dollars, of the present worths of various legal claims. It therefore includes the worth of all available and marketable intangibles… as well as the worth of claims to the uses of physical forms of wealth. Their summation as a financial fund is the resultant of a capitalization process. Physical objects of value are not capital, being sufficiently designated as goods, wealth or agents. Capital as here defined is a conception of individual riches having real meaning only within the price system and in the market place where it originated, and developing with the spread of the financial calculus in business practise.

Distinction in law

General

Various fields of law draw, or attempt to draw, a distinction between 'capital' and 'income'. Perhaps the most notorious example of this distinction is drawn in income tax law, which distinguishes between revenue and capital receipts and expenses for

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[55] Rowles, above n 50, 299.
[56] Fetter, 'Capital', above n 40, 149.

the purpose of the computation of taxable income.[57] In this context, the High Court[58] has adopted the classic 'tree' and 'fruit' formulation of the relationship between income and capital articulated by Pitney J in the opinion of the Supreme Court of the United States in *Eisner v Macomber*.[59] In *Eisner*, Pitney J stated:[60]

> The fundamental relation of 'capital' to 'income' has been much discussed by economists, the former being likened to the tree or the land, the latter to the fruit or the crop; the former depicted as a reservoir supplied from springs, the latter as the outlet stream, to be measured by its flow during a period of time… 'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets… Here we have the essential matter: *not* a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in*, being '*derived*', that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal; – *that* is income derived from property. Nothing else answers the description.

Several other fields of law also draw a distinction between income and capital. For example, in trusts law a distinction is drawn between capital and income to achieve, *inter alia*, equity between beneficiaries and classes of beneficiaries.[61] In a trust involving successive beneficiaries, the interests of the life tenant and the remainderman may conflict: the life tenant may wish the trustee to invest the trust fund in a manner that maximises the 'income' of the trust; the remainderman may wish the trustee to invest in a manner that maximises the value of the trust fund, rather than the income produced by that fund.[62] To balance these competing interests, various rules were developed in trusts law by which the 'income' receipts and expenses were attributed to the life tenant, and the 'capital' receipts and expenses were attributed to the remainderman.[63]

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[57] See generally R W Parsons, *Income Taxation in Australia: Principles of Income, Deductibility and Tax Accounting* (Lawbook, 1985) ch 2, 7.
[58] *Commissioner of Taxation v Montgomery* (1999) 198 CLR 639, 661–2 [65], 677–8 [117] (Gaudron, Gummow, Kirby and Hayne JJ); *Commissioner of Taxation v McNeil* (2007) 229 CLR 656, 663–4 [21] (Gummow ACJ, Hayne, Heydon and Crennan JJ).
[59] *Eisner v Macomber* (1920) 252 US 189.
[60] *Eisner v Macomber* (1920) 252 US 189, 206–7 (emphasis in original).
[61] See, eg, H A J Ford and W A Lee, Thomson Reuters, *The Law of Trusts*, [11.000]; Lynton Tucker, Nicholas Le Poidevin and James Brightwell, *Lewin on Trusts* (Sweet & Maxwell, 19th ed, 2015) ch 25.
[62] Ford and Lee, above n 61.
[63] See generally, ibid [11.1000]–[11.3240]; Tucker, Le Poidevin and Brightwell, above n 61.

In company law, a distinction is drawn between amounts paid by a subscriber for shares in a company (share capital), and dividends paid by the company to its shareholders (income).[64] Similarly, the law of partnership draws a distinction between contributions made by partners to the partnership (partnership capital) and the derivation of income by the partners from the carrying on of the partnership business (partnership income).[65]

Damages context

In a general damages context, a distinction is often drawn between a claimant's 'capital' loss, and a claimant's 'income' loss. Typically, this distinction is drawn in claims for damages arising out of the sale of an asset (both income producing and non-income producing).

Sale of income-producing asset

In *Wenham v Ella*,[66] the High Court drew this distinction in the context of a claim for breach of contract. The claimant and the defendant entered into an agreement under which the defendant agreed to acquire the claimant's shareholding in a company, and a debt owed to the claimant by that company, in consideration for the payment of a total purchase price of $76,400. Under the terms of the agreement, the defendant was to satisfy its obligation to pay the purchase price by a cash payment of $50,000, and by procuring the transfer to the claimant of a six-twentieth undivided 'share' in an investment syndicate. The syndicate owned income-producing land. A share entitled the owner to be registered as the owner of a one-twentieth undivided interest in the land, and to receive one-twentieth of the net income from the land. Each share had a value of $4,400, and generated net income equal to approximately 8% of the value of the share.

[64] See R P Austin and I M Ramsay, *Ford's Principles of Corporations Law* (LexisNexis, 15th ed, 2013) ch 17, 18.
[65] See generally Roderick I'Anson Banks, *Lindley & Banks on Partnership* (Sweet & Maxwell, 19th ed, 2010) ch 17.
[66] *Wenham v Ella* (1972) 127 CLR 454.

The defendant failed to procure the transfer of the interest in the land. The claimant commenced proceedings against the defendant for breach of contract, seeking damages for the value of the fractional interest in the land, and for the income attributable to that interest that would have been received by the claimant between the date of completion of the sale agreement and the date of the trial.

The relevant issue before the High Court was whether the claimant was entitled to damages for the lost income, in addition to damages for the loss of the interest in the land. The defendant argued that, at the date of breach, the value of the interest in the land ($26,400) was based solely on its yield (8%) and therefore the claimant's loss should be limited to the value of the interest in the land; to award the claimant both the value of its interest in the land, and the income attributable to that interest would allow the claimant to recover twice for the same loss.

The Court unanimously rejected the defendant's argument. Each member of the Court held that, in circumstances where the claimant had paid the purchase price and could not go into the market to mitigate its loss, the loss of income caused by the failure to transfer title to an income-producing asset was within the contemplation of the parties and therefore could be recovered as damages for breach of contract in addition to the value of the asset itself.[67] In Stephen J's view, in theory, the market (or capital) value of the land *included* the discounted value of the lost income, but the defendant failed to lead evidence identifying that separate income interest:[68]

> No doubt in theory one constituent of the market value of the interest reflects the discounted value of future income which it will bring in. Were it ever possible to separate that element from others, such as the value of the site itself which is no doubt not depreciating but may, in fact, be of a substantially appreciating nature, and the value of the structure erected on it, it might properly be taken into account in reduction of the second element of damages here awarded. However, in the present case, the only evidence as to damages available to the learned primary judge was that of the market value of the interest and of the loss of subsequent entitlement to income. In those circumstances, the evidence provided no basis for attributing to any specific portion of that market value a discounted value of that income entitlement.

[67] *Wenham v Ella* (1972) 127 CLR 454, 461 (Barwick CJ), 464 (Menzies J), 465, 467 (Walsh J), 472 (Gibbs J), 474 (Stephen J).
[68] *Wenham v Ella* (1972) 127 CLR 454, 475–6.

In *Esso Petroleum Co Ltd v Mardon*,[69] the English Court of Appeal distinguished between a claimant's capital and income losses in the context of a claim for damages for breach of contract and negligent misrepresentation.[70] The claimant was induced to enter into a lease of a petrol station by the defendant's representation, which was negligently made and in breach of warranty, concerning the throughput of the station.

Lord Denning MR (with whom Shaw LJ agreed) held that the claimant was entitled to damages for his '[c]apital loss', being the 'cash put into the business and lost', and the 'overdraft incurred in running the business.'[71] His Lordship also considered that the claimant was entitled to damages for loss of earnings and interest to be determined. Ormrod LJ held that the claimant had lost his 'capital' and 'the income which he could reasonably have expected to earn from the business, made up partly by loss of the use of his capital and partly by the loss of his time and energy in running the business.'[72] His Lordship would have included amounts owing to creditors in the claimant's award for capital loss, and awarded damages for loss of income in the form of 'interest on the overdraft, and on his capital investment.'[73] Ormrod LJ considered that the claim for loss of profits was 'virtually incapable of proof',[74] and declined to consider it.

In this context, a distinction between capital and income losses is often drawn in cases involving the sale of a business induced by deceit or misleading or deceptive conduct. In those cases, the prima facie measure of damages is the difference between the price paid for the business, and its 'true' value at the time of acquisition.[75] A claimant may also be awarded damages for any additional losses flowing directly from the wrong,

[69] *Esso Petroleum Company Ltd v Mardon* (1976) QB 801.
[70] For a similar approach in the case of a claim for damages for deceit and misleading or deceptive conduct, see *TN Lucas Pty Ltd v Centrepoint Freeholds Pty Ltd* (1984) 1 FCR 110; reversed on the question of interest, sub nom *Centrepoint Freeholds Pty Ltd v TN Lucas Pty Ltd* (1985) 6 FCR 133.
[71] *Esso Petroleum Company Ltd v Mardon* (1976) QB 801, 822.
[72] *Esso Petroleum Company Ltd v Mardon* (1976) QB 801, 828.
[73] *Esso Petroleum Company Ltd v Mardon* (1976) QB 801, 829.
[74] *Esso Petroleum Company Ltd v Mardon* (1976) QB 801, 829.
[75] *Holmes v Jones* (1907) 4 CLR 1692, 1702–3 (Griffith CJ; O'Connor and Isaacs JJ agreeing); *Potts v Miller* (1940) 64 CLR 282, 289–90 (Starke J), 297–300 (Dixon J), 307 (Williams J); *Toteff v Antonas* (1952) 87 CLR 647, 650–1 (Dixon J), 652 (McTiernan J), 654 (Williams J); *Gould v Vaggelas* (1985) 157 CLR 215, 220 (Gibbs CJ), 255 (Brennan J), 265 (Dawson J); *Kizbeau Pty Ltd v WG & B Pty Ltd* (1995) 184 CLR 281, 291 (Full Court); *HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd* (2004) 217 CLR 640, 656 [35] (Full Court).

such as trading losses,[76] and the loss of 'profit' that the claimant could have made from an alternative hypothetical business.[77] In this context, courts sometimes speak of the difference between the price paid for the business and its true value as being a 'capital' loss,[78] and the latter type of losses as a loss of 'income' or 'profit'.[79]

For example, in *East v Maurer*,[80] the claimant, who had been induced to buy a hairdressing salon by the deceit of the defendant, was awarded damages for its 'capital expenditure', *viz* the difference between the purchase and sale price of the salon; the fees and expenses incurred in buying and selling the salon, and in making improvements; the trading losses incurred during the claimant's ownership of the salon; and the loss of 'profits' the claimant could reasonably have anticipated had it bought not the salon it was induced to buy but rather a different salon bought for a similar sum.

More recently, in *IBEB Pty Ltd v Duncan*,[81] Macfarlan JA (with whom Young and Meagher JJA agreed) held that the claimants, who had been induced to buy a newsagency business by negligent and misleading representations made by the defendants, were entitled to damages for their 'capital loss', being the difference between the amount that the claimants paid for goodwill and the value of the goodwill that they purchased; and certain 'continuing losses', being the trading losses sustained by the claimants in the 10 months following settlement of the purchase of the business.[82]

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76 *Gould v Vaggelas* (1985) 157 CLR 215, 221–2 (Gibbs CJ), 242 (Wilson J), 255 (Brennan J), 266–7 (Dawson J); *Kizbeau Pty Ltd v WG & B Pty Ltd* (1995) 184 CLR 281, 291 (Full Court).

77 *East v Maurer* [1991] 1 WLR 461.

78 See, eg, *Slinger v Southern White Pty Ltd* (2005) 92 SASR 303, 328 [90] (Besanko J; Duggan and Layton JJ agreeing). For an example of this practice in a non-business sale context, see *Whitaker v Paxad Pty Ltd* [2009] WASC 47 (27 February 2009), [101], [111] (Blaxell J) (sale and purchase of a residential property induced by misleading conduct).

79 See, eg, *East v Maurer* [1991] 1 WLR 461, 464, 466–7 (Beldam LJ), 468 (Mustill LJ).

80 *East v Maurer* [1991] 1 WLR 461.

81 *IBEB Pty Ltd v Duncan* [2011] NSWCA 368 (28 November 2011).

82 *IBEB Pty Ltd v Duncan* [2011] NSWCA 368 (28 November 2011), [54]–[60].

Sale of non-income producing asset

A distinction between a claimant's capital loss, and a claimant's income loss, has also been drawn in claims for damages arising out of the sale of a non-income producing asset.

In *Murphy v Overton Investments Pty Ltd*,[83] the claimants were induced to enter into the lease of a unit in a retirement village by a statement of estimated outgoings that was misleading because it did not take into account of all amounts that could properly be charged as outgoings. The claimant sought relief under s 237, or alternatively damages under s 236, of the ACL. In relation to the claim for damages, the claimants contended that they had suffered loss or damage in the form of the diminution in value of the lease due to the increased future contributions. Importantly, the claimants did not claim, or lead any evidence, that the price paid for the lease exceeded its market value at the time the lease was signed. The trial judge, and a majority of the Full Federal Court, rejected the claim for damages on the basis that the claimants had failed to prove that they had suffered any loss.

The Full Court of the High Court allowed an appeal by the claimants. The Court held that '[t]he appellants suffered loss because the continuing financial obligations they undertook when they took the lease proved to be larger than they had been led to believe.'[84] While the Court rejected the claim for damages based on the diminution in value of the lease, the Court agreed with a new contention raised by the claimants that they may be entitled to damages assessed on a different basis, *viz*, the present value of the anticipated increased payments in contributions under the lease. On that basis, the Court remitted the matter to the trial judge to assess damages.

The Full Court explained this conclusion by drawing on the distinction made in the law of taxation between capital and revenue account:[85]

[83] *Murphy v Overton Investments Pty Ltd* (2004) 216 CLR 388.
[84] *Murphy v Overton Investments Pty Ltd* (2004) 216 CLR 388, 413 [66].
[85] *Murphy v Overton Investments Pty Ltd* (2004) 216 CLR 388, 408–9 [49]–[51] (emphasis in original).

> It should not be assumed that the loss or damage which a person suffers as a result of a contravention of Pt V is necessarily singular. Nor should it be assumed that loss or damage is incurred *either* as a loss on capital account, *or* as a loss on revenue account which, if to be compensated by an award of damages, must be translated into a single capital sum. These assumptions find no support in the language of the relevant provisions. Loss or damage may be a loss of capital. But there may also be a loss on revenue account which, unless some other remedy is granted which will prevent it continuing into the future, will, or may, continue into the future. And the losses on capital account may be sustained at a time different from any loss on revenue account. The latter form of loss may, in many cases, be sustained after the loss on capital account has been suffered. In some cases the loss on capital account may overlap with a loss on revenue account. If that is so, it is necessary to mould relief in a way which will avoid double compensation. A loss on revenue account, whether past or future, can be reduced to a single capital sum. Courts often undertake that exercise, and in doing so may acknowledge that it is difficult and that the result is imperfect. But the frequency with which the courts have had to grapple with the problem of translating a continuing stream of future losses (sometimes of uncertain amounts, over an indefinite and uncertain time) into a single capital sum does not mean that the only kind of loss which a person may sustain as a result of conduct of the kind now in issue is the loss of a capital sum. Nor does it mean that remedies other than an award of damages may not be made under the Act to compensate for, prevent or reduce those future losses.

In other words, while the Court rejected the contention that the claimant had suffered a 'capital' loss in the form of a diminution in value of the lease, that did not mean that the claimant had not suffered a 'revenue' loss in the form of the present value of the anticipated increased payments in contributions under the lease.

Problems with distinction

In a damages context, the attempt to draw a distinction between capital and income losses gives rise to both conceptual, and practical, problems.

Conceptual problems

In a damages context, the valuation and assessment of loss are ultimately legal issues to be determined by the relevant court, tribunal or other decision maker. However, while these issues remain the responsibility of the relevant decision maker, they are necessarily determined by reference to prevailing economic and finance theory concepts, particularly where damages are to be awarded for economic loss.

The distinction between capital and interest, and the implicit assumption underpinning that distinction that capital and interest are separate, independent states of wealth, is inconsistent with the modern economic understanding of capital and income as antithetical states of wealth. On that basis, in a damages context, there is no theoretical justification for distinguishing between capital and income losses. In *Jamieson v Westpac Banking Corporation*,[86] Jackson J made this point, *obiter*:[87]

> Generally speaking, compensatory damages are not concerned with whether loss is on a revenue or capital account. On the contrary, the accounting or tax incidents of a particular loss are not generally relevant here. Accountants who value discounted cash flows, both inflows and outflows, for compensatory damages awards, would be surprised to hear lawyers say that there are two different losses involved, one on 'capital' account and another on 'revenue' account, although they can and often do make allowance for the incidence of taxation. Cash flow analysis operates independently of that division.

In finance theory, value is solely a function of expected cash flow, and no analytical distinction is made between cash as 'capital' and cash as 'income'. In finance theory, loss or damage is viewed as a loss of 'value', and in determining whether the actions of another party have affected the value of the firm, value is understood as a function of expected cash flows. Losses which appear to resemble losses of capital and losses of income are both treated as being of the same character, because they both describe amounts of cash that should have been received (at given times) but were not, or were not received in full or at the right times. All losses are therefore of the same essence, and are offset only by further cash flows that are conceptually (logically and mathematically) equivalent to those not received in full and on time. Giving these cash flows different names – 'capital' or 'income' – does not change their essence (that is, their timing and uncertainty). More simply, cash is cash, whatever else it is called. This is because cash is fungible.

In making financial investment decisions and estimating the values of those investments (or the values of the firms making them), cash flows are all treated the

[86] *Jamieson v Westpac Banking Corporation* (2014) 283 FLR 286; affirmed, without reference to the issue, sub nom *Westpac Banking Corporation v Jamieson* (2015) 294 FLR 48.
[87] *Jamieson v Westpac Banking Corporation* (2014) 283 FLR 286, 322 [191] (citations omitted).

same way, no matter whether they have legal or superficial properties that make them more akin to capital or income in conventional terms. There is often no harm in calling some cash flows 'capital' and others 'income' but this does not add anything to the logic by which they are valued, and as a general rule it is not possible to partition a stream of cash flows into innate capital and income components. Attempts to differentiate between capital and income also beg the philosophical question as to what objectively constitutes capital and under what circumstances capital is returned or maintained. This issue has long been debated without agreement in accounting (eg, is capital just a nominal sum of money or is it an amount of 'purchasing power' or 'operating capability'?).[88]

When a distinction is made between capital and income in this context, misconceptions easily arise. For example, if a borrower falls behind in the contractual interest payments on a loan, has the lender suffered a loss of capital, even though the loan principal (its face value) is not as yet due for repayment? The best answer is almost certainly yes, because the value at which the delinquent loan can be on-sold is bound to be greatly reduced, and hence much lower than its face value. Another example is a 'zero coupon' bond, where the repayment of the loan is to be made in a single payment that includes both interest and capital. Assume that the loan is for \$100 and that the single repayment is to be \$120, suggesting that \$20 is interest or income and \$100 is principal or capital. If the borrower manages to pay back just \$110, is the shortfall of \$10 a loss of capital or interest? There is no objective answer to this question because the general conceptual distinction between receiving \$1 of capital and \$1 of income is meaningless and illusory. Again, that is because cash is fungible.

The methodological principle of viewing all cash flows as just amounts of money flowing at given times, and with given uncertainty, eliminates any need for a conceptual distinction between different types of cash. An exception to this rule is where the different statutory tax treatment of capital and income alters the quantum of

[88] See Stewart Jones and Ahmed Riahi-Belkaoui, *Financial Accounting Theory* (Cengage Learning, 3rd Aust ed, 2010) 417–18.

actual cash flows because the tax is computed differently, or because the income year in which tax is imposed is different, or both.[89]

In financial and business practice, there is an endless game of converting back and forth between income (eg, contractual interest payments) and capital (eg, bond values). Consider for example the device of mortgage-backed securities, where loans are packaged together and on-sold for large one-off payments. Similarly, when a borrower wants a loan to be refinanced, the lender will devise a completely new sequence of capital and interest payments. One sequence of cash flows is merely exchanged for a different sequence that the bank regards as equivalent (the two cash streams have the same expected net present value to the bank). Consider also a perpetual bond of face value $100 with a coupon payment of $10 per year. The $100 capital on this bond is guaranteed by contract never to be re-paid, yet that does not stop an investor paying $100 to buy it. Rather, rational investors buy a sequence of future cash inflows, and (excluding tax considerations) they are not influenced by the fact that all these cash flows look like income rather than capital.

The above examples suggest that cash flows do not have any permanent or intrinsic nature as 'capital' or 'income'. Labelling them as such may be conventional, and may sometimes assist communication, but no essentially arbitrary separation of a sequence of cash flows into supposed capital flows and income flows assists in the conceptual problem of how to value them individually or as a set. For this reason, apart from tax effects, there is no mention of a capital-versus-income schema in the economic or statistical theory of financial decision-making and valuation.

Practical problems

At a practical level, the attempt to distinguish between capital and income losses in a damages context can give rise to various errors of economic logic, such as double counting, or mischaracterising or omitting a loss altogether.

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[89] For example, an amount derived on the sale of shares might be treated as a revenue receipt and subject to tax in the year of receipt (for example, if the recipient was a share trader); the same amount in the hands of a different taxpayer may be treated as capital and taxed as a capital gain (and perhaps computed differently) in an earlier income year if the contract for sale was entered into in that year: see *Income Tax Assessment Act 1997 (Cth)*, s 104–10(3)(a).

Double counting

Double counting occurs when a court awards damages for two or more aspects or elements of the same loss. That can arise where a court awards damages for a so-called revenue loss in addition to awarding damages for a loss in the capital value of the underlying right or asset, in circumstances where the revenue loss is reflected in the value, or diminution in value, of that asset. In *Jamieson*, Jackson J observed:[90]

> Generally speaking, where a plaintiff is compensated for financial loss on revenue account, such as lost rent, under a recurring obligation to pay and correlative right to receive that rent, the methodology is clear. Past losses are calculated to the date of the judgment. Future losses are assessed by a hypothetical cash flow basis discounted for present receipt, so as to represent a capital sum which would produce the lost cash flow, if invested. The total is the amount of the judgment on a lump sum basis. The capital value of the same loss, being the reduced market value of the property at the date of the wrong due to the lost rent, is not also recoverable, because that would be double compensation.

The problem of double counting often arises in the context of claims involving the purchase of a business induced by some sort of wrongdoing, such as deceit or misleading or deceptive conduct. This was recognised by Gibbs CJ in *Gould v Vaggelas*:[91]

> If the purchaser, besides paying more for the business than it was worth, has suffered additional losses which resulted directly from the fraud he ought to be compensated for them. Of course, the court must … ensure that no additional compensation is given for losses when those losses, or the probability of their occurrence, has already been taken into account in determining the value of the business.

The classic illustration of the impermissibility of double counting is the decision of the English Court of Appeal in *Cullinane v British 'Rema' Manufacturing Co Ltd*.[92] The claimant purchased a pulverising and drying plant from the defendant. The defendant delivered the plant, but it failed to perform at the rate warranted by the defendant. The claimant kept the plant, but claimed damages for breach of warranty from the defendant under five heads. The first four heads related to the expenses

[90] *Jamieson v Westpac Banking Corporation* (2014) 283 FLR 286, 322 [192].
[91] *Gould v Vaggelas* (1985) 157 CLR 215, 221–2; see also 266–7 (Dawson J).
[92] *Cullinane v British 'Rema' Manufacturing Co Ltd* [1954] 1 QB 292.

incurred by the claimant in purchasing and housing the plant and ancillary equipment, plus interest, less the unpaid balance of the purchase price and the residual value of the plant, equipment and buildings. Under the fifth head the claimant sought the 'profit' it would have made from the machine, had it met the defendant's warranty, from the date of delivery to the date of trial. The trial took place three years after delivery, and therefore the loss of profits claim was limited to that period, despite the fact that the machine had a useful life of 10 years. In calculating its loss of profits claim, the claimant deducted from its estimated gross receipts at the warranted output, operating expenses, and depreciation at 10% per annum, and maintenance at 5% per annum, on the plant and buildings. The official referee awarded the claimant damages under the first four heads, representing the capital thrown away as a result of the breach of warranty, plus interest. The referee also awarded damages under the fifth head for the period of three years, but without any deduction for depreciation.

On appeal, a majority of the Court held that in awarding damages for the capital expenses, and the lost profits, the referee had compensated the claimant twice in respect of the capital expenditure. Lord Evershed MR said:[93]

> It seems to me, as a matter of principle, that the full claim of damages in the form in which it is pleaded was not sustainable, in so far as the plaintiff sought to recover both the whole of his original capital loss and also the whole of the profit which he would have made. I think that that is really a self-evident proposition, because a claim for loss of profits could only be founded upon the footing that the capital expenditure had been incurred.

Jenkins LJ said:[94]

> The general principle applicable to the case is, I apprehend, this: the plant having been supplied in contemplation by both parties that it should be used by the plaintiff in the commercial production of pulverized clay, the case is one in which the plaintiff can claim as damages for the breach of warranty the loss of the profit he can show that he would have made if the plant had been as warranted… It follows that in such a case, while no doubt the plaintiff can at his option claim damages based on the difference between the value to him of the article as actually supplied and the contract price of the article, he cannot claim both that amount, representing his capital expenditure thrown away by reason of the breach, and also the full amount of the profit which he can show that he would have made in the

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93 *Cullinane v British 'Rema' Manufacturing Co Ltd* [1954] 1 QB 292, 302.
94 *Cullinane v British 'Rema' Manufacturing Co Ltd* [1954] 1 QB 292, 308.

event of the article answering the warranty. In considering loss of profit he must be placed in the same position as if the article had been as warranted. On that hypothesis, the full contract price would have to be paid, and all other expenditure necessary to use the article for the contemplated purpose would have to be incurred before any profit could be earned at all. Therefore, where the claim is based on loss of profit it must be calculated either by estimating the difference between the contract price of the article and the value of the article as supplied, allowing the amount claimed for loss of profit only in so far as it is in excess of that amount, or, more simply, by letting the capital expenditure lie where it falls and computing the amount of loss of profit.

On this basis the majority allowed the defendant's appeal and reduced the claimant's damages by excluding the amount awarded for capital expenditure.

Morris LJ dissented. His Lordship considered that the way in which the claimant pleaded its damages was 'permissible and logical.'[95] In Morris LJ's view, by its pleading the claimant sought by way of damages its capital expenditure (less any residual value), plus its *net* profit for the three years up to the date of the trial (having allocated and subtracted by way of depreciation one-tenth of the capital expenditure for each year).[96] His Lordship considered that this formulation was, *in principle*, simply an alternative way of claiming for gross profits.[97] On that basis Morris LJ would have allowed the defendant's appeal, but on a different basis. His Lordship would have varied the referee's award by deducting from the total amount awarded an amount equal to the aggregate of 10% of the claimant's capital expenditure for each of the three years up until the date of the trial.

In *TC Industrial Plant Pty Ltd v Robert's Queensland Pty Ltd*,[98] the High Court explained the difference between the majority and minority opinions in *Cullinane*. The Court explained that the difference turned on the significance attached to the limitation on the claim for loss of profits to a period of three years. In the Court's view, the majority 'thought that as a result of the limitation the case had to be decided on the footing that if the machine had been as warranted it would have earned profits during the three years but none thereafter', whereas Morris LJ, on the other hand,

[95] *Cullinane v British 'Rema' Manufacturing Co Ltd* [1954] 1 QB 292, 315.
[96] *Cullinane v British 'Rema' Manufacturing Co Ltd* [1954] 1 QB 292, 315–16.
[97] *Cullinane v British 'Rema' Manufacturing Co Ltd* [1954] 1 QB 292, 315.
[98] *TC Industrial Plant Pty Ltd v Robert's Queensland Pty Ltd* (1963) 180 CLR 130.

‘thought that the limitation meant only that although loss of profits after the three years would have been incurred it was not claimed for.’[99]

The Court agreed with Morris LJ that the formulation of the damages claim was just an alternative way of claiming for gross profits, and was unobjectionable in principle, observing that:[100]

> [W]here the plaintiff adopts, as the amount the machine would have been worth to him if it had been as warranted, the amount of the profits he would have made by using it to the point of exhausting its useful life, he is entitled to recover the whole amount of those profits, without making provision for replacement of the cost of the machine; for those profits are what he was really buying when he bought the machine in reliance upon the warranty. But the same result may be produced by claiming for recoupment of his capital outlay and in addition for the excess of the estimated profits over the amount of the capital outlay; and that is all that is done by a plaintiff who claims his capital outlay and in addition profits estimated after deduction of depreciation.

The Court suggested that:[101]

> The justification for the refusal of the majority of the Court in *Cullinane's Case* to follow such a course lies, we venture to think, in the fact that since nothing was proved about the probable amount of the profits that would have been made in the final seven years of the machine's life, and therefore nothing about any probable excess of profits during the whole ten years of the machine's life over amounts of depreciation equalling the total capital cost, the plaintiff failed to show that damages assessed on the loss-of-profits basis would be greater than damages assessed by reference to capital expenditure plus interest.

In other words, on the majority’s interpretation, the three-year limitation on the claim for loss of profits meant that the claimant would not be able to recoup its capital expenditure on the plant. In those circumstances, the claimant was limited to the recovery of its profit over the three-year period (without any deduction for depreciation), but could not in addition recover its capital expenses. On the other hand, Morris LJ did not think that the limitation on the claim for loss of profits meant that the claimant would be unable to recoup its capital expenditure on the plant. His

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[99] *TC Industrial Plant Pty Ltd v Robert’s Queensland Pty Ltd* (1963) 180 CLR 130, 139 (Full Court).
[100] *TC Industrial Plant Pty Ltd v Robert’s Queensland Pty Ltd* (1963) 180 CLR 130, 141 (Full Court) (citations omitted).
[101] *TC Industrial Plant Pty Ltd v Robert’s Queensland Pty Ltd* (1963) 180 CLR 130, 141 (Full Court).

Lordship therefore considered that the claimant was entitled to claim for its capital expenditure (which ultimately would have been recovered) plus its net profit for three years, less a pro rata amount for depreciation of the plant.

Cullinane illustrates that double counting is prone to occur when a distinction is made between capital and income losses. This problem is also illustrated by the High Court's decision in *Wenham*. In that case, the Court assessed damages at the date of breach. The Court considered that, at that time, the claimant had suffered two distinct losses: the loss of the value of the interest in the land; and the loss of the future cash flow that would have been received in respect of the interest in the land. However, there did not appear to be any evidence to support the conclusion that the future cash flow was a different type of loss. To the contrary, the evidence led by the defendant suggested that the value of the interest in the land was determined solely by its expected yield. In those circumstances, the claimant had only suffered one single undivided loss of future cash flow. That loss was represented by the value of the interest in the land, which in turn reflected the expected net present value of the future cash flow to be received from the land. By awarding damages for both of these 'losses', the Court compensated the claimant twice for the same loss.

In *Wenham*, it appears that the High Court considered that, because the land was income producing, the parties contemplated that the loss of the interest in the land would cause the loss of a further, and separate, consequential loss of that 'income' (ie, cash flow). However, the value of the land already reflected that expected cash flow. If the claimant did suffer a consequential loss, that loss did not take the form of a loss of the 'income' from the land; rather it took the form of the loss of an opportunity to invest elsewhere an amount corresponding to the value of the land at the date of breach, the return from which may or may not equal the expected future income from the land.

In *Wenham*, damages were assessed at the date of breach. From that point in time, all loss is future loss. In general, the loss in the value of an asset at that point in time is a function of the anticipated future cash flow of the asset. Accordingly, an award of damages for the loss of that cash flow, in addition to damages for the loss in value of the asset, involves double counting. The decision of the Full Court of the South

Australia Supreme Court in *Slinger v Southern White Pty Ltd*[102] illustrates this point. The sale of land and a business was induced by misrepresentations and misleading or deceptive conduct. The trial judge awarded the claimant damages under two heads. Under the first head, the claimant was awarded $70,000, representing the difference between the price paid for the business, and its true value at the time of acquisition. Under the second head, the claimant was awarded $60,000, representing the profit the claimant would have made in the business in the period of 15 months following its acquisition by the claimant.

Besanko J (with whom Duggan and Layton JJ agreed) allowed an appeal by the defendant from the trial judge's decision on the second head of damages. His Honour accepted the defendant's argument that the claimant, having received compensation for the difference between the price paid for the business and the value received, was not entitled to also receive damages for loss of profit in the conduct of the business. Applying *Cullinane*, Besanko J held:[103]

> [T]he awarding of the difference between price paid and value received or capital loss (that is, the first head of damages) and interest puts the plaintiff in the position in which it has in effect paid the right price for the business. I do not think that over and above that figure he can, in the absence of a warranty or promise, recover the profits that might have been made had the business been worth the figure he initially paid for the business. To allow the second head of damages may see the plaintiff doubly compensated for the same loss.

In *Slinger*, the claimant's 'capital' loss, that is, the difference in the value of the business at the time of the wrong, represented the loss of the anticipated future cash flow from the business. This loss constituted one single undivided future loss. It followed that the claimant did not suffer, and was not entitled to be compensated for, a further and separate loss of 'income' in the form of the future profits that would have been earned by the business, because the expected value of those 'profits' (ie, cash flow) was already accounted for in the value of the business itself.

[102] *Slinger v Southern White Pty Ltd* (2005) 92 SASR 303. See also, *IBEB Pty Ltd v Duncan* [2011] NSWCA 368 (28 November 2011).
[103] *Slinger v Southern White Pty Ltd* (2005) 92 SASR 303, 328 [90]–[91].

The same approach is taken if damages are assessed at the date of the trial. In *4 Eng*, damages for the claimant's 'capital' and income' losses were assessed at the date of trial. At that date, the claimant's 'capital' loss (the loss in value of Tarvail as at the date of trial) was represented by the loss of uncertain *future* expected cash flow from Tarvail. The claimant's 'income' loss (the loss of profits from Tarvail) was represented by the loss of the uncertain *past* expected cash flow from Tarvail between the date of the wrong and the date of the trial.

The claimant's loss constituted one single undivided loss, occurring over two time periods. The value of Tarvail at the date of the trial was purely a function of its expected future cash flow, and therefore there was no double recovery in also permitting the claimant to recover the expected cash flow that would have been received up to (but not beyond) the date of trial.

Mischaracterisation of loss

The mischaracterisation of loss involves ascribing incorrect characteristics to a claimant's loss, with the result that the loss is not properly identified and assessed. Again, this type of error is prone to arise when a distinction is made between capital and income losses.

An example is the decision of the High Court in *Murphy*, considered earlier in this chapter. In *Murphy*, the Court considered that, even though the claimants had not suffered a 'capital' loss in the form of a diminution in value of the lease, they may have suffered a 'revenue' loss in the form of the present value of the anticipated increased payments in contributions under the lease. The difficulty with this reasoning, however, is that, on the facts of the case, there was nothing to suggest that the so-called 'capital' and 'revenue' losses were separate and distinct losses. The case was very different, for example, from a case like *Esso Petroleum* or *East* where a person is induced by deceit to purchase a business and thereby suffers a *direct* loss of 'capital' (the difference between the price paid for the business and its true value) and a separate *consequential* loss of 'revenue' (such as trading losses). It is also very different from a case like *Browning*, where a person has two distinct assets, a so-called 'capital' asset (such as a farm), and a so-called 'revenue' asset (such as a business), each of which is capable of suffering a loss in value.

On the facts in *Murphy*, it appears that the only loss potentially suffered by the claimants was the loss in value of the lease, however that loss is described. If it is accepted that the value of an asset, such as the lease, is simply a function of its discounted expected cash flow, and the increased outgoings had no impact on the value of the lease assessed on that basis, then it follows that the claimants suffered no loss.

It appears that the Court, by classifying the claimants' potential loss as a distinct 'revenue' loss, mischaracterised that loss. This point was forcefully made, *obiter*, by Jackson J in *Jamieson*:[104]

> I can find nothing in *Murphy* to explain how resort to the distinction between losses on the capital account and losses on the revenue account made what was not compensation on ordinary principles, on a capital account basis, compensation when looked at from the revenue account perspective. The analysis in this respect appears to change the characterisation of something which otherwise was not a loss as a 'loss' under s 82. Before that case, it would have been characterised as an expected benefit or protection that was neither promised by the defendant nor obtainable by the plaintiffs elsewhere for the same price as was paid in the transaction in question.

A further example can be found in the Full Federal Court decision in *La Trobe*. The Full Court separated the claimant's loss into a loss of capital (the shortfall on the loan principal) and a loss of income (the net interest that would have been made on a hypothetical alternative loan), but then failed to characterise both elements of the claimant's loss as the loss of a commercial opportunity.

The Full Court treated the loss of capital as a direct loss, and assessed damages for that loss on the hypothetical that, but for the defendant's negligence, the claimant would not have made any loan at all. The claimant was therefore awarded damages equal to the entire shortfall on the loan principal. On the other hand, the Full Court treated the loss of income as a consequential loss, and assessed damages for that loss

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[104] *Jamieson v Westpac Banking Corporation* (2014) 283 FLR 286, 322 [193].

on the hypothetical that, but for the defendant's negligence, the claimant would have made, and generated a return on, an alternative loan (or investment). The claimant was then awarded damages equal to the net return on that investment in the form of interest.

The obvious problem with this approach is that the two hypotheses are inconsistent and so the claimant is overcompensated. The claimant is awarded the shortfall on its principal, and the return on that principal, but without any discount to reflect its principal investment risk. Contrary to the view of the Full Court, the whole of the claim (and not just the interest component) was a claim for a loss of a commercial opportunity. This is because, properly understood, what the claimant had lost was an opportunity to receive an undivided cash flow that would have been generated on the whole of the hypothetical alternative loan (comprising a sequence of payments made up of both principal and interest).

A principled approach

The above analysis demonstrates that, in a damages context, loss (whether loss of a commercial opportunity or otherwise) is purely a function of cash flow. Further, because money is fungible, any loss of cash flow is an indivisible loss. It follows that, while the terms 'capital' and 'income' may be used as convenient descriptors of loss, they do not themselves constitute separate individual and distinct types of loss.

The above analysis also demonstrates that the terms 'capital' and 'income' do not necessarily have a universal meaning, and their use can cause confusion and errors of economic logic in the computation of damages. In a claim for damages for loss of a commercial opportunity (and perhaps more generally), the better approach is to discard any distinction between capital and income losses, and instead to recognise that the claimant's loss is a loss of cash flow, and compute damages accordingly. Support for this approach can be found in *TC Industrial* itself. The High Court held that, subject to proof, the claimant was entitled to damages for breach of warranty assessed on the basis of its expenditure, plus its net profit. However, in remitting the question of damages to the Supreme Court of New South Wales, the Court suggested that:[105]

> It may of course be that the learned judge will find it preferable to work out a single calculation, taking the whole of the actual and probable expenditure which the plaintiff would have incurred in performing its contract with the Commonwealth and the probable extension thereof had the crusher been of the warranted fitness, and subtracting the resulting figure from the total receipts the plaintiff would have obtained under the contract and the extension.

In *East*, Mustill LJ summed up the general approach, and its advantages, as follows:[106]

> In my judgment the best course in a case of this kind is to begin by comparing the position of the plaintiff as it would have been if the act complained of had not take [sic] place with the position of the plaintiff as it actually became. This establishes the actual loss which the plaintiff has suffered and often helps to avoid the pitfalls of double counting, omissions and impermissible awards of both a capital and an income element in respect of the same loss.

Conclusion

This chapter examined the economic character of the loss of a commercial opportunity.

The chapter demonstrated that a commercial opportunity is an asset. This follows from the analysis in chapter four. In order to form the subject matter of a compensable loss, a commercial opportunity must have some non-negligible monetary value. A chance with a non-negligible monetary value constitutes an asset, because it represents the chance of an anticipated future cash flow. The loss of a commercial opportunity therefore represents the loss of an asset, being the chance or opportunity of an anticipated future cash flow. That cash flow may consist of the receipt of an anticipated cash inflow, such as an expected benefit, or avoiding, reducing or deferring an anticipated cash outflow, such as an expected detriment.

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[105] *TC Industrial Plant Pty Ltd v Robert's Queensland Pty Ltd* (1963) 180 CLR 130, 143 (Full Court).
[106] *East v Maurer* [1991] 1 WLR 461, 468.

This chapter also demonstrated that the loss of a commercial opportunity constitutes a single, indivisible loss of anticipated future cash flow. It follows that such a loss cannot be separated into a loss of 'capital' and a loss of 'income'. This is because money, or cash, is fungible. In this context, the practice of separating the loss of a commercial opportunity into two types of loss: a loss of capital, and a loss of income, lacks a proper theoretical foundation. Furthermore, the division of loss into those categories tends to obscure the true nature of the loss suffered, with the result that serious errors are made in the valuation of damages, such as double counting or mischaracterising or omitting a loss altogether. The better approach may be to discard the use of these terms in a damages context, and instead simply refer to the loss of a commercial opportunity as the loss of the chance of an anticipated future cash flow.

Chapter 6

Valuation of loss

Introduction

Purpose and object

This chapter examines the valuation of the loss of a commercial opportunity.

The object of this chapter is to draw together the analysis contained in Parts one and two of the thesis to construct a general legal framework for the valuation of the loss of a commercial opportunity, which is based on and consistent with the financial theory of valuation.

This framework is based on the argument that, in principle, the loss of a commercial opportunity should be valued by reference to the present value of cash flows that represents a market value. This follows from the analysis in chapters two and five. Chapter five demonstrated that a commercial opportunity is an asset. Chapter two demonstrated that the value (or loss in value) of an asset is determined by reference to its DCF based market value.

Structure

This chapter is divided into an introduction and four main sections. The first section considers the preliminary issue of proof of the value of a commercial opportunity. This section is divided into two parts. The first part examines the burden and standard of proof, and the second part considers the evidentiary foundation required to prove the value of a lost commercial opportunity. The second section considers the meaning of value in this context. The third section identifies the general approach taken by courts to the valuation of loss of a commercial opportunity. This section is divided into two parts. The first part identifies the approach, and the second section examines the ways in which that approach is applied. The final section of this chapter applies this general approach to construct a framework for the valuation of loss of a commercial opportunity. This section is divided into five parts. The first part contains an introduction. The following three parts identify and analyse the steps in the framework. The final part examines the valuation of additional opportunities.

Proof of value

Burden and standard of proof

A claimant bears the legal burden of proving the *value* of the lost commercial opportunity.[1] However, the claimant is not required to prove the value or extent of that loss on the balance of probabilities.[2] The value of the loss involves the evaluation of hypothetical (past and future) events, and is therefore assessed by reference to the court's assessment of the degrees of probabilities and possibilities that the relevant benefit would have been realised, or the relevant loss or liability would have been avoided.[3] It follows that a claimant may be entitled to damages for loss of a commercial opportunity even though it is improbable that the opportunity will be realised.[4] On this basis, damages have been awarded for loss of an opportunity assessed at only 10%.[5]

[1] *Waribay Pty Ltd v Minter Ellison* [1991] 2 VR 391, 397 (Young CJ and Kaye J); *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003), [32]–[33] (Chernov JA; Buchanan JA agreeing); *Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd) v BestCare Foods Ltd* [2013] NSWCA 90 (24 April 2013), [86] (Ward JA; Hoeben JA agreeing).
[2] *Waribay Pty Ltd v Minter Ellison* [1991] 2 VR 391, 397 (Young CJ and Kaye J); *Price Higgins & Fidge v Drysdale* [1996] 1 VR 346, 354 (Winneke P; Ormiston J and Charles JA agreeing).
[3] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ), 368 (Brennan J); *Tabet v Gett* (2010) 240 CLR 537, 585 [136] (Kiefel J; Hayne, Crennan and Bell JJ agreeing); *Price Higgins & Fidge v Drysdale* [1996] 1 VR 346, 354 (Winneke P; Ormiston J and Charles JA agreeing).
[4] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 92–4 (Mason CJ and Dawson J), 104 (Brennan J), 118–19 (Deane J); *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 349–50, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ), 364–5, 368 (Brennan J). See also *Allied Maples Group Ltd v Simmons & Simmons (a firm)* [1995] 1 WLR 1602, 1612 (Stuart-Smith LJ; Hobhouse LJ agreeing).
[5] *Global Network Services Pty Ltd v Legion Telecall Pty Ltd* [2001] NSWCA 279 (28 August 2001), [120] (Meagher JA; Beazley JA agreeing); *Sharpe v Addison* [2003] EWCA Civ 1189 (23 July 2003). See also, *QCoal Pty Ltd v Cliffs Australia Coal Pty Ltd* [2009] QCA 358 (20 November 2009), [45] (Fraser JA; Holmes JA and White J agreeing) (*obiter*).

Evidentiary foundation

Requirement for evidence

The claimant is required to prove the value of a lost commercial opportunity 'with as much certainty and particularity as is reasonable in the circumstances.'[6] In order to recover substantial damages, a claimant must therefore adduce 'evidence from which the value of that lost opportunity can be assessed.'[7] In valuing a lost opportunity, a court must provide 'basic reasons'[8] for its assessment, which disclose a reasoning process that has a rational basis.[9] A court is not entitled to simply guess the value of an opportunity, or pluck a figure from the air.[10] It follows that, if a claimant fails to adduce evidence of value, or that evidence is rejected, a 'claim for substantial damages will fail even though the plaintiff may have suffered the loss of a commercial opportunity that had some value.'[11]

The importance of adducing evidence of value is illustrated by the decision of the Victoria Court of Appeal in *Longden v Kenalda Nominees Pty Ltd*.[12] The claimant and the defendant entered into a lease of premises to be used by the claimant to conduct a business. The defendant repudiated the lease before the claimant took possession and the business was never commenced. The claimant sought damages for the loss of the opportunity to earn profits from the conduct of the business at the premises. At trial the claimant sought to prove its loss, not by adducing evidence of how profits would have been earned in the proposed business, but by leading evidence of the profitability of another, allegedly comparable, business. The trial

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[6] *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003), [33] (Chernov JA; Buchanan JA agreeing).

[7] *Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd) v BestCare Foods Ltd* [2013] NSWCA 90 (24 April 2013), [86] (Ward JA; Hoeben JA agreeing). See also, *McCrohon v Harith* (2010) Aust Torts Reports 82–056, 64,145–7 [118]–[126] (McColl JA; Campbell JA and Handley AJA agreeing); *Elobadi v Royal Australasian College of Surgeons* [2014] WASCA 117 (9 June 2014), [57] (Full Court); *Thompson v Schacht* [2014] NSWCA 247 (30 July 2014), [76] (Barrett JA; Leeming JA agreeing).

[8] *Royal Dental Hospital of Melbourne v Akbulut* [2002] VSCA 88 (20 June 2002), [29] (Winneke P; Callaway and Vincent JJA agreeing).

[9] *McCrohon v Harith* (2010) Aust Torts Reports 82–056, 64,147 [127] (McColl JA; Campbell JA and Handley AJA agreeing).

[10] *Sensis Pty Ltd v McMaster-Fay* [2005] NSWCA 163 (17 May 2005), [57] (Full Court).

[11] *Kosho Pty Ltd v Trilogy Funds Management Ltd* [2013] QSC 135 (29 May 2013), [192] (Applegarth J).

[12] *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003).

judge rejected this evidence, and in the absence of any other evidence of the value of the proposed business, held that the claimant had failed to prove any loss.

Chernov JA (with whom Buchanan JA agreed) dismissed an appeal by the claimant. His Honour held that the trial judge's rejection of the claimant's evidence led to two conclusions: first, the claimant failed to discharge its onus of establishing, on the balance of probabilities, that the alleged opportunity had some non-negligible value;[13] secondly, even if it could be said that the alleged opportunity had some value, the clamant failed to prove the amount of that value.[14]

In relation to the second conclusion, Chernov JA observed that '[i]t was not a case of the court facing difficulties in establishing the amount of the loss from the available evidence. Rather, it was a case where there was *no* relevant evidence before the judge on that issue.'[15] Similarly, Buchanan JA observed that the claimant 'was required to prove the loss of profit with as much precision as the subject matter reasonably allowed. It was necessary for her to lay a foundation for an estimate of the lost profit which was not mere guesswork, for this was not a case where precise evidence of what had been lost could not be adduced.'[16]

In *Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd) v BestCare Foods Ltd*,[17] the claimant's pet food factory was destroyed by an explosion and fire that resulted from the leakage of liquefied petroleum gas into the factory. The claimant sued the defendant alleging that the defendant had breached various duties of care owed to the claimant and that as a result of those breaches the claimant had lost, among other things, the opportunity to make profits under a supply agreement between the claimant and a third party. The supply agreement contained an estimate of the third party's annual quantity requirements, but did not contain a provision for any minimum or maximum quantity.

[13] *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003), [32], [34], [37].
[14] *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003), [32], [38].
[15] *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003), [38] (emphasis in original).
[16] *Longden v Kenalda Nominees Pty Ltd* [2003] VSCA 128 (4 September 2003), [12].
[17] *Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd) v BestCare Foods Ltd* [2013] NSWCA 90 (24 April 2013).

At trial, liability was established and the issue of damages was heard before a referee. The claimant led evidence from two accountants who estimated the claimant's loss under two alternative scenarios. The referee preferred the second scenario, and based on that scenario recommended an award of damages for loss of opportunity assessed at 60% of the present value, at the date of the explosion, of the future profits under the supply agreement. McDougall J adopted the referee's report with some minor variations.

Ward JA (with whom Hoeben JA agreed) allowed an appeal by the defendant. The defendant argued that there was no evidence before the referee that properly permitted damages for the loss of profits to be calculated using the second damages scenario, and that the assumptions as to both the period and volume of production on which the damages scenario was based, had not been proved. In support of the damages award, the claimant pointed to evidence including general statements made by the third party regarding its estimated quantity requirements; the claimant's contemporaneous budgets forecasting profits equivalent to those under the damages scenario; opinions as to the growth of the claimant's business; the time and resources devoted by the third party to secure the supply agreement; and the claimant's actual or intended plant capacity.

Ward JA observed that 'it does not appear to be disputed that there was evidence on the balance of probabilities'[18] that an opportunity was lost, however 'it cannot be sufficient simply to establish loss of an opportunity to sell pet food to (among others) IAMS and then to put forward a range of projected prediction figures without establishing what prospect or likelihood there was of those prediction levels being achieved.'[19] In general, Ward JA considered that the problem with the claimant's evidence of the value of its loss was that it did not establish a commitment by the third party to any particular quantity, nor did it establish what the third party's actual requirements were at any stage; there was therefore no evidence from which findings

[18] *Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd) v BestCare Foods Ltd* [2013] NSWCA 90 (24 April 2013) [106].
[19] *Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd) v BestCare Foods Ltd* [2013] NSWCA 90 (24 April 2013) [108].

could be made as to the possibility of a particular level of trade being achieved.[20] In the result, Ward JA held that there was no evidence made available to the referee that was able reasonably to satisfy a decision-maker as to, or to support, an award of damages for loss of future profits referable to the selected damages scenario and therefore the adoption of the referee's finding to that effect was manifestly unreasonable.[21]

It follows from the above cases that the extent to which the claimant is required to adduce evidence of value will depend heavily on the nature of the alleged lost opportunity. For example, in cases like *Longden* and *Origin* where the claimant alleges the loss of an opportunity to profit from an existing or imminent contract or business, the claimant is likely to be required to adduce precise evidence of value. However, in a case like *Commonwealth v Amann Aviation Pty Ltd*,[22] where the claimant alleges the loss of a more remote opportunity of profit, the evidential threshold is likely to be lower.

Armory v Delamirie presumption

If proof of the value of a lost commercial opportunity has been made difficult or impossible by the conduct of the defendant, the court may apply the presumption in *Armory v Delamirie*,[23] and resolve any uncertainty against the defendant.[24] In

[20] *Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd) v BestCare Foods Ltd* [2013] NSWCA 90 (24 April 2013) [122]–[126], [138] –[139], [147], [156] –[158], [160], [173], [176], [182] –[183], [188], [193].
[21] *Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd) v BestCare Foods Ltd* [2013] NSWCA 90 (24 April 2013) [227].
[22] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64.
[23] *Armory v Delamirie* (1722) 1 Strange 505; 93 ER 664. See generally, *Murphy v Overton Investments Pty Ltd* (2004) 216 CLR 388, 416 [74] (Full Court); *LJP Investments Pty Ltd v Howard Chia Investments Pty Ltd* (1990) 24 NSWLR 499, 508 (Hodgson J); *Houghton v Immer (No 155) Pty Ltd* (1997) 44 NSWLR 46, 59D (Handley JA; Mason P and Beazley JA agreeing); *Chen v Karandonis* [2002] NSWCA 412 (18 December 2002), [59]–[63] (Beazley JA; Heydon and Hodgson JJA agreeing); *McCartney v Orica Investments Pty Ltd* [2011] NSWCA 337 (8 November 2011), [148]–[160] (Giles JA; Macfarlan JA agreeing), [198]–[219] (Young JA).
[24] *Radosavljevic v Radin* [2003] NSWCA 217 (13 August 2003), [54] (Mason P; Handley and McColl JJA agreeing); *Mount v Barker Austin (a firm)* [1998] PNLR 493; *Sharif v Garrett & Co (a firm)* [2002] 1 WLR 3118; *Browning v Brachers* [2005] EWCA Civ 753 (20 June 2005). See also *State of New South Wales v Burton* [2008] NSWCA 319 (27 November 2008), [107]–[110] (Basten JA; Allsop P and Handley AJA agreeing) (presumption applied in valuing loss of a chance of a better medical outcome).

Browning v Brachers,[25] Jonathan Parker LJ (with whom Mance LJ and the Vice Chancellor agreed) described this presumption as 'a general principle to the effect that, in a case where the defendant has wrongfully deprived the claimant of property of value (be it an item of physical property or a chose in action), the court will, save to the extent that it is persuaded otherwise by the defendant, assess the value of the missing property on a basis which is generous to the claimant.'[26] His Lordship observed that, in the context of a claim for loss of a commercial opportunity, the presumption 'is not directed at the legal burden of proof; rather it raises an evidential (ie, rebuttable) presumption in favour of the claimant which gives him the benefit of any relevant doubt. The practical effect of that is to give the claimant a fair wind in establishing the value of what he has lost.'[27]

Minimum obligation rule

If damages for loss of a commercial opportunity are sought in contract, the assessment of those damages may be affected by the operation of the 'minimum' or 'least onerous' obligation rule.[28] This rule provides that 'in an action for breach of contract, a defendant is not liable in damages for not doing that which he or she has not promised to do.'[29]

In a lost commercial opportunity context, the operation of the rule is illustrated by the decision of the English Court of Appeal in *Withers v General Theatre Corporation Ltd*.[30] The defendant engaged the claimant to perform a show, at the defendant's option, at the London Palladium, or at another theatre controlled by it. The defendant refused to allow the claimant to perform at the Palladium. The claimant sought damages for breach of contract, including damages for the loss of an opportunity to enhance his reputation by performing at that theatre. Liability was admitted and on the question of damages, the trial judge directed the jury to assess the claimant's

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[25] *Browning v Brachers* [2005] EWCA Civ 753 (20 June 2005).
[26] *Browning v Brachers* [2005] EWCA Civ 753 (20 June 2005), [205].
[27] *Browning v Brachers* [2005] EWCA Civ 753 (20 June 2005), [210].
[28] See generally, Harvey McGregor, *McGregor on Damages* (Sweet & Maxwell, 19th ed, 2014) [10–104]–[10–119]; Adam Kramer, *The Law of Contract Damages* (Hart Publishing, 2014) [13.3B].
[29] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 91 (Mason CJ and Dawson J); see also, 152 (Gaudron J).
[30] *Withers v General Theatre Corporation Ltd* [1933] 2 KB 536; overruled, on a different issue, *Malik v Bank of Credit and Commerce International SA* [1998] AC 20.

damages on the footing that the claimant was entitled to perform at the Palladium, without directing the attention of the jury to the defendant's option to require the claimant to perform at another hall. The jury awarded the claimant substantial damages.

Scrutton LJ allowed an appeal by the defendant from this direction, and ordered a retrial on the question of damages. His Lordship observed that where a defendant may perform a contract in one of several ways, damages must be assessed 'on the basis that the defendant will perform the contract in the way most beneficial to himself and not in the way that is most beneficial to the plaintiff.'[31] Scrutton LJ held that that the jury 'ought to have been told that the question was what would be the most beneficial performance of the contract to the defendants, and that the damages could not exceed a basis calculated upon that.'[32] Romer LJ delivered a separate judgment allowing the appeal on similar grounds.

In *North Sea Energy Holdings NV v Petroleum Authority of Thailand*,[33] the claimant and the defendant entered into a contract under which the claimant agreed to supply to the defendant a large quantity of Arabian Oil for 5 years. The defendant repudiated the contract and the claimant sought damages for loss of profit. The central issue in the damages case was whether the claimant would have been able to supply the oil in any event. The original supplier of the oil imposed destination restrictions on the oil. In order to secure the oil for supply to the defendant, the claimant therefore required the defendant to specify, in advance, the port of destination of the oil. Without those details, the original supplier would not have supplied the oil. The claimant argued that it was a term of the contract, on its proper construction or alternatively to be implied, that the defendant was obliged to specify the ports of destination before the first nomination. Alternatively, the claimant argued that there was a chance that even in the absence of a contractual obligation, the defendant would in fact have supplied the ports of destination and therefore damages could be assessed by reference to the loss of that chance.

[31] *Withers v General Theatre Corporation Ltd* [1933] 2 KB 536, 549.
[32] *Withers v General Theatre Corporation Ltd* [1933] 2 KB 536, 551.
[33] *North Sea Energy Holdings NV v Petroleum Authority of Thailand* [1999] 1 Lloyd's Rep 483.

Waller LJ (with whom Ward and Roch LJJ agreed) upheld the decision of the trial judge to award only nominal damages to the claimant. His Lordship held that the defendant was not under any contractual obligation to specify the ports of destination in advance. On the loss of chance case, Waller LJ held that the claimant was unable to prove, on the balance of probabilities, that it would have been able to supply the oil. This was because, on the facts, the defendant could not have supplied the port of destination information, and even if there was some chance it could have supplied the information, the court would not assume that a contract breaker would act contrary to its own commercial interests.[34]

The minimum obligation rule is frequently invoked by defendants in claims for the loss of an opportunity to renew a fixed-term contract. In *Amann*, the High Court considered whether the prospect of renewal of a fixed-term commercial contract, among other things, should be taken into account in determining the claimant's entitlement to damages for its reliance loss. Mason CJ and Dawson J rejected the defendant's argument that, because it was under no legal obligation to renew the contract, the prospect of renewal should be ignored. Their Honours observed that the minimum obligation rule is 'necessarily subject to the rule in *Hadley v Baxendale*'[35] and that, in the present case, the prospect of renewal was within the contemplation of the parties as a probable result of the defendant's breach and therefore the value of the loss of that prospect could be taken into account in determining the claimant's entitlement to reliance damages.[36]

However, *Amann* is not a true loss of commercial opportunity case. This is because, in that case, the fact of the claimant's loss depended solely on the past hypothetical conduct of the defendant in renewing the contract. In that situation, the claimant must prove (as a matter of causation) that, on the balance of probabilities, the defendant would have renewed the contract.[37] Subject to the minimum obligation rule, the claimant is then entitled to damages for its full loss.[38]

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[34] *North Sea Energy Holdings NV v Petroleum Authority of Thailand* [1999] 1 Lloyd's Rep 483, 496.
[35] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 91.
[36] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 92–4.
[37] See above, Part two, ch 4.
[38] See *New South Wales Cancer Council v Sarfaty* (1992) 28 NSWLR 68, 80–1 (Gleeson CJ and Handley JA); *Murray Irrigation Ltd v Balsdon* [2006] NSWCA 253 (19 September 2006), [46]–[58] (Bryson JA; Handley and Ipp JJA agreeing). Cf *Tasmania Development & Resources v Martin* (2000)

Value of loss

Market value

General position

In principle, the loss of a commercial opportunity should be valued by reference to its market value.[39] This follows from the analysis in chapters two and five. Those chapters demonstrated that a commercial opportunity is an asset, and, in a legal context, the value (or loss) in value of an asset is determined by reference to its market value.

Market value is a measure or representation of the forward-looking DCF of the relevant net cash flows associated with the asset being valued. In some cases, relevant market values are observable in market trades, and in others it is necessary to calculate theoretical market value, using the models accepted in finance theory.

Support for the market value approach can be found in the decision of the English Court of Appeal in *Chaplin v Hicks*.[40] Vaughan Williams LJ (with whom Fletcher Moulton and Farwell LJJ agreed) observed that the claimant's right to participate in the competition according to its terms was incapable of transfer and could not be sold in a market, however, 'a jury might well take the view that such a right, if it could have been transferred, would have been of such a value that every one would recognise that a good price could be obtained for it.'[41]

97 IR 66, 74–5 [35]–[38] (Kiefel J; Lee and Cooper JJ agreeing); *Guthrie v News Ltd* (2010) 27 VR 196, 210–14 [46]–[57] (Kaye J); *Ramsey v Annesley College* [2013] SASC 72 (17 May 2013), [388]–[403] (Blue J).

[39] Wex S Malone, 'Ruminations on Cause-In-Fact' (1956) 9 *Stanford Law Review* 60, 80; Elmer J Schaefer, 'Uncertainty and the Law of Damages' (1978) 19 *William and Mary Law Review* 719, 762–3; Stephen F Brennwald, 'Proving Causation in "Loss of a Chance" Cases: A Proportional Approach' (1985) 34 *Catholic University Law Review* 747, 768–72; Melvin Aron Eisenberg, 'Probability and Chance in Contract Law' (1998) 45 *Univeristy of California at Los Angeles Law Review* 1005, 1051; Jeremy L Pryor, 'Lost Profit or Lost Chance: Reconsidering the Measure of Recovery for Lost Profits in Breach of Contract Actions' [2007] 19 *Regent University Law Review* 561, 578–9.

[40] *Chaplin v Hicks* [1911] 2 KB 786.

[41] *Chaplin v Hicks* [1911] 2 KB 786, 793.

A potential qualification?

Theoretically, the market value approach applies to all types of lost opportunity. However, some cases indicate that this approach is not applicable to the valuation of claims for loss of a cause of action. Thus, in *Johnson v Perez*,[42] Brennan J observed, '[t]he value of the lost cause of action cannot be assessed as though there were a market for doubtful causes of action in damages for personal injury.'[43] More recently, in *Harrison v Bloom Camillin (a firm)*,[44] Neuberger J observed that the market value approach is not appropriate in the valuation of claims for the loss of a cause of action. His Honour reasoned:[45]

> First, there is no sort of market, and therefore no sensible comparable transactions, in causes of action, unlike in shares or interests in real property. Secondly, it is not, in general, legally permissible to sell a cause of action: although subject to exceptions, the rule against maintenance still stands. Thirdly, each case turns so much on its particular facts and applicable law that it is difficult to see how it would be helpful to value a particular cause of action by reference to a notional or actual market in any event. Fourthly, because the assessment of the prospects of a particular case involves assessing the view that a judge would take (or, perhaps, the course litigants would anticipate the court taking), the court would not normally be assisted by evidence, and would expect to make up is own mind in the light of the facts and argument presented to it. Fifthly, and perhaps slightly tentatively, the valuation of the loss of the opportunity to sue, given that it involves potential proceedings in court, may occasionally involve policy considerations which are absent in most other types of case where a claim is based on loss of opportunity.

Despite these reservations, properly understood, the market value approach is also capable of applying to claims for loss of a cause of action. As *Chaplin* demonstrates, the market value approach applies, despite the fact that no formal market for the outcome of the relevant opportunity exists, and despite the fact that the assessment of the value of that opportunity is purely subjective. In this context, in the absence of market pricing, each cause of action constitutes a 'micro-market.'[46] This market has three characteristics: first, each cause of action has a unique set of buyers and sellers; secondly, the asset for sale (the cause of action) is not fungible and therefore no

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[42] *Johnson v Perez* (1988) 166 CLR 351.
[43] *Johnson v Perez* (1988) 166 CLR 351, 372.
[44] *Harrison v Bloom Camillin (a firm)* [2000] Lloyd's Rep PN 89.
[45] *Harrison v Bloom Camillin (a firm)* [2000] Lloyd's Rep PN 89, 95.
[46] Robert J Rhee, 'The Effect of Risk on Legal Valuation' (2007) 78 *University of Colorado Law Review* 193, 227.

general market exists for the sale and purchase of that asset; thirdly, in the absence of settlement, a transaction can be forced on the participants by judgment.[47] These characteristics dictate that the price or value of a cause of action is set by reference to the alternative pricing mechanisms of litigation or settlement.[48]

The following sections of this chapter examine the valuation of the loss of a commercial opportunity using the market value approach. The first section explains the general approach taken in the case law to the valuation of such a loss. The second section applies that approach to construct a framework for determining the market value of the loss.

Valuation approach

Simple probability approach

Anglo-Australian law[49] has adopted what has been described as the 'simple probability',[50] 'probability theory',[51] 'percentage probability',[52] or 'proportional valuation'[53] approach to the valuation of loss of a commercial opportunity.[54]

Under this approach, the value of the loss of a commercial opportunity is determined by assessing the degree of probability of the opportunity, and then by assigning a monetary value to that probability.

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[47] Robert J Rhee 'A Price Theory of Legal Bargaining: An Inquiry into the Selection of Settlement and Litigation Under Uncertainty' (2006) 56 *Emory Law Journal* 619, 672–3.
[48] Rhee, 'The Effect of Risk', above n 46, 227–53; Rhee, 'A Price Theory of Legal Bargaining', above n 47, 666–90.
[49] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332; *Tabet v Gett* (2010) 240 CLR 537, 585 [137] (Kiefel J; Hayne, Crennan and Bell JJ agreeing). See also, *Davies v Taylor* [1974] AC 207.
[50] Note, 'The Labor-Management Relationship: Present Damages for Loss of Future Contracts' (1962) 71 *Yale Law Journal* 563, 571. See generally, Ken Cooper, 'Assessing Possibilities in Damage Awards – The Loss of a Chance or the Chance of a Loss' (1973) 37 *Saskatchewan Law Review* 193.
[51] Note, 'Damages Contingent Upon Chance' (1964) 18 *Rutgers Law Review* 875, 876.
[52] Joseph H King Jr, 'Causation, Valuation, and Chance in Personal Injury Torts Involving Preexisting Conditions and Future Consequences' (1981) 90 *Yale Law Journal* 1353, 1382.
[53] Todd S Aagaard, 'Identifying and Valuing the Injury in Lost Chance Cases' (1998) 96 *Michigan Law Review* 1335, 1349.
[54] For an analysis of different approaches to the valuation of loss of a chance in a medical negligence context, see, eg, ibid; David A Fischer, 'Tort Recovery for Loss of a Chance' (2001) 36 *Wake Forest Law Review* 605; Zaven T Saroyan, 'The Current Injustice of the Loss of Chance Doctrine: An Argument for a New Approach to Damages' (2002) 33 *Cumberland Law Review* 15; Alice Ferot, 'The Theory of Loss of Chance: Between Reticence and Acceptance' (2013) 8 *Florida International University Law Review* 591.

The simple probability approach was approved by the High Court in *Sellars v Adelaide Petroleum NL*.[55] Mason CJ, Dawson, Toohey and Gaudron JJ observed that, in assessing damages for personal injuries involving future or hypothetical events, 'the court assesses the degree of probability that an event would have occurred, or might occur, and adjusts its award of damages to reflect the degree of probability.'[56] Their Honours observed that the reasons for adopting that approach in a personal injury context 'apply with equal force to the assessment of damages for loss of a commercial opportunity.'[57] Mason CJ, Dawson, Toohey and Gaudron JJ concluded that the acceptance of this principle 'requires that damages for deprivation of a commercial opportunity, whether the deprivation occurred by reason of breach of contract, tort or contravention of s 52(1), should be ascertained by reference to the court's assessment of the prospects of success of that opportunity had it been pursued.'[58]

While the simple probability approach has been widely accepted by Australian courts, it does not require the application of a particular percentage discount to the claimant's damages.[59] Thus, in *Malec v J C Hutton Pty Ltd*,[60] Brennan and Dawson JJ observed that damages based on hypothetical events 'need not be assessed by first determining an award on the footing that the hypothetical situation would have occurred and then discounting the award by a selected percentage. Damages founded on hypothetical evaluations defy precise calculation.'[61]

In *Glenmont Investments Pty Ltd v O'Loughlin (No 2)*,[62] the claimant, the owner of a giant mechanical dinosaur that was destroyed by a fire started by one of the

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[55] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332.
[56] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 350, citing *Malec v J C Hutton Pty Ltd* (1990) 169 CLR 638, 643 (Deane, Gaudron and McHugh JJ).
[57] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 350.
[58] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332, 355.
[59] *Blakes (a firm) v Berrivale Orchards Ltd* [1996] ANZ ConvR 577; *Glenmont Investments Pty Ltd v O'Loughlin (No 2)* (2000) 79 SASR 185, 283 [442] (Full Court); *Rockdale City Council v Micro Developments Pty Ltd* (2008) Aust Torts Reports 81–954; *Jacfun Pty Limited v Sydney Harbour Foreshore Authority* [2012] NSWCA 218 (25 July 2012), [69] (Allsop P; Macfarlan and Barrett JJA agreeing).
[60] *Malec v J C Hutton Pty Ltd* (1990) 169 CLR 638.
[61] *Malec v J C Hutton Pty Ltd* (1990) 169 CLR 638, 640; *Wynn v NSW Insurance Ministerial Corporation* (1995) 184 CLR 485, 499 (Dawson, Toohey, Gaudron and Gummow JJ).
[62] *Glenmont Investments Pty Ltd v O'Loughlin (No 2)* (2000) 79 SASR 185.

defendants, sought damages for loss of an opportunity to exploit the dinosaur commercially. The Full Court of the South Australia Supreme Court upheld, but varied, an award of damages to the claimant for the loss of an opportunity to 'pursue the display of the dinosaur in America, the [proposed] film… possible sequels, the sale of video and television rights, and the opportunity to earn fees for appearances by the dinosaur.'[63] The trial judge assessed the quantum of this loss at $100 million, to which he applied a discount of 80% to allow for various adverse contingencies. However, the Full Court considered that the figure of $100 million was an 'unrealistic and erroneous starting point' and that the highest figure that the evidence could support was $50 million.[64] The Full Court observed that:[65]

> It is not appropriate simply to take a figure of $100 million as his Honour did, or even the figure of $50 million suggested by us, and then to apply a certain percentage to that figure. The process is necessarily subjective, but it requires appropriate allowance to be made for all the relevant factors.

The Full Court concluded that $50 million was a reasonable starting point and that, after allowing for the contingencies, $5 million was an adequate award of damages for the claimant's lost commercial opportunities.[66]

Single outcome or weighted average method?

In general, the simple probability approach can be applied in one of two ways: the 'single outcome' method;[67] or the 'expected value' or 'weighted average' method.[68]

The singe outcome approach requires the court to determine, from the competing figures before the court, the 'likely',[69] 'most probable',[70] or 'most likely'[71] outcome

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[63] *Glenmont Investments Pty Ltd v O'Loughlin (No 2)* (2000) 79 SASR 185, 280 [427].
[64] *Glenmont Investments Pty Ltd v O'Loughlin (No 2)* (2000) 79 SASR 185, 283 [440]–[441].
[65] *Glenmont Investments Pty Ltd v O'Loughlin (No 2)* (2000) 79 SASR 185, 283 [442].
[66] *Glenmont Investments Pty Ltd v O'Loughlin (No 2)* (2000) 79 SASR 185, 284 [443].
[67] King, above n 52, 1383.
[68] Ibid 1384 (citing Schaefer, above n 39, 722). See also, John Leubsdorf, 'Remedies for Uncertainty' (1981) 61 *Boston University Law Review* 132, 150–3; Rafael Stern and Joseph Kadane, 'Compensating for the loss of a chance' arXiv:1412.1501v1 [stat AP] 5 December 2014 <http://arxiv.org/abs/1412.1501>.
[69] *Johnson v Perez* (1988) 166 CLR 351, 366 (Wilson, Toohey and Gaudron JJ); *Harrison v Bloom Camillin* [2000] Lloyds Rep PN 89, 96 (Neuberger J).
[70] *Browning v Brachers* [2005] EWCA Civ 753 (20 June 2005), [212] (Jonathan Parker LJ; Mance LJ and the Vice Chancellor agreeing).

of the opportunity, and then assessing the probability of that outcome. On the other hand, the weighted average method involves the court identifying each potential outcome of the opportunity, assigning a weight (probability) to each outcome, and then averaging the results to arrive at a probability weighted average.

In *Seventh Earl of Malmesbury v Strutt & Parker (a partnership)*,[72] Jack J explained the difference between the two approaches in the context of a claim for loss of an opportunity to negotiate a turnover rent provision in a lease:[73]

> In the present situation there are then two questions. The first is whether the claimants have lost a significant chance of obtaining a rent with a turnover element, and, if yes, the second is the value to be put on the chance. The evaluation of the chance has itself two aspects: what terms including a turnover rent would most likely have been achieved, and the monetary value to be put on a lease with those terms in comparison with the existing 2002 and 2003 leases. The logic of these questions can be shown as follows. If there was no significant chance that terms could have been negotiated including provision for a turnover rent, the claimants fail. If there would have been a, say, 60 per cent chance, the claimants are entitled to 60 per cent of the value of the chance lost. If the figure for turnover split most likely to have been agreed in a negotiation in which the principle of a turnover rent was accepted was 20 per cent in favour of the claimants the hypothetical lease is to be valued on that basis. The claimants would have lost 60 per cent of the resulting figure, because they had a 60 per cent chance of obtaining it if Mr Ashworth had carried out his duty. There are other ways of looking at the problem, but they achieve the same result. Thus one could say, for example, that there was, on the basis that the principle of a turnover element was accepted by BIA, then a fifty per cent chance of achieving a turnover split of 10 per cent and a similar chance of achieving 30 per cent, so one would take 20 per cent. In my judgment, it is most helpful and realistic to decide what the most likely figure is rather than looking at the chances of a range of figures.

While each method is legitimate, courts appear to favour the single outcome method.[74] This is for two main reasons. Firstly, the single outcome method is

[71] *Commonwealth v Ryan* [2002] NSWCA 372 (21 November 2002), [73] (Hodgson JA); *Rakic v Johns Lyng Insurance Building Solutions (Victoria) Pty Ltd (Trustee)* [2016] FCA 430 (27 April 2016), [227] (Bromberg J); *Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 999 (11 May 2007), [149] (Jack J).
[72] *Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 999 (11 May 2007).
[73] *Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 999 (11 May 2007), [149].
[74] See, eg, *Fightvision Pty Ltd v Onisforou* (1999) 47 NSWLR 473, 505–6, 507 (Full Court); *Commonwealth v Ryan* [2002] NSWCA 372 (21 November 2002), [73] (Hodgson JA); *Rakic v Johns Lyng Insurance Building Solutions (Victoria) Pty Ltd (Trustee)* [2016] FCA 430 (27 April 2016), [227] (Bromberg J); *Browning v Brachers* [2005] EWCA Civ 753 (20 June 2005), [212] (Jonathan Parker LJ; Mance LJ and the Vice Chancellor agreeing); *Law Debenture Trust Corporation plc v Elektrim SA*

simpler to apply. Secondly, the weighted average method, while theoretically more statistically accurate, it is heavily dependent on reliable data. Each method is considered in further detail below.

Single outcome method

The single outcome approach is most commonly used in claims for loss of a cause of action. In *Browning v Brachers*,[75] the English Court of Appeal approved the single outcome approach in the context of a claim for the loss of the chance of pursuing a counterclaim. Jonathan Parker LJ (with whom Mance LJ and the Vice Chancellor agreed) recorded the trial judge's explanation of the approach:[76]

> Where the claimant's chances of success on liability at the notional trial are in dispute and what he might then have recovered by way of damages at the notional trial is also in dispute, in my judgment the first dispute is to be resolved by determining the chances of success as a percentage. The second dispute is to be resolved by determining the figure representing damages, which it is most probable that the claimant would have recovered if he had succeeded on liability. By 'most probable' I mean the figure more probable than any other figure. That figure is then reduced by the percentage to reflect the risk of failure on liability. That provides the best estimate, which the court can make, of what the claimant has lost through his solicitor's negligence.

Jonathan Parker LJ observed that the trial judge's 'two-stage approach of inquiring as to the amount of damages which would "most probably" have been awarded at the notional trial, and then discounting the resulting sum to take account of the uncertainties on the issue of liability, is in my judgment an entirely legitimate approach, provided of course that in addressing each of the two stages due regard is had to the *Armory v Delamirie* presumption.'[77]

The single outcome approach has also been used to value other types of lost opportunity. In *Law Debenture Trust Corporation plc v Elektrim SA*,[78] the English

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[2010] EWCA Civ 1142 (22 October 2010) (Full Court); *Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 999 (11 May 2007), [149] (Jack J); *Harrison v Bloom Camillin* [2000] Lloyds Rep PN 89, 96 (Neuberger J).

[75] *Browning v Brachers* [2005] EWCA Civ 753 (20 June 2005).

[76] *Browning v Brachers* [2005] EWCA Civ 753 (20 June 2005), [122].

[77] *Browning v Brachers* [2005] EWCA Civ 753 (20 June 2005), [212].

[78] *Law Debenture Trust Corporation plc v Elektrim SA* [2010] EWCA Civ 1142 (22 October 2010).

Court of Appeal approved the use of the single outcome method to value the loss of an opportunity to receive payment of a contractually agreed sum money, the amount of which was to be fixed by reference to a third party valuation. The Court agreed with the trial judge's rejection of the weighted average approach, observing that such an approach 'is over-complicated and no more likely to achieve an accurate (or even predictable) result'[79] and that 'there are dangers of extending it to commercial cases, especially valuation cases where permutations may be almost infinite.'[80] The Court agreed with the trial judge that, in assessing the likely conclusion of the third party valuer, the court adopt the approach taken in valuing a lost cause of action,[81] which the trial judge had described as follows:[82]

> In this type of case, the court hearing the negligence claim usually makes a single broad assessment of the value of the opportunity which has been lost, assessing the legal merits for itself and allowing an appropriate discount to take account of contingencies which might have affected the claimants' prospects of winning at trial. The court does not usually try to assess a range of different possible judgments on the legal merits which might have been given by the notional trial court, and then produce a table of probabilities in respect of the possibilities in that range and aggregate the resulting values. Rather, the court draws on its own legal knowledge and expertise to produce the best assessment it can of the legal merits, with a discount primarily to take account of contingencies and uncertainties in relation to the evidence which might have been called in the case.

Weighted average approach

Despite its apparent unattractiveness, the weighted average approach may be useful in certain contexts. In *Elektrim*, the Full Court observed that the weighted average approach may be appropriate in three circumstances:[83] first, in a claim for loss of the chance of future earnings as a result of personal injury, especially by a young person at the beginning of his or her career; secondly, in a claim for loss of an opportunity where the ultimate outcome depends on further negotiations; and thirdly, in a claim

[79] *Law Debenture Trust Corporation plc v Elektrim SA* [2010] EWCA Civ 1142 (22 October 2010), [47].
[80] *Law Debenture Trust Corporation plc v Elektrim SA* [2010] EWCA Civ 1142 (22 October 2010), [48].
[81] *Law Debenture Trust Corporation plc v Elektrim SA* [2010] EWCA Civ 1142 (22 October 2010), [48].
[82] *Law Debenture Trust Corporation plc v Elektrim SA* [2010] EWCA Civ 1142 (22 October 2010), [44].
[83] *Law Debenture Trust Corporation plc v Elektrim SA* [2010] EWCA Civ 1142 (22 October 2010), [48].

for loss of an opportunity if the outcome depends on decisions to be reached by a number of other bodies on what might not be a strictly legal basis.

The weighted average approach has been considered in two decisions of the New South Wales Court of Appeal. In *Norris v Blake (No 2)*,[84] the claimant was a young film actor, who had been catastrophically injured in a car accident caused by the defendant's negligence. The trial judge awarded the claimant substantial damages for past and future loss of earning capacity. This award was based on the 'weighted average' method of assessment. Under this method, the trial judge assigned a probability to the claimant's four possible career paths (ranging from an Australian career to international superstardom) and then multiplied the probabilities by what the claimant would have earned had he followed each of those paths.

Clarke JA (with whom Handley and Sheller JJA agreed) rejected the trial judge's use of the weighted average method of assessment. His Honour observed:[85]

> There is nothing in any of the judgments of the High Court (except perhaps the reference to percentages in the majority judgment in *Malec*) which supports the adoption of a scientific, or quasi-scientific, approach to the assessment of damages in a case in which there is a requirement that account be taken of future possibilities and past hypothetical situations. That is not to say that where a scientific method is available it should not be adopted. Indeed, in my opinion if there is evidence in a case capable of demonstrating that a particular scientific approach is likely to lead to a more accurate assessment than an intuitive judicial approach then, provided full weight is given to the uncertain nature of the future, there is no reason for failing to adopt that method.

Turning to the weighted average method, Clarke JA observed that '[i]t may be that it is possible to apply a mathematical theory of probabilities, or a doctrine of averaging, in a case in which the chances are limited and there is sufficient data on which to reach a conclusion as to the particular degree of chance',[86] however 'it suffers from a lack of available information where the possibilities are indeterminate and there is no rational basis for restricting the alternative possibilities to the small number necessary for carrying out a weighted average exercise.'[87]

[84] *Norris v Blake (No 2)* (1997) 41 NSWLR 49.
[85] *Norris v Blake (No 2)* (1997) 41 NSWLR 49, 68–9.
[86] *Norris v Blake (No 2)* (1997) 41 NSWLR 49, 70.
[87] *Norris v Blake (No 2)* (1997) 41 NSWLR 49, 72.

On this basis, His Honour held that the trial judge's use of the weighted average method in the present case was 'fundamentally erroneous.'[88] In Clarke JA's view, the proper approach, involving a more intuitive process, was 'to assess what it was most likely he would earn during the rest of his working life and adjust this for contingencies, including the possibility that he might have done far better.'[89]

In *Fightvision Pty Ltd v Onisforou*,[90] the Full Court of the New South Wales Court of Appeal applied *Norris* in the context of a claim for damages for loss of a commercial opportunity. The claimant and the defendant entered into a contract under which the claimant agreed to promote the boxing career of the defendant. The term of the contract was for three years, with an option exercisable by the claimant to extend the term for a further period of two years. The claimant purported to exercise the option and the defendant repudiated the contract effected by the exercise of the option. The claimant sued the defendant claiming damages for the loss of the opportunity to make profits from the promotion or co-promotion of fights in which the defendant would have participated during the two-year extension of the contract. The trial judge assessed damages on a global basis, assuming a reduced number of fights and earnings than that suggested by the claimant.

The Full Court dismissed an appeal by the defendant on the ground that, in assessing damages, the trial judge should have assessed each hypothetical fight separately, striking a degree of possibility or probability of the first bout occurring and bringing earnings as claimed, and then adopting the same approach for each successive hypothetical fight.

The Full Court referred with approval to *Norris*, observing that, in cases of this kind, it was not essential 'to express a percentage possibility or probability of the occurrence of the events necessary for the claimed lost profits, here the number of fights and the amounts of earnings.'[91] The Full Court also observed:[92]

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[88] *Norris v Blake (No 2)* (1997) 41 NSWLR 49, 73.
[89] *Norris v Blake (No 2)* (1997) 41 NSWLR 49, 73.
[90] *Fightvision Pty Ltd v Onisforou* (1999) 47 NSWLR 473.
[91] *Fightvision Pty Ltd v Onisforou* (1999) 47 NSWLR 473, 505.
[92] *Fightvision Pty Ltd v Onisforou* (1999) 47 NSWLR 473, 505–6.

> [T]he customary course of taking a hypothetical exercise of an uninjured earning capacity until retirement, then making an allowance for vicissitudes, is a way of arriving at the degree of probability of the future hypothetical event of the exercise of that earning capacity … It can make no difference in principle if a past hypothetical event is in question rather than a future hypothetical event, or if damages for loss of profits rather than for lost earning capacity is in question.

Turning to the defendant's submission regarding the proper approach to the assessment of damages, the Full Court stated:[93]

> We consider that this approach suffers from a similar difficulty to the weighted average exercise in *Norris v Blake (No 2)*. There are too may uncertainties in the prediction of fights and earnings, so that attempted calculation in this way is unrealistic. We consider that it was open to his Honour to take a global approach, finding as his measure a reduced programme of fights and a reduced level of earnings, by what Clarke JA in *Norris v Blake (No 2)* described as the traditional exercise in judgment, undoubtedly involving a measure of guesswork.

Valuation of loss

Introduction

Determining the market value of the loss of a commercial opportunity using the simple probability approach involves two steps.[94] First, the market value of the object of the opportunity is determined. Secondly, the probability of the opportunity is assessed and the market value of the object is then adjusted to reflect that probability. This second step is a kind of *ex post* adjustment that captures the uncertainty about whether the lost opportunity would have amounted to anything materially. This adjustment is a legal step that overlays the underlying DCF or financial calculation.

If the claimant receives a benefit as a result of the defendant's wrong, an intermediate step is also involved: the claimant must first account to the defendant for the value of that benefit before the market value of the object is adjusted. This requires the court to subtract the value of the benefit from the market value of the object of the

[93] *Fightvision Pty Ltd v Onisforou* (1999) 47 NSWLR 473, 507 (citations omitted).
[94] See, eg, *Glenmont Investments Pty Ltd v O'Loughlin (No 2)* (2000) 79 SASR 185, 281 [429] (Full Court).

opportunity, and then to adjust the resulting sum to reflect the probability of the opportunity.

Adelaide Petroleum NL v Poseidon Ltd,[95] is an example of the application of this three step approach. French J assessed the claimant's damages as the benefit represented by the Pagini agreement, which the claimant would have entered into but for the defendant's wrong, less the benefit obtained by the claimant from the Pagini agreement concluded in fact. His Honour then applied a discount to the net amount to reflect the contingencies affecting its realisation.[96] This approach was not challenged before the Full Federal Court[97] or the High Court.[98]

Each of these three steps is analysed below.

Value of the object of the opportunity

Introduction

The market value of the object of a commercial opportunity can be estimated using either a formal or an informal valuation methodology. In any particular case, the appropriate methodology will depend on the precise nature and evidence of the claimant's loss. The two primary formal valuation methodologies are explicit DCF analysis, and the comparable market price methodology.[99] The informal valuation methodology involves an intuitive or 'broad brush' approach.

Theoretically, the loss of a commercial opportunity should be valued using DCF analysis. This follows from the analysis in chapters two and five. The loss of a commercial opportunity represents the loss of a chance of an anticipated future cash flow, and DCF analysis is the best method for valuing future cash flow. Under that method, the market value of an asset is the present value of the anticipated future cash

[95] *Adelaide Petroleum NL v Poseidon Ltd* (1990) 98 ALR 431.
[96] See *Adelaide Petroleum NL v Poseidon Ltd* (1990) 98 ALR 431, 528–32.
[97] *Poseidon Ltd v Adelaide Petroleum NL* (1991) 105 ALR 25.
[98] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332.
[99] Malone, above n 39; Schaefer, above n 39, 763; Eisenberg, above n 39, 1051–2, 1062–4; Pryor, above n 39, 577–8.

flow of the asset. Theoretically, DCF analysis produces a reasonable estimate of, or proxy for, the market or exchange price of the asset.

Chapter two also demonstrated that DCF analysis is most useful in valuing assets with reliable or predictable future cash flow. This is because, in those circumstances, a reasonably accurate estimate of the timing and riskiness (and hence value) of those future cash flows can be made. However, if it is difficult or impossible to estimate the amount, timing and risk of the future cash flow of an asset, it may be necessary to use an alternative valuation methodology.

If a market for the object of the opportunity exists, the best alternative methodology is the comparable market price methodology. This methodology is most likely to appeal to a court because it involves observable (rather than forecast) data and is simple to understand and apply. Importantly, under this methodology the value of an asset is also based on future cash flow, and therefore it acts as a surrogate for DCF analysis.

The practical utility of DCF analysis, and the comparable market price methodology, depends on the availability of reasonably precise evidence of the value of the claimant's loss. Where such evidence is unavailable, an intuitive approach may be used to value the object of an opportunity.

The application of each of these methodologies is illustrated below.

DCF analysis

Theoretically, DCF analysis is the primary methodology for valuing the object of a commercial opportunity. DCF analysis is most commonly used to value the object of an opportunity that involves the use or exploitation of an income-producing asset.[100] However, DCF analysis is not confined to valuing income-producing assets, and may

[100] See, eg, *Hungry Jack's Pty Ltd v Burger King Corporation* [1999] NSWSC 1029 (5 November 1999) (franchise agreement); *P M Sulcs v Daihatsu Australia* [2001] NSWSC 636 (1 August 2001) (software licence and reference site agreements); *BestCare Foods Ltd v Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd)* [2013] NSWSC 1287 (10 September 2013) (supply agreement); *North East Solution Pty Ltd v Masters Home Improvement Australia Pty Ltd* [2016] VSC 1 (28 January 2016) (commercial lease); *James Carleton Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 2641 (10 December 2007) (car park leases).

extend to valuing other assets, including assets that involve highly subjective assessments such as legal claims.[101]

In *Hungry Jack's Pty Ltd v Burger King Corporation*,[102] the defendant had wrongfully terminated a franchise development agreement with the claimant. The claimant sought, among other things, damages from the defendant for loss of an opportunity to open restaurants and introduce third party franchisees. One area of dispute between the parties was the proper approach to value the loss of opportunity claims. The claimant argued that this loss should be calculated on a 'loss of profits' approach. The defendant contended that a 'cash flow' approach should be used.

Rolfe J gave judgment for the claimant on the loss of opportunity claims, but agreed with the defendant that it was preferable to value this loss using the cash flow approach.[103] His Honour reasoned that the cash flow approach was preferable because it recognised the claimant's hypothetical expenses and receipts at the actual times they would have occurred, rather than in accordance with the accounting standards, and therefore it more accurately reflected the position the claimant would have been in but for the breach:[104]

> [T]he cash flow basis is preferable to the loss of profits basis, when one is giving consideration to what might have occurred but for the breach, because it takes into account, in the view to which I have come, the reality of the situation with which HJPL would have been confronted; namely the necessity to expend money from which it would have derived benefits. As Mr Bryant pointed out, as a matter of reporting, the appropriate method may well be by having regard to the profit and loss situation. However, in seeking to put HJPL into the position in which it would have been but for the breach, in the particular circumstances of this case, it seems to me that that is achieved by looking at what HJPL would actually have done. That can be seen better, in my view, from the adoption of the cash flow

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[101] See, Rhee, 'A Price Theory of Legal Bargaining', above n 47; Rhee, 'The Effect of Risk', above n 46. Legal claims have also been characterised, and valued, as options: see, eg, Joseph A Grundfest and Peter H Huang, 'The Unexpected Value of Litigation: A Real Options Perspective' (2006) 58 *Stanford Law Review* 1267. For a brief history of various approaches to the valuation of legal claims in law and economics scholarship, see Maya Steinitz, 'How Much Is That Lawsuit in the Window? Pricing Legal Claims' (2013) 66(6) *Vanderbilt Law Review* 1889, 1903–17.

[102] *Hungry Jack's Pty Ltd v Burger King Corporation* [1999] NSWSC 1029 (5 November 1999).

[103] *Hungry Jack's Pty Ltd v Burger King Corporation* [1999] NSWSC 1029 (5 November 1999), [626], [633], [636]. The decision to adopt a cash flow approach was not challenged on appeal: see, *Burger King Corporation v Hungry Jack's Pty Ltd* [2001] NSWCA 187 (21 June 2001), [581] (Full Court). Challenges to the discount rate and the discount for contingencies were rejected: [699], [704], [720] (Full Court).

[104] *Hungry Jack's Pty Ltd v Burger King Corporation* [1999] NSWSC 1029 (5 November 1999), [626].

method, and, what is more, it seems to me to accord better with the fact that HJPL, as I am satisfied it would have done, was developing its business, each restaurant forming a part of that business but, not relevantly, being used as a separate entity for the purpose of the determination of the overall profit and loss of the business.

In *Seventh Earl of Malmesbury v Strutt & Parker (a partnership)*,[105] the claimants, the owners of land adjacent to an airport, entered into a series of leases with the owners of the airport under which the owners used the land for car parking. The defendants represented the claimants in the negotiation of the leases. The defendants were negligent in representing and advising the claimants in respect of two of the leases, primarily by failing to negotiate for and obtain a turnover rent provision. Jack J held that, by reason of this negligence, the claimants had lost the opportunity of securing leases giving them the right to 10% of the net car parking revenue from the land in question over the period of the leases.[106]

In relation to the proper measure of damages, the claimant and the defendant took different approaches. The claimant adopted what Jack J described as a 'loss of earnings' or 'personal injury' approach, under which the claimant's loss was assessed as the difference between the rent under the actual and hypothetical leases, with past rent calculated on actual figures carrying interest and the estimated future rent discounted to present value at the risk-free rate.[107] On the other hand, the defendant adopted what his Honour described as a 'valuation' approach, under which the claimant's loss was assessed, at the time of entry into the leases, as the difference between the market value of the land with the actual and hypothetical leases.[108] Jack J held that the proper measure was the valuation approach, assessed at the date of entry into the leases.[109]

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[105] *Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 999 (11 May 2007).
[106] *Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 999 (11 May 2007), [163].
[107] *Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 999 (11 May 2007), [167], [169].
[108] *Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 999 (11 May 2007), [168]–[169].
[109] *Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 999 (11 May 2007), [187], [192].

In the damages judgment, Jack J assessed the market value of the leases using DCF analysis.[110] His Honour observed that the market value of the leases was to be determined by reference to their hypothetical exchange price:[111]

> The value of an item is often expressed as the price it may be expected to fetch between a willing buyer and a willing seller. If there is a ready market for the item in question, such as is the case with quoted shares and many commodities including metals, the price, the value, can be found by looking at the market at the appropriate moment. It does not follow that if the item had been sold at that moment a bargain would have been struck at precisely that price. There is always an element of the hypothetical in a valuation. Here, it has to be imagined that the leases were put up for sale at the dates they were entered into and sold. The actuality is that the sales would themselves have taken some time to secure. But nonetheless the prices which might have been obtained are the relevant prices for the assessment of damages on this basis.

His Honour observed the agreement of the parties that, in the absence of comparable market prices, the leases would have been valued principally by reference to their rental income.[112] Jack J ultimately held that the market value of the leases was to be calculated based on the cash flow projections prepared by the claimant's expert, discounted for risk by 17% in respect of one lease, and 20% in respect of the second lease.[113]

Comparable market price

The comparable market price approach will be most useful where the object of the opportunity involves an identifiable item of property for which an established and liquid market exists at the time for assessment of damages. Thus, in *Harrison*, Neuberger J observed that in loss of opportunity claims involving the loss of shares or an interest in real property, the relevant chance could be assessed by reference to 'the market's assessment of that chance.'[114]

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[110] *James Carleton Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 2641 (10 December 2007), [37].
[111] *James Carleton Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 2641 (10 December 2007), [14].
[112] *James Carleton Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 2641 (10 December 2007), [17]–[18].
[113] *James Carleton Seventh Earl of Malmesbury v Strutt & Parker (a partnership)* [2007] EWHC 2641 (10 December 2007), [37].
[114] *Harrison v Bloom Camillin (a firm)* [2000] Lloyd's Rep PN 89, 94.

In *Hartle v Laceys (a firm),*[115] a third party made a subject to contract offer to purchase a parcel of land from the claimant for £400,000. As a result of the negligence of the claimant's solicitor, the offer was withdrawn and the claimant lost the benefit of the sale. The property was eventually sold for £150,000. Ward LJ (with whom Beldam and Schiemann LJJ agreed) held that the claimant had lost the opportunity to sell the land for £375,000 (or £360,000 net of expenses). His Lordship assessed at 60% the chance of selling the land at that price. Ward LJ explained that the Court's valuation of the land was based on 'the price which would have been agreed between a willing vendor … and a willing purchaser in the market conditions of the day.'[116]

In *G W Sinclair & Co Pty Ltd v Cocks*,[117] the claimants engaged the defendants to act as their sales agent for the purpose of selling a residential property. The defendants caused the claimants to enter into a contract of sale with a third party, contrary to the claimants' instructions and without advising the claimants that the contract was less favourable to the claimants than the contract drawn by the claimants' solicitor, in that it did not adequately protect the claimants against the third party failing to proceed with the sale. The third party failed to complete the contract and was unable to satisfy a judgment awarded against it in favour of the claimants. The claimants sought damages from the defendants, including damages for loss of an opportunity to sell the property to another buyer between the time the contract with the third party was signed, and the time it was rescinded by the claimants. Charles JA (with whom Brooking and Buchanan JJA agreed) upheld the trial judge's decision to award damages for loss of a 40% chance of selling the property for its market value during the relevant time. His Honour concluded that there was an abundance of evidence to support the trial judge's view as to market value.[118] This evidence included evidence given by a real estate agent, and by an expert valuer, each of whom would have based their opinion of market value on comparable sales data.

[115] *Hartle v Laceys (a firm)* [1999] 1 Lloyd's Rep PN 315.
[116] *Hartle v Laceys (a firm)* [1999] 1 Lloyd's Rep PN 315, 329.
[117] *G W Sinclair & Co Pty Ltd v Cocks* [2001] VSCA 47 (26 April 2001).
[118] *G W Sinclair & Co Pty Ltd v Cocks* [2001] VSCA 47 (26 April 2001), [33].

In some circumstances, a court will assess the value of the object of an opportunity by reference to a contract price,[119] or an accepted contemporaneous offer price.[120] This approach is akin to the comparable market price approach. In *Stovold v Barlows (a firm)*,[121] a third party made an offer to purchase the claimant's house for £505,000. The claimant accepted that offer, subject to contract. As a result of the negligence of the claimant's solicitor, the offer was withdrawn and the claimant lost the benefit of the sale. The property was eventually sold for substantially less than the offer price. The trial judge held that the defendants were negligent and that, but for that negligence, the claimant would have sold his house to the third party. On that basis, the trial judge awarded the claimant damages for the whole of his loss, being the difference between £505,000 (the offer price), and the eventual sale price of the house. Stuart-Smith LJ (with whom Otton and Pill LJJ agreed) allowed an appeal by the defendants on the ground that, where the claimant's loss depends on the hypothetical action of a third party, the court had to evaluate the loss of the chance that the sale would have gone ahead.[122] His Lordship assessed this chance at 50%, and reduced the claimant's damages accordingly.[123]

Intuitive approach

The intuitive approach involves a court assigning a value to the object of a commercial opportunity based on the evidence, and the court's judgment, knowledge and experience. The intuitive approach is often used when precise evidence of the value of that object is unavailable, or where the assessment of that value involves considerations that are highly subjective or policy driven.[124]

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[119] See, eg, *Blakes (a firm) v Berrivale Orchards Ltd* [1996] ANZ ConvR 577.
[120] See, eg, *Stovold v Barlows (a firm)* [1996] PNLR 91. Under Australian law, evidence of an unaccepted offer is not generally admissible as direct evidence of the market value of an asset: see *McDonald v Deputy Federal Commissioner of Land Tax (NSW)* (1915) 20 CLR 231; *Cordelia Holdings Pty Ltd v Newkey Investments Pty Ltd* [2004] FCAFC 48 (5 March 2004); *Auxil Pty Ltd v Terranova* (2009) 260 ALR 164. *Contra MMAL Rentals Pty Ltd v Bruning* (2004) 63 NSWLR 167. For a discussion of this issue in the context of the valuation of land, see Alan A Hyam, *The Law Affecting Valuation of Land in Australia* (Federation Press, 5th ed, 2014) 122–34.
[121] *Stovold v Barlows (a firm)* [1996] PNLR 91.
[122] *Stovold v Barlows (a firm)* [1996] PNLR 91, 98.
[123] *Stovold v Barlows (a firm)* [1996] PNLR 91, 104.
[124] *Johnson v Perez* (1988) 166 CLR 351, 367 (Wilson, Toohey and Gaudron JJ); *Nikolaou v Papasavas Phillips & Co* (1989) 166 CLR 394, 404 (Wilson, Dawson, Toohey and Gaudron JJ); *Fightvision Pty Ltd v Onisforou* (1999) 47 NSWLR 473.

The intuitive approach reflects the ultimate responsibility of the court for determining an award of damages, despite any difficulty or uncertainty in the assessment of loss. Thus, in *Commonwealth v Amann Aviation Pty Ltd*,[125] Mason CJ and Dawson J stated that '[t]he settled rule, both here and in England, is that mere difficulty in estimating damages does not relieve a court from the responsibility of estimating them as best it can.'[126]

The intuitive approach is most commonly used in claims for loss of an opportunity to bring or defend legal proceedings. This is because the valuation of the object of such an opportunity, a cause of action, involves the assessment of '[c]oncepts of probability, weight, unique risk, and general risk', which are 'highly subjective' and 'susceptible to multiple plausible interpretations.'[127]

In *Perez*, the High Court approved the intuitive approach to valuing the loss of an opportunity to prosecute legal proceedings. Wilson, Toohey and Gaudron JJ observed, *obiter*, that, in assessing damages for loss of an opportunity to prosecute legal proceedings, the court was required to assess the amount of damages likely to have been awarded by the court before whom the action would have come, and this process 'may well require a broad brush approach in determining when, in the absence of negligence, the action would have come to trial and the evidence bearing on the quantum of damages that would or should have been available for tender to the court.'[128] Similarly, in *Nikolaou v Papasavas Phillips & Co*,[129] Wilson, Dawson, Toohey and Gaudron JJ observed:[130]

> That loss would ordinarily be quantified by the trial judge taking a broad brush approach to the several matters that in a particular case may require to be resolved – the likely date when in the absence of the negligence of the solicitor the action would have come to trial, the evidence that would or should have been available to the plaintiff at that time, the relevant principles of law then governing the assessment

[125] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64.
[126] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 83 (citations omitted). See also, *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377, 411–12 (Dixon and Fullagar JJ; McTiernan J agreeing); *Fink v Fink* (1946) 74 CLR 127, 143 (Dixon and McTiernan JJ); *Howe v Teefy* (1927) 27 SR (NSW) 301, 306 (Street CJ; Gordon and Campbell JJ agreeing); *Chaplin v Hicks* [1911] 2 KB 786, 792 (Vaughan Williams LJ; Fletcher Moulton and Farwell LJJ agreeing).
[127] Rhee, 'A Price Theory of Legal Bargaining', above n 47, 690.
[128] *Johnson v Perez* (1988) 166 CLR 351, 366–7.
[129] *Nikolaou v Papasavas Phillips & Co* (1989) 166 CLR 394.
[130] *Nikolaou v Papasavas Phillips & Co* (1989) 166 CLR 394, 404.

of damages, the question of contributory negligence, and … the prospects of any judgment given in favour of the plaintiff being satisfied – in order to arrive at a figure representing the loss suffered by the plaintiff when his action against the defendant was dismissed.

Probability of the opportunity

The second step in valuing the loss of a commercial opportunity is to assess the probability of the successful realisation of the opportunity.

The most common way to assess this probability is to select a percentage figure that reflects the 'contingencies' or 'vicissitudes' affecting the successful realisation of the object of the opportunity. This percentage figure is then used to adjust the market value of the object of the opportunity. In most cases, the selected percentage will be used to discount (rather than compound) the market value of the object of the opportunity.

Nature of contingencies

In a damages context, a contingency is a possibility that may affect the claimant's hypothetical loss.[131] A discount for contingencies is designed to take account of matters that might otherwise adversely affect the loss.[132] However, it is clear that contingencies may increase as well as reduce the claimant's loss.[133] This is because, as noted by Windeyer J in *Bresatz v Przibilla*,[134] '[a]ll "contingencies" are not adverse: all "vicissitudes" are not harmful.'[135]

The fact that the object of an opportunity is subject to multiple adverse contingencies does not necessarily mean that the opportunity has little or no value. In *Hall v*

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[131] *Wynn v NSW Insurance Ministerial Corporation* (1995) 184 CLR 485, 497 (Dawson, Toohey, Gaudron and Gummow JJ).
[132] *Wynn v NSW Insurance Ministerial Corporation* (1995) 184 CLR 485, 497 (Dawson, Toohey, Gaudron and Gummow JJ).
[133] See *Wynn v NSW Insurance Ministerial Corporation* (1995) 184 CLR 485, 497 and the cases cited at fn 32 (Dawson, Toohey, Gaudron and Gummow JJ). See also, *Norris v Blake (No 2)* (1997) 41 NSWLR 49, 78 (Clarke JA; Handley and Sheller JJA agreeing).
[134] *Bresatz v Przibilla* (1962) 108 CLR 541.
[135] *Bresatz v Przibilla* (1962) 108 CLR 541, 544.

Meyrick,[136] Ashworth J said '[t]he more the contingencies, the lower the value of the chance or opportunity of which the plaintiff was deprived.'[137] However, the object of an opportunity subject to two adverse contingencies, each with a 10% probability, has a greater value than an object subject to a single adverse contingency with a 90% probability. It follows that Ashworth J's statement is true only to the extent that it 'imports that each *additional* contingency decreases the expectation.'[138]

In valuing the loss of a commercial opportunity a court will not inevitably apply a contingency discount.[139] In *Rosa v Galbally & O'Bryan (No 2)*,[140] Tate JA (with whom Harper JA and Kyrou AJA agreed) cautioned that the valuation of a commercial opportunity 'does not require an inevitable application of an arbitrary discount once the elements of the valuation have been identified.'[141] In his Honour's view, '[t]o require such a discount in every case could be to misstate the value of the chance lost', with the result that '[t]he compensation afforded may not serve to achieve the purpose of putting a plaintiff into the same position as if he or she had not sustained the injuries.'[142]

Assessment of contingencies

The assessment of contingencies requires the court to make a subjective, or personalistic, probability assessment based on the evidence before the court.[143] In *Glenmont Investments Pty Ltd v O'Loughlin (No 2)*,[144] the Full Court of the South Australia Supreme Court observed that the assessment of contingencies is 'necessarily subjective.'[145]

[136] *Hall v Meyrick* [1957] 2 QB 455, reversed on other grounds [1957] 2 QB 472.
[137] *Hall v Meyrick* [1957] 2 QB 455, 471.
[138] Note, above n 51, 883 (emphasis in original).
[139] See, eg, *Nicholas Prestige Homes v Neal* [2010] EWCA Civ 1552 (1 December 2010).
[140] *Rosa v Galbally & O'Bryan (No 2)* [2013] VSCA 154 (20 June 2013).
[141] *Rosa v Galbally & O'Bryan (No 2)* [2013] VSCA 154 (20 June 2013), [30].
[142] *Rosa v Galbally & O'Bryan (No 2)* [2013] VSCA 154 (20 June 2013), [30].
[143] Note, above n 51.
[144] *Glenmont Investments Pty Ltd v O'Loughlin (No 2)* (2000) 79 SASR 185.
[145] *Glenmont Investments Pty Ltd v O'Loughlin (No 2)* (2000) 79 SASR 185, 283 [442].

Various descriptions of this process of assessment have been given in the case law. The process has been described as 'fundamentally of a qualitative nature';[146] 'quintessentially evaluative';[147] a matter of 'common sense',[148] 'judgment',[149] or 'impression';[150] and analogous to 'decisions involving the exercise of a discretion.'[151] In *BestCare Foods Ltd v Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd)*,[152] Stevenson J summed up the task of assessing contingencies more fully as follows:[153]

> The task involves an exercise of judgment… and which, necessarily, cannot be scientific or mathematical in nature, nor susceptible to a detailed process of reasoning. To a large extent, I find the process to be one of impression. It is… 'an evaluative determination of a discretionary nature, not susceptible of complete exposition' which is 'inexact, non-scientific, not narrow or purely mathematical, and fact and circumstance specific.'

The nature of this process means that an appellate court must exercise restraint in reviewing a trial judge's assessment of the probability of the successful realisation of the commercial opportunity.[154]

Multiple contingencies

If the object of an opportunity is subject to multiple contingencies, a court may assess those contingencies on a global basis, or alternatively, by assessing each contingency separately.[155]

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[146] *Adelaide Petroleum NL v Poseidon Ltd* (1990) 98 ALR 431, 532 (French J).
[147] *Horne v Cranney* [2011] QCA 149 (24 June 2011), [9] (Full Court).
[148] *Poseidon Ltd v Adelaide Petroleum NL* (1991) 105 ALR 25, 42 (Burchett J; Sheppard J agreeing).
[149] *Poseidon Ltd v Adelaide Petroleum NL* (1991) 105 ALR 25, 42 (Burchett J; Sheppard J agreeing); *First Interstate Bank of California v Cohen Arnold (a firm)* [1996] PNLR 17, 25 (Nourse LJ).
[150] *Falkingham v Hoffmans (a firm)* (2014) 46 WAR 510, 532 [84] (Pullin and Murphy JJA); *First Interstate Bank of California v Cohen Arnold (a firm)* [1996] PNLR 17, 30 (Ward LJ).
[151] *Hammond Worthington v Da Silva* [2006] WASCA 180 (7 September 2006), [128] (Buss JA; McLure and Pullin JJA agreeing).
[152] *BestCare Foods Ltd v Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd)* [2013] NSWSC 1287 (10 September 2013).
[153] *BestCare Foods Ltd v Origin Energy LPG Ltd (formerly Boral Gas (NSW) Pty Ltd)* [2013] NSWSC 1287 (10 September 2013), [175].
[154] *Falkingham v Hoffmans (a firm)* (2014) 46 WAR 510, 524 [47] (Pullin and Murphy JJA).
[155] *Falkingham v Hoffmans (a firm)* (2014) 46 WAR 510, 570 [288] (Buss JA).

Global approach

In a loss of commercial opportunity context, the weight of authority favours a global approach to the assessment of contingencies.[156] In *Poseidon*, the Full Federal Court dismissed an appeal by the defendant from trial judge's decision to apply a global discount to account for several contingencies affecting the completion of the hypothetical Pagini agreement. The defendant argued that the trial judge should have assessed the contingencies by multiplying the probability of each contingency. Burchett J (with whom Sheppard J agreed) rejected this argument. His Honour considered that the trial judge 'was not bound to put immutable figures on each of the contingencies involved and then to make the suggested calculation' and that 'to do so would have a spurious air of precision, for none of the elements in such a calculation was capable of exact expression.'[157] In Burchett J's view, it was appropriate for the trial judge 'to approach the matter more generally, and upon the broad common sense basis upon which a jury might have proceeded', provided that 'full weight' was given to 'the true effect of the accumulation of a number of contingencies.'[158]

In *Nigam v Harm (No 2)*,[159] the Western Australia Court of Appeal considered the question whether a court should assess contingencies on an individual, or global, basis in the context of a claim for damages against a firm of solicitors for loss of an opportunity to prosecute legal proceedings against a medical practitioner. The trial judge held that the claimant was negligent, and awarded damages assessed at 40% of

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[156] See, eg, *Poseidon Ltd v Adelaide Petroleum NL* (1991) 105 ALR 25; *Feletti v Kontoulas* [2000] NSWCA 59 (23 March 2000), [45]–[46], [76] (Mason P; Sheller JA and Rolfe AJA agreeing); *Burger King Corporation v Hungry Jack's Pty Ltd* [2001] NSWCA 187 (21 June 2001); *Reading Entertainment Australia Pty Ltd v Whitehorse Property Group Pty Ltd* [2007] VSCA 309 (19 December 2007), [74]–[75] (Full Court); *Heenan v De Sisto* (2008) Aust Torts Reports 81–941, 61,423 [50] (Giles JA; Mason P and Mathews AJA agreeing); *Williams v Pagliuca* [2009] NSWCA 250 (19 August 2009), [38] (Hodgson JA; Ipp JA and Sackville AJA agreeing); *Nigam v Harm (No 2)* [2011] WASCA 221 (18 October 2011), [266] (Murphy JA); *Pritchard v DJZ Constructions Pty Ltd* [2012] NSWCA 196 (28 June 2012), [88] (Bathurst CJ), [570] (Whealy JA; Barrett JA agreeing); *Falkingham v Hoffmans (a firm)* (2014) 46 WAR 510, 524 [46] (Pullin and Murphy JJA), 573 [298] (Buss JA); *Kronenberg v Bridge* [2014] TASFC 10 (20 October 2014), [64] (Blow CJ; Porter and Pearce JJ agreeing); *Molinara v Perre Bros Lock 4 Pty Ltd* (2014) 121 SASR 61, 86 [98]–[99] (Nicholson J; Parker J agreeing); *Stovold v Barlows (a firm)* [1996] PNLR 91, 104 (Stuart-Smith LJ; Otton and Pill LJJ agreeing); *Hanif v Middleweeks (a firm)* [2000] Lloyd's Rep PN 920. Cf *Sharpe v Addison* [2003] EWCA Civ 1189 (23 July 2003), [50] (Chadwick LJ; Simon Brown LJ agreeing).

[157] *Poseidon Ltd v Adelaide Petroleum NL* (1991) 105 ALR 25, 41.

[158] *Poseidon Ltd v Adelaide Petroleum NL* (1991) 105 ALR 25, 41; see also, 50 (Lee J; Sheppard J also agreeing).

[159] *Nigam v Harm (No 2)* [2011] WASCA 221 (18 October 2011).

the value of the notional claim against the medical practitioner. Newnes JA (with whom McLure P agreed) allowed an appeal by the defendant on the ground that the trial judge had erred in finding that the defendant had breached its duty of care to the claimant. His Honour then considered, *obiter*, the defendant's appeal against the quantum of damages.

The defendant contended that the trial judge had erred in his assessment of the value of the claimant's lost opportunity by failing to separately address two contingencies affecting the claim against the medical practitioner: the uncertainty of the outcome on breach, and the uncertainty of the outcome on causation. The defendant argued that English authority supported this 'two-step' approach,[160] and that while the trial judge was not required to expressly treat each step separately, if the two steps had been taken it was evident that the relevant chance would have been much lower than 40% (ie, the proper contingency discount would have been much greater than 60%).

Newnes JA rejected this argument. In his Honour's view 'it is not significant whether the assessment is approached by taking each element to be proved in turn or by an overall assessment … so long as proper allowance is made for the separate considerations that must be taken into account in assessing the prospects of success.'[161] Murphy JA, who dissented in the result, agreed with the majority on this point. His Honour also considered that Australian and English authority[162] 'do not support the two-stage discount approach contended for by the appellant.'[163] In Murphy JA's view, the global approach was the appropriate approach, at least in the context of a claim for damages for loss of an opportunity to prosecute or defend legal proceedings:[164]

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[160] Citing *Harrison v Bloom Camillin (a firm)* (No 2) [2000] Lloyd's Rep PN 404; *Sharpe v Addison* [2003] EWCA Civ 1189 (23 July 2003).
[161] *Nigam v Harm (No 2)* [2011] WASCA 221 (18 October 2011), [155].
[162] Citing *Johnson v Perez* (1988) 166 CLR 351, 391 (Dawson J); *Nikolaou v Papasavas Phillips & Co* (1989) 166 CLR 394, 400 (Mason CJ); *Gregg v Scott* [2005] 2 AC 176, 232 [218] (Baroness Hale); *Malec v JC Hutton Pty Ltd* (1990) 169 CLR 638, 640 (Brennan and Dawson JJ); *Hammond Worthington v Da Silva* [2006] WASCA 180 (7 September 2006); *Sloane v McDonald & Sutherland* (Unreported, Western Australia Court of Appeal (Full Court), Library No 970608A, 14 November 1997).
[163] *Nigam v Harm (No 2)* [2011] WASCA 221 (18 October 2011), [266].
[164] *Nigam v Harm (No 2)* [2011] WASCA 221 (18 October 2011), [266].

> The trial judge must make an assessment as to the prospects of success of the claim which was lost by reason of the lawyers' negligence. In doing so, the trial judge should take into account any uncertainties, evidentiary difficulties or problems establishing particular elements of the cause of action. The discount applied by the judge is to account for these contingencies as a whole. The trial judge is not required to isolate each contingency and apply a separate discount. The discount is global and evaluative in nature rather than mathematical.

If a court assesses contingencies globally, it must still articulate reasons, based on the evidence, for selecting the contingency discount chosen. This is particularly important where the discount chosen is very precise. In *Rosa v Galbally & O'Bryan*,[165] Tate JA (with whom Harper JA and Kyrou AJA agreed) allowed an appeal from the decision of the trial judge to apply a discount of 17.5% to an award of damages made in favour of a claimant against her former solicitor for loss of an opportunity to commence legal proceedings against the claimant's employer. The trial judge held that there was a substantial likelihood that the claimant would establish her claim in negligence against her employer, and that that any attempt to establish a case of contributory negligence had a low likelihood of succeeding. However, despite these findings, the trial judge adopted a discount of 17.5% to reflect the combined risk that that these matters would be decided against the claimant.

Tate JA observed that the trial judge adopted a discount embodying 'an appearance of precision', which 'conveyed an impression of numerical exactitude down to a fraction of a per cent.'[166] His Honour considered that such a precise approach required 'adequate justification'[167] and, in the absence of the identification of particular difficulties with the claimant's hypothetical claim, the discount was without basis and appeared arbitrary. Tate JA concluded '[t]he discount of 17.5 per cent was not properly accounted for in the judge's reasons and to that extent his reasons were inadequate. More importantly, there was nothing in the evidence, or in the elements of the cause of action, or other manifest difficulties, to support the finding that the prospects of success of establishing liability should be reduced by 17.5 per cent.'[168]

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[165] *Rosa v Galbally & O'Bryan* [2013] VSCA 116 (17 May 2013).
[166] *Rosa v Galbally & O'Bryan* [2013] VSCA 116 (17 May 2013), [102].
[167] *Rosa v Galbally & O'Bryan* [2013] VSCA 116 (17 May 2013), [102].
[168] *Rosa v Galbally & O'Bryan* [2013] VSCA 116 (17 May 2013), [106].

Separate approach

If, on the other hand, a court assesses contingencies separately, it may be necessary to apply the mathematical rules of probability.[169]

If the object of the opportunity is subject to two or more independent contingencies, the probability of each contingency must be multiplied.[170] This follows from the multiplication rule. The multiplication rule provides that 'the probability that both of two events occur is the probability of the first, multiplied by the probability of the second, conditional on the first happening.'[171] This rule applies where the two events are independent, that is, the occurrence of the first event does not affect the assessment of the chance of the second.[172]

Recently, the Privy Council applied the multiplication rule in *Phillips & Co v Whatley*.[173] The claimant was injured at work, giving rise to a potential claim against his employer. This claim became statute barred, and was therefore lost, due to the negligence of the claimant's solicitor. The claimant sought damages from the defendant. The claimant's employer was then wound up, and its insurer did not accept liability for the claim. Lord Mance (delivering the unanimous advice of the Board) held that the claimant's prospects of success against his employer were

[169] See Hugh Evans, 'Lies, damn lies, and the loss of a chance' (2006) 22(2) *Professional Negligence* 99; Jill Poole, 'Loss of chance and the evaluation of hypotheticals in contractual claims' [2007] *Lloyd's Maritime and Commercial Law Quarterly* 63, 77–9.

[170] See, eg, *Ministry of Defence v Wheeler* [1998] 1 WLR 637, 650 (Swinton Thomas LJ; Mantell and Hirst LJJ agreeing); *Pearson v Sanders Witherspoon (a firm)* [2000] Lloyd's Rep PN 151, 166 (Ward LJ; Chadwick and Peter Gibson LJJ agreeing); *Talisman Property Co (UK) Ltd v Norton Rose (a firm)* [2006] EWCA Civ 1104 (28 July 2006), [58] (Moses LJ; Carnwath LJ and the Chancellor agreeing); *Sharpe v Addison* [2003] EWCA Civ 1189 (23 July 2003), [34]–[35] (Rix LJ), [50] (Chadwick LJ; Simon Brown LJJ agreeing); *Phillips & Co v Whatley* [2008] Lloyd's Rep IR 111, 121 [47] (Lord Mance). The multiplication rule has also been recognised in Australia: see, eg, *Malec v JC Hutton Pty Ltd* (1990) 169 CLR 638, 645 (Deane, Gaudron and McHugh JJ); *Bak v Glenleigh Homes Pty Limited* [2006] NSWCA 10 (15 February 2006), [76] (Hodgson JA; McColl JA agreeing); *Reading Entertainment Australia Pty Ltd v Whitehorse Property Group Pty Ltd* [2007] VSCA 309 (19 December 2007), [76] (Full Court); *Heenan v De Sisto* (2008) Aust Torts Reports 81–941, 61,423 [50] (Giles JA; Mason P and Mathews AJA agreeing); *Pritchard v DJZ Constructions Pty Ltd* [2012] NSWCA 196 (28 June 2012), [570] (Whealy JA; Barrett JA agreeing). See also, King, above n 52, 1387–90; Justice D H Hodgson, 'The Scales of Justice: Probability and Proof in Legal Fact-finding' (1995) 69 *Australian Law Journal* 731, 746–8; David Hamer, 'Chance Would Be a Fine Thing: Proof of Causation and Quantum in an Unpredictable World' (1999) 23(3) *Melbourne University Law Review* 557, 585, 595.

[171] John Haigh, *Probability: A Very Short Introduction* (Oxford University Press, 2012), 20.

[172] Ibid.

[173] *Phillips & Co v Whatley* [2008] Lloyd's Rep IR 111.

70%,[174] and his prospects of recovery from the insurer were 40%,[175] with the result that the claimant's overall prospects of success were 28% (ie, 70% × 40%).[176]

If, on the other hand, the object of the opportunity is subject to a contingency that is dependent, wholly or partly, on another contingency, it may be necessary for the court to assess the contingencies on a global basis because of the difficulties in applying the multiplication rule to dependent contingencies.[177]

In *Hanif v Middleweeks (a firm)*,[178] the claimant and his partner were the owners of a property that was destroyed by fire. There was evidence that suggested that the claimant had started the fire deliberately. The insurer sought a declaration that the claimant was not entitled to an indemnity because of breach of a condition precedent to liability, material non-disclosure and fraud. The claimant counterclaimed for an indemnity, but this counterclaim was struck out for want of prosecution because of the negligence of the claimant's solicitors, the defendants. The claimant sought damages from the defendant's for loss of the opportunity to pursue the counterclaim. The trial judge held that the claimant would have had an 80% chance of success on the condition precedent issue, a 60% chance of success on the non-disclosure issue, and a 25% chance of success on the fraud issue. The trial judge considered that the first two issues could be ignored because the chance of success on those issues did not affect the chance of success on the third issue, and on that basis the value of the claimant's lost opportunity was assessed at 25% of the value of the insurance claim.

Mance LJ (with whom Roch LJ agreed) allowed an appeal by the defendants on the quantum of the claimant's loss. His Lordship held that the trial judge was wrong to assess the lost opportunity at 25% because that did not allow for the chance that the claimant may have failed on the first two issues.[179] Mance LJ observed that each of the three issues involved the credibility of the claimant, and that success on the major

[174] *Phillips & Co v Whatley* [2008] Lloyd's Rep IR 111, 115 [17].
[175] *Phillips & Co v Whatley* [2008] Lloyd's Rep IR 111, 121 [46].
[176] *Phillips & Co v Whatley* [2008] Lloyd's Rep IR 111, 121 [47].
[177] *Reading Entertainment Australia Pty Ltd v Whitehorse Property Group Pty Ltd* [2007] VSCA 309 (19 December 2007), [75] (Full Court); *Hanif v Middleweeks (a firm)* [2000] Lloyd's Rep PN 920, 925–6 [43]–[44] (Mance LJ), 928 [72]–[74] (Roch LJ). See generally, Hodgson, above n 170.
[178] *Hanif v Middleweeks (a firm)* [2000] Lloyd's Rep PN 920.
[179] *Hanif v Middleweeks (a firm)* [2000] Lloyd's Rep PN 920, 925 [43].

issue, the third issue, could improve the chance of success on the other two issues.[180] In those circumstances, his Lordship held that it was inappropriate to apply the multiplication rule, and that the value of the lost opportunity should be assessed on an 'overall basis' at 20%.[181]

Double counting

In assessing contingencies, a court must be careful not to double count a risk relating to the relevant loss of opportunity. The danger of double counting may arise, for example, where there is a high degree of overlap between the contingencies affecting the claimant's loss. In *Sharpe v Addison*,[182] the claimant lost the opportunity to continue legal proceedings against a third party because of the defendant's negligence. This loss was subject to two contingencies: the claimant's chance of success on liability; and secondly, the chance of a finding that the claimant was responsible for his own loss.

Chadwick LJ (with whom Simon Brown LJ agreed) observed that any discount for liability must take account of the discount for contributory negligence because '[i]n a case such as the present, where both liability and contributory negligence would have turned on the single question of causation, the discount for the one is closely linked to the discount for the other. The greater the discount for contributory negligence, the greater the chance that the claimant would have recovered that discounted amount.'[183] Similarly, Rix LJ observed that there was a high degree of overlap between the two contingencies because both issues are concerned with responsibility and causation, and therefore '[i]t is obvious that if one simply multiplied the discounts for contributory negligence and for the establishment of liability together, there would be grave danger of counting the same considerations twice over.'[184]

The danger of double counting can also arise in cases where the method of computing the value of the object of the opportunity incorporates an adjustment for

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[180] *Hanif v Middleweeks (a firm)* [2000] Lloyd's Rep PN 920, 925 [37]–[41].
[181] *Hanif v Middleweeks (a firm)* [2000] Lloyd's Rep PN 920, 925–6 [43]–[44].
[182] *Sharpe v Addison* [2003] EWCA Civ 1189 (23 July 2003).
[183] *Sharpe v Addison* [2003] EWCA Civ 1189 (23 July 2003), [50].
[184] *Sharpe v Addison* [2003] EWCA Civ 1189 (23 July 2003), [33].

contingencies. This danger may arise, for example, where the value of the object of the opportunity is computed using a risk-adjusted discount rate model.[185] In this model, the risk of a contingency may be reflected in the discount rate, and therefore the court should only make a contingency discount where the subject matter of the relevant contingency (ie, the relevant risk) has not already been factored into the discount rate. This requires the court to acquire an intimate understanding of the expert valuation evidence, and in particular, the assumptions on which that evidence is based, in order to isolate those risks for which a contingency discount will be applied.

Burger King provides an illustration of the danger of double counting in this context. The claimant and the defendant were parties to a franchise development agreement which the defendant wrongfully terminated. The claimant sought, among other things, damages from the defendant for loss of an opportunity to open new restaurants and introduce new third party franchisees.

At trial, Rolfe J accepted that, but for the defendant's wrong, the claimant would have opened approximately 17 new restaurants, and introduced 77 new franchisees during the relevant time period. His Honour applied a present value discount rate of 9% (comprising a 5.5% risk-free rate, and a 3.5% risk premium), and a contingency discount of 55%, in relation to the hypothetical loss of cash flow associated with the new restaurants; and a 9% present value, and a 40% contingency, discount in relation to the hypothetical loss of cash flow associated with the new franchisees. Rolfe J explained that the contingency discount in relation to the new restaurants took into account the possibility that the forecast of 17 new restaurants 'may prove unduly optimistic.'[186]

The Full Court of the New South Wales Court of Appeal dismissed an appeal by the defendant against Rolfe J's decision on the number of hypothetical new restaurants and new franchisees, and against his decision on the appropriate contingency discounts to apply. In relation to the assessment of the contingency discounts, the

[185] See *North East Solution Pty Ltd v Masters Home Improvement Australia Pty Ltd* [2016] VSC 1 (28 January 2016), [343] (Croft J).
[186] *Hungry Jack's Pty Ltd v Burger King Corporation* [1999] NSWSC 1029 (5 November 1999), [635].

Court observed that 'the discount for vicissitudes may include an allowance for the validity of the hypothesis',[187] and therefore '[i]t was appropriate to calculate the discount in a way which had regard to the possibility that HJPL would not have opened 17 new restaurants in each of the years in question or introduced 77 new franchisees during those years. The base chosen was the best estimate … The degree of the decision-maker's confidence in that best estimate will be reflected in the discount for contingencies.'[188]

In principle, these statements are unobjectionable. The problem with this reasoning in the instant case, however, was that Rolfe J also applied a risk-adjusted present value discount of 9% to the claimant's damages. In theory, the risk-premium component of this discount (ie, 3.5%) is designed to reflect the risk of the cash flows associated with the hypothetical new restaurants and franchisees. Accordingly, to this extent, a discount for the validity of the hypothesis was double counted: once in the present value discount, and then a second time in the contingency discount.

In order to avoid double counting, it may be preferable for the Court to apply a risk-free discount rate to determine the value of the object of the opportunity, and then to apply a contingency discount separately.[189]

Accounting for benefits received

In a loss of opportunity claim, if the claimant receives a benefit as a result of the defendant's wrong (say, for example, from an alternative investment), the claimant must account to the defendant for that benefit.

This principle is not controversial. What is controversial, however, is the timing of such an account: should it occur *before* or *after* any contingency adjustment is applied? In the former case, the court first subtracts the value of the benefit from the market value of the object of the opportunity, and then adjusts the resulting sum to

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[187] *Burger King Corporation v Hungry Jack's Pty Ltd* [2001] NSWCA 187 (21 June 2001), [594] (citing *Fightvision Pty Ltd v Onisforou* (1999) 47 NSWLR 473, 505–6 (Full Court)).
[188] *Burger King Corporation v Hungry Jack's Pty Ltd* [2001] NSWCA 187 (21 June 2001), [596].
[189] *North East Solution Pty Ltd v Masters Home Improvement Australia Pty Ltd* [2016] VSC 1 (28 January 2016), [343]–[344] (Croft J).

reflect the probability of the opportunity. In other words, the adjustment (eg, discount) is applied to the difference between the market value of the object of the opportunity, and the value of the benefit received by the claimant as a result of the defendant's wrong. In the latter case, the court applies the adjustment (eg discount) to the market value of the object of the opportunity, and then subtracts the value of the benefit received by the claimant.

In some early cases, the former approach was applied intuitively, and without explanation. For example, in *Adelaide Petroleum*, French J applied a contingency discount to the difference between the benefit represented by the Pagini agreement, which the claimant would have entered into but for the defendant's wrong, and the benefit obtained by the claimant from the Pagini agreement concluded in fact.[190] More recently, however, Australian courts have adopted the latter approach, but without exposing any detailed reasoning or comparing the two approaches.[191]

The latter approach is more logically compelling. The reasons for this approach have been articulated in two decisions of the English Court of Appeal.[192] In *Hartle*, a third party made a subject to contract offer to purchase a parcel of land from the claimant for £400,000. As a result of the negligence of the claimant's solicitor, the offer was withdrawn and the claimant lost the benefit of the sale. The property was eventually sold for £150,000.

Ward LJ (with whom Beldam and Schiemann LJJ agreed) held that the claimant had lost a 60% chance of selling the property for a net sum of £360,000 (ie, £216,000).[193]

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[190] *Adelaide Petroleum NL v Poseidon Ltd* (1990) 98 ALR 431, 532. For recent examples of an intuitive application, see *Heenan v De Sisto* (2008) Aust Torts Reports 81–941; *Williams v Pagliuca* [2009] NSWCA 250 (19 August 2009). For express support for this approach, see *Jamieson v Westpac Banking Corporation* (2014) 283 FLR 286, 330 [236] (Jackson J) (*obiter*); affirmed, without reference to the issue, sub nom *Westpac Banking Corporation v Jamieson* (2015) 294 FLR 48.

[191] *Maritime Union of Australia v Fair Work Ombudsman* [2015] FCAFC 120 (28 August 2015), [127] (Full Court). See also *Doppstadt Australia Pty Ltd v Lovick & Son Developments Pty Ltd* [2014] NSWCA 158 (21 May 2014), [305] (Gleeson JA; Ward and Emmett JJA agreeing); *Molinara v Perre Bros Lock 4 Pty Ltd* (2014) 121 SASR 61, 86 [99] (Nicholson J; Parker J agreeing); *First Interstate Bank of California v Cohen Arnold (a firm)* [1996] PNLR 17.

[192] *Hartle v Laceys (a firm)* [1999] 1 Lloyd's Rep PN 315; *Ministry of Defence v Wheeler* [1998] 1 WLR 637. See also, *Walker v Citigroup Global Markets Pty Ltd* (2005) 226 ALR 114, 143 [132]–[134] (Kenny J), reversed, without reference to the issue, (2006) 233 ALR 687.

[193] *Hartle v Laceys (a firm)* [1999] 1 Lloyd's Rep PN 315, 329.

The next question for resolution was the proper method for applying the contingency discount of 60%. His Lordship posed the question as follows:[194]

> If 'a' is the lost sale proceeds and 'b' the actual proceeds, are the damages properly to be awarded (a × 60%) – b or are they (a – b) × 60 per cent? … On the figures, is it £216,000 – £150,000 ie £66,000 or is it 60 per cent of the difference between £360,000 and £150,000 ie £126,000?

Ward LJ concluded that the latter approach was correct. His Honour reasoned that the claimant 'did not lose everything when he lost this sale. He lost the chance of the sale but he did not lose the property itself. He retained the chance to sell it at some indeterminate time for some indeterminate price. He lost the chance of getting the excess of a over b but his chance of getting a – b was only 60 per cent and so he should only recover 60 per cent of it.'[195]

In *Ministry of Defence v Wheeler*,[196] the English Court of Appeal applied its earlier reasoning in *Hartle*. The defendant unlawfully dismissed the claimants from their positions in the armed forces. The claimants sought damages for loss of an opportunity to remain in the forces until the conclusion of their service. Following their dismissal, each of the claimants had obtained alternative employment, but at lower rates of pay. The question before the Court was how to account for those earnings in calculating the claimants' loss. The claimants contended that the proper approach was to take the sum that the claimant would have earned in the forces, deduct from that sum the amount that she had, or should have, earned elsewhere, and then apply to the net loss the relevant percentage discount reflecting the chance that the claimant would or would not have remained in the forces. On the other hand, the defendant contended that the proper approach should be to take the total sum that the claimant would have earned had she remained in the forces, at that point apply the percentage discount, and then deduct from that sum the total amount that the claimant had or should have earned during that period.

194 *Hartle v Laceys (a firm)* [1999] 1 Lloyd's Rep PN 315, 329–30.
195 *Hartle v Laceys (a firm)* [1999] 1 Lloyd's Rep PN 315, 330.
196 *Ministry of Defence v Wheeler* [1998] 1 WLR 637.

Swinton Thomas LJ (with whom Mantell and Hirst LJJ agreed) held that the claimants' method was the correct approach. His Lordship observed that the defendant's approach did not represent the claimants' total loss. Rather, it focused:[197]

> solely on the amount that the applicant would have earned in the armed forces instead of focusing on the entire picture which is the amount she would have earned in the armed forces and the lesser amount that she has or would have earned in civilian life and deducting one from the other. Thus it is clearly wrong to take, for example, 60 per cent of the salary that she would have earned in the armed forces and deduct from that 60 per cent, 100 per cent of the sums earned in civilian life. The same discount must be applied to both sides of the equation to obtain a fair and just result and an accurate calculation as to the amount that the claimant has actually lost. (Accordingly to reach that result you take 60 per cent of the potential earnings, and 60 per cent of the actual earnings and deduct one from the other.)

Additional opportunities

In some cases, the claimant may suffer the loss of additional commercial opportunities. In this case, it may be necessary to apply the addition rule. This rule provides that whenever two (or more) events are mutually exclusive, 'the probability that at least one occurs is the sum of their individual probabilities.'[198] A number of events will be mutually exclusive provided 'no two of them have any outcomes in common.'[199]

An additional opportunity may be an alternative, or cumulative, opportunity. An example of additional alternative opportunities is provided in *Amann*. The defendant's breach of contract caused the claimant to suffer the loss of two opportunities: first, the opportunity to tender for a renewal of the surveillance contract at the expiry of the initial term; secondly, in the event that the tender was unsuccessful, the opportunity to sell 'either its local business (including its planes) or the planes themselves to a new operator at a price which reflected the value of the planes' special equipment to a supplier of the relevant coastal surveillance services.'[200]

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[197] *Ministry of Defence v Wheeler* [1998] 1 WLR 637, 644.
[198] Haigh, above n 171, 17.
[199] Ibid.
[200] *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 133 (Deane J).

In *Inter-Leisure Ltd v Lamberts (a firm)*,[201] the claimant engaged the defendant to provide advice in relation to the negotiation of a long-term lease between the claimant as landlord and a third party. The defendant negligently failed, among other things, to include an upward only rent review provision in the lease. The claimant suffered loss when, at the first rent review date, the rent payable under the lease fell. The claimant sought damages from the defendant for the loss of two alternative commercial opportunities: first, the opportunity to negotiate a lease containing an upward only rent review provision; and secondly, on the hypothesis that the third party would have accepted such a provision, the opportunity to obtain vacant possession of the premises after the first rent review date following the exercise by the third party of a right of termination.

The first opportunity was subject to two contingencies: the chance that the third party would agree to the upward only rent review provision; and secondly, the chance that, having agreed to the provision, the third party would *not* have elected to exercise its right to terminate the lease at the first rent review date. The trial judge assessed the probability of these two contingencies as 75% and 33% respectively, with the result that the overall probability of realising the first opportunity for the duration of the lease was 25% (ie, 75% × 33%).[202]

In relation to the second opportunity, the trial judge accepted the claimant's argument that, if there was a 75% probability of the third party accepting an upward only rent review provision, and a 66% probability that the third party would have terminated the lease at the first rent review date, then it followed that the claimant had also lost a 50% chance (ie, 75% × 66%) of obtaining vacant possession of the premises. The trial judge observed, '[w]here two alternative events are possible, each of which would have given benefit to a plaintiff, it is wrong to look solely to the event which would have given the greater benefit. The chance of benefit from each event must be considered, provided always that each of these chances is a substantial and not a

[201] *Inter-Leisure Ltd v Lamberts (a firm)* (Unreported, Queen's Bench Division, Judge Hodge QC, 26 March 1997).
[202] *Inter-Leisure Ltd v Lamberts (a firm)* (Unreported, Queen's Bench Division, Judge Hodge QC, 26 March 1997), 17–18.

speculative one and that there is no overlap between them.'[203] His Honour held that the two opportunities were mutually exclusive, and therefore added the value of each opportunity together to determine the claimant's total loss.[204]

An example of additional cumulative opportunities is provided in *Jackson v Royal Bank of Scotland plc*.[205] The claimant imported certain goods from a supplier and on-sold them to a customer. The customer paid for the goods using a transferable letter of credit issued by the defendant to the customer and naming the claimant as the beneficiary. When handling one of the letters of credit, the defendant mistakenly disclosed to the customer, in breach of the duty of confidentiality owed to the claimant, information revealing the claimant's mark-up on the goods sold to the customer. The customer made no further orders from the claimant and started buying the goods directly from the supplier. The claimants commenced an action for breach of contract against the defendant claiming damages for loss of the opportunity to make profits from the continuing trading relationship with the customer.

The trial judge held that the defendant was in breach and that, but for the breach, there was a significant chance that the trading relationship would have continued for a further four years, but on a declining basis. The trial judge held that the claimant had suffered a separate loss of opportunity in each of those years, calculated as a percentage of the claimant's projected loss of profit based on the customer's purchases made directly from the supplier. The trial judge held that the claimant's loss was 57% in the first year; 46% in the second year; 29% in the third year; and 16% in the final year. The trial judge awarded the total of those amounts to the claimant as damages.

One of the issues before the House of Lords was whether the trial judge had adopted the correct approach to quantifying the claimant's loss. Lord Hope (with whom Nicholls, Hoffmann, Walker and Brown LJJ agreed) concluded that, despite some minor errors, the method of assessment of damages adopted by the trial judge was 'as

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[203] *Inter-Leisure Ltd v Lamberts (a firm)* (Unreported, Queen's Bench Division, Judge Hodge QC, 26 March 1997), 18.
[204] *Inter-Leisure Ltd v Lamberts (a firm)* (Unreported, Queen's Bench Division, Judge Hodge QC, 26 March 1997), 18.
[205] *Jackson v Royal Bank of Scotland plc* [2005] 1 WLR 377.

good an estimate as can now be made of the effect on Samson's profits of the bank's breach of contract.'[206]

Conclusion

This chapter examined the valuation of loss of a commercial opportunity.

The first part of this chapter described the general principles relating to proof of the value of loss of a commercial opportunity. A claimant must prove the value of its loss by reference to the degrees of probabilities and possibilities, based on a proper evidentiary foundation. The value of that loss may be affected by two presumptions: first, the *Armory v Delamirie* presumption; and secondly, the minimum obligation rule.

The next part of the chapter considered the meaning of value in this context. It demonstrated that, in principle, the loss of a commercial opportunity should be valued by reference to its market value. This follows from the analysis in chapters two and five. Chapter five demonstrated that a commercial opportunity is an asset. Chapter two demonstrated that the value (or loss in value) of an asset is determined by reference to its market value. The chapter also demonstrated that, theoretically, the market value approach applies to all types of lost opportunity, including loss of a cause of action.

The final two sections of the chapter examined the valuation of loss of a commercial opportunity. The chapter identified the simple probability approach as the general approach taken by courts to the valuation of loss of a commercial opportunity. The simple probability approach was then applied to construct a framework for determining the market value of the loss of a commercial opportunity, which is consistent with the financial theory of valuation.

This framework consists of three steps. The first step is to determine the market value of the object of the opportunity. This can be done using either a formal valuation

[206] *Jackson v Royal Bank of Scotland plc* [2005] 1 WLR 377, 389 [43].

methodology, such as DCF analysis or the comparable market price methodology; or an informal methodology, involving an intuitive or 'broad brush' approach. Theoretically, the loss of a commercial opportunity should be valued using DCF analysis. This follows from the analysis in chapters two and five. The loss of a commercial opportunity represents the loss of a chance of an anticipated future cash flow, and DCF analysis is the best method for valuing future cash flow.

The second step is to assess the probability of the opportunity and adjust the market value of the object by that probability. The most common way to assess this probability is to select a percentage figure that reflects the contingencies affecting the successful realisation of the object of the opportunity. This percentage figure is then used to adjust the market value of the object of the opportunity.

The final step is to account for any benefits received by the claimant as a result of the defendant's wrong. The claimant must account to the defendant for the value of any such benefit before the market value of the object of the opportunity is adjusted to reflect the probability of the opportunity. This requires the court to first subtract the value of the benefit from the market value of the object, and then to adjust the resulting sum. In other words, the adjustment (eg, discount) is applied to the difference between the market value of the object of the opportunity, and the value of the benefit received by the claimant as a result of the defendant's wrong.

Part 3

Case study

Chapter 7

Valuation of loss of a lending opportunity

Introduction

Purpose and object

This chapter examines the valuation of loss of a lending opportunity. The loss of a lending opportunity is a particular type of loss of commercial opportunity. This type of loss arises where a lender (claimant) lends money to a defaulting borrower in reliance on a valuation of the mortgage security negligently prepared by a valuer (defendant), and as a result the lender loses the opportunity to lend that money to an alternative (performing) borrower.

This chapter applies the valuation framework developed in Parts one and two of the thesis to the valuation of loss of a lending opportunity. The object of this chapter is twofold. First, it will demonstrate the utility of the valuation framework. In particular, this chapter will show, by applying the framework, the errors that have been made by courts in valuing the loss of a lending opportunity. Secondly, at a more general level, this chapter will demonstrate the importance of finance theory in providing a coherent and rigourous theoretical framework with which to value the loss of a commercial opportunity.

A main purpose of this chapter is to illustrate the practical integration of legal and financial theory in the context of valuing a lost commercial opportunity. This chapter will show that the use of financial logic in this context does not remove subjectivity from the valuation process, indeed it can serve to highlight that subjectivity and even necessitate the consideration of additional subjective considerations that courts would not otherwise make. However, it is clear that courts attempt to employ basic finance logic in the valuation process, and so a direct injection of finance methodology is likely to enhance the legal process of valuation.

Structure

This chapter is divided into an introduction and four main sections. The first section provides an introduction to claims for the negligent valuation of mortgage securities, including the basis of liability, and a taxonomy of the different types of claims. The second section examines the general approach taken by courts in valuing the loss of a lending opportunity. This section is divided into two parts. The first part contains an introduction. The second part identifies the general approach, and examines the leading cases that illustrate that approach. The third section applies the valuation framework developed in Parts one and two of the thesis to these cases. This section is divided into four parts. The first part contains an introduction. The following parts examine the fact, character and valuation of loss. The final section sets out a basic model for the valuation of loss of a lending opportunity.

Limitations

This chapter does not address the question whether the defendant should be held liable in negligence for losses caused by any actual fall in the market in which the mortgage security is traded. This question is the subject of controversy,[1] and is

[1] This question has been settled in England, but not in Australia. Cf the view expressed by the House of Lords in *South Australia Asset Management Corporation v York Montague Ltd* [1997] AC 191; with the views expressed by the Federal Court, the Full Federal Court, and the various members of the High Court, in *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 199 CLR 413; (1997) 77 FCR 307; (1996) 140 ALR 313. For a detailed discussion, see: Jane Stapleton, 'Negligent valuers and falls in the property market' (1997) 113 *Law Quarterly Review* 1; S M Waddams, 'Liability of valuers: *Kenny & Good Pty Ltd v MGICA (1992) Ltd*' (1997) 5 *Torts Law Journal* 218; Janet O'Sullivan, 'Negligent Professional Advice and Market Movements' [1997] 56 *Cambridge Law Journal* 19; D W McLauchlan, 'A Damages Dilemma' (1997) 12 *Journal of Contract Law* 114; Brian Coote, 'Is There Hope, Still, for Negligent Valuers?' (1997) 12 *Journal of Contract Law* 145; John Wightman, 'Negligent Valuations and a Drop in the Property Market: The Limits of the Expectation Loss Principle' (1998) 61 *Modern Law Review* 68; Alexander Loke, 'The valuer's liability for negligent valuation – toward a more principled allocation of the risk of market decline' (1999) 19 *Legal Studies* 47; Jane Stapleton, 'Valuer liability and normal expectancies' (1999) 7 *Torts Law Journal* 296; Stanley W Drummond, 'Liability of valuers and other professionals: *Kenny & Good v MGICA*' (1999) 7 *Torts Law Journal* 217; D W McLauchlan and C E F Rickett, 'SAAMCO in the High Court of Australia' (2000) 116 *Law Quarterly Review* 1; Anthony M Dugdale, 'Conceptualising Limits to Valuers' Liability' (2000) 8 *Tort Law Review* 7; John Murdoch, 'Negligent Valuers, Falling Markets and Risk Allocation' (2000) 8 *Tort Law Review* 183.

beyond the scope of this thesis. This is for two reasons. First, the question is primarily relevant in a no-transaction case, which is not the focus of this chapter. Secondly, the question involves considering of an array of complex causation, remoteness and policy issues. The question therefore involves considering broader aspects of the assessment of loss.

For the purposes of this chapter it is assumed that the defendant is liable for any actual decline in the value of the mortgage security granted by the defaulting borrower following entry by the claimant into the loan. On this assumption, a fall in the market in which the mortgage security is traded is relevant to the value of the loss of a lending opportunity: the hypothetical counterfactual that is constructed in order to compute the claimant's loss necessarily excludes the defendant's negligence, and therefore it must follow that any hypothetical decline in the value of any mortgage security granted in relation to that counterfactual is relevant to the valuation of the claimant's loss.

Negligent valuation

Introduction

A potential claim for damages for negligent valuation will arise when the claimant advances money to a borrower in reliance on a valuation of the mortgage security made without reasonable care. If the borrower becomes insolvent or bankrupt and defaults on the loan, and the net proceeds of sale of the security are insufficient to repay the claimant, the claimant will often seek to recover its loss under the loan from the defendant.

Basis of liability

In modern commercial litigation, claims for negligent valuation are typically brought on one of two alternative bases. The first basis involves a claim that the defendant breached a duty or obligation to exercise reasonable care in preparing its valuation.[2] This claim may be brought in negligence, and in contract.[3]

The second basis involves a claim that the defendant contravened s 18(1) of the ACL. In this type of claim, the claimant asserts that the defendant has contravened s 18(1) by making a false representation relating to the value of the mortgage security,[4] and that the claimant has suffered loss or damage because of this conduct.

While each of these claims may involve the same set of factual circumstances, the principles of liability for each claim will differ. Further, the measure of damages awarded for each claim may not necessarily be the same.[5] For convenience, and ease of exposition of this chapter, each of these claims will be referred to as 'negligent valuation' claims, and it will be assumed that the measure of damages for each claim is identical.

Taxonomy of claims

In general, the common law distinguishes between two types of claim for negligent valuation: a 'no-transaction' claim, and a 'successful transaction' claim.[6] In a no-transaction claim, the claimant asserts that it would not have made the loan at all had it known about the true value of the mortgage security. In a successful transaction claim, the claimant asserts that had it known about the true value of the mortgage security it would still have made the loan, but for a lesser sum.

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[2] For a description of the duty of a valuer, see *MGICA (1992) Ltd (formerly MGICA Ltd) v Kenny & Good Pty Ltd* (1996) 140 ALR 313, 371 (Lindgren J).

[3] As a professional, a valuer's liability in tort and contract is concurrent: *Astley v Austrust Ltd* (1999) 197 CLR 1, 20 [44] (Gleeson CJ, McHugh, Gummow and Hayne JJ). See also, *MGICA (1992) Ltd (formerly MGICA Ltd) v Kenny & Good Pty Ltd* (1996) 140 ALR 313, 372 (Lindgren J).

[4] See, eg, *MGICA (1992) Ltd (formerly MGICA Ltd) v Kenny & Good Pty Ltd* (1996) 140 ALR 313, 356–7 (Lindgren J) (lender argued that the valuer's report conveyed representations that the valuer's opinions as to the value of the mortgage security were held and were based on reasonable grounds; that they were the product of the exercise of due care and skill; and that they were safe to be relied on and not outside the range of latitude properly to be allowed to a valuer).

[5] See *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 199 CLR 413, 428 [30] (Gaudron J).

[6] For the original use of this terminology, see *Hayes v James & Charles Dodd* [1990] 2 All ER 815, 818–19 (Staughton LJ) (negligence claim against a firm of solicitors).

This simple, binary classification of negligent valuation claims has been adopted both in England,[7] and in Australia.[8] However, this classification has been criticised by some courts and academic commentators. For example, in *South Australia Asset Management Corporation v York Montague Ltd*[9] Lord Hoffmann (with whom Goff, Jauncey, Slynn and Nicholls LJJ agreed) stated:[10]

> Every transaction induced by a negligent valuation is a 'no-transaction' case in the sense that ex hypothesi the transaction which actually happened would not have happened. A 'successful transaction' in the sense in which that expression is used by the Court of Appeal (meaning a disastrous transaction which would have been somewhat less disastrous if the lender had known the true value of the property) is only the most common example of a case in which the court finds that, on the balance of probability, some other transaction would have happened instead. The distinction is not based on any principle and should in my view be abandoned.

There are at least two other types of negligent valuation claim: a 'different transaction' claim; and an 'alternative transaction' claim.[11] In a different transaction claim, if the defendant had reported the true value of the mortgage security the claimant would have lent a similar amount of money to the borrower on the security of a different property.[12] In an alternative transaction claim, if the defendant had reported the true value of the mortgage security the claimant would have lent a similar amount of money to an alternative borrower on the security of an alternative property.

The above categories are not helpful. The question is always: what would the claimant have done but for the defendant's negligence? The answer will be one of three hypothetical counterfactuals. Each of these counterfactuals is simply a different answer to the same question. These counterfactuals are set out below.

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[7] See, eg, *Banque Bruxelles Lambert SA v Eagle Star Insurance Co Ltd* [1995] QB 375. See also, *Swingcastle Ltd v Alastair Gibson (a firm)* [1991] 2 AC 223.

[8] See, eg, *MGICA (1992) Ltd (formerly MGICA Ltd) v Kenny & Good Pty Ltd* (1996) 140 ALR 313. In Australia, the terms 'no transaction' claim and 'alternative transaction' claim have also been used outside the negligent valuation context: see, eg, *Wealthsure Pty Ltd v Selig* (2014) 221 FCR 1 (various statutory and common law claims relating to inappropriate investment advice); *BHP Billiton (Olympic Dam) Corp Pty Ltd v Steuler Industriewerke GmbH (No 2)* [2011] VSC 659 (16 December 2011) (claim for misleading or deceptive conduct and negligence in relation to the suitability of goods).

[9] *South Australia Asset Management Corporation v York Montague Ltd* [1997] AC 191.

[10] *South Australia Asset Management Corporation v York Montague Ltd* [1997] AC 191, 218.

[11] A M Dugdale, 'A purposive analysis of professional advice: reflections on the BBL decision' (1995) *Journal of Business Law* 533, 535–6.

[12] The use of the different descriptions noted in the text is not always uniform. See, eg, *Adelaide Bank Ltd v DTS Property Services Pty Ltd* [2008] NSWSC 1328 (4 December 2008), [37] (McDougall J) (term 'different transaction' used to describe what appeared to be a 'successful transaction' claim).

1. *Claimant makes a loan to the defaulting borrower*

The first counterfactual postulates a situation where the claimant would still have proceeded to make a loan to the defaulting borrower, but for a lesser sum. These types of claims have conventionally been referred to as 'successful transaction' claims. A variation of this type of claim is the 'different transaction' claim described above.

Traditionally, successful transaction claims have not been treated as claims for loss of a commercial opportunity.[13] Presumably, this is because, in the reported cases, the relevant counterfactual has been established on the balance of probabilities. Accordingly, this counterfactual will not be considered in this chapter.

2. *Claimant does not make any loan or investment*

The second counterfactual concerns a situation where the claimant would not have made any loan or investment.[14] Properly understood, this counterfactual involves a situation where the claimant would not have made any loan or investment at all, *and* would have otherwise done nothing with its money.[15] In some cases, however, despite the claim being put on a no-transaction basis, the claimant will claim (or be awarded) damages for the loss of the use of the money lent to the defaulting borrower.[16] This practice confuses no transaction claims with the alternative

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[13] See *Singer & Friedlander Ltd v John D Wood & Co* [1977] 2 EGLR 84; *Corisand Investments Ltd v Druce & Co* [1978] 2 EGLR 86; *Laughton-Boyd v Moloney* (Unreported, Supreme Court of New South Wales, Yeldham J, 8 June 1979); *Duncan & Weller Pty Ltd v Mendelson* [1989] VR 386.

[14] *Baxter v F W Gapp & Co Ltd* [1939] 2 All ER 752; *Kooragang Investments Pty Ltd v Richardson & Wrench Ltd* (Unreported, Supreme Court of New South Wales, Rogers J, 4 July 1980); *Trade Credits Ltd v Baillieu Knight Frank (NSW) Pty Ltd* (1985) 12 NSWLR 670; *MGICA (1992) Ltd (formerly MGICA Ltd) v Kenny & Good Pty Ltd* (1996) 140 ALR 313, affirmed sub nom *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1997) 77 FCR 307; *National Australia Bank Ltd v Hann Nominees Pty Ltd* [1999] FCA 1262 (13 September 1999), affirmed sub nom *Hann Nominees Pty Ltd v National Australia Bank Ltd* [2000] FCA 454 (12 April 2000).

[15] This point appears to have been recognised in *Australian Executor Trustees Ltd v Propell National Valuers (WA) Pty Ltd* [2011] FCA 522 (18 May 2011), [232] (Barker J); affirmed, without reference to the issue of damages, sub nom *Propell National Valuers (WA) Pty Ltd v Australian Executor Trustees Ltd* (2012) 202 FCR 158. The point also appears to have been implicitly recognised by some academic commentators: see O'Sullivan, above n 1, 21; Loke, above n 1, 49; Murdoch, above n 1, 195.

[16] See, eg, *Trade Credits Ltd v Baillieu Knight Frank (NSW) Pty Ltd* (1985) 12 NSWLR 670. On this issue, and the question whether a lender is entitled to recover contractual interest from the valuer, see *Swingcastle Ltd v Alastair Gibson (a firm)* [1991] 2 AC 223.

transaction counterfactual described below, where the claimant would have used some or all of its funds to make an alternative loan or investment. This confusion leads to damages awards that are inconsistent with the factual basis of the claim. This confusion is compounded by the practice of describing claims made on an alternative transaction counterfactual as no-transaction claims.[17] This description is incorrect and apt to lead to confusion and misapplication of principle.

A true no-transaction claim will be made where the claimant would not have made an alternative loan or investment, or where the claimant is unable to prove that it would have done so. Another situation in which a true no-transaction claim may be made is where a mortgage insurer insures a loan in reliance on a negligent valuation.[18] In this situation, the counterfactual is that, but for the defendant's negligence, the insurer would not have insured the loan. The loss claimed by the insurer is an amount equal to the sum paid by the insurer to the lender in satisfaction of its claim under the policy. This loss represents the loss suffered by the lender under the loan transaction, not a loss suffered by the insurer or the borrower under some alternative transaction.

This chapter will not consider no-transaction claims.

3. *Claimant makes an alternative loan or investment*

The third counterfactual is that the claimant would have used all or part of its funds to make an alternative loan to a third party. Included in this category are what have been labelled 'alternative transaction' claims. In that type of claim the claimant asserts that, if the defendant had reported the true value of the mortgage security, the claimant would have lent a similar amount of money to an alternative borrower on the security of an alternative property. For the purposes of this thesis, these claims are referred to as claims for the loss of a lending opportunity. This is not intended to be a category of the kind criticised above. It is simply a description for the purposes of analysis in this chapter.

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[17] See, eg, *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299; *Valcorp Australia Pty Ltd v Angas Securities Ltd* [2012] FCAFC 22 (9 March 2012).
[18] See, eg, *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 199 CLR 413.

This chapter will explore the way in which courts have dealt with and valued lost commercial opportunities in the context of the assessment of damages for negligent valuation. Accordingly, the focus of this chapter must necessarily be on claims for loss of a lending opportunity — ie, cases where the proper counterfactual is one in which the claimant would have taken a different commercial opportunity.

Loss of a lending opportunity

Introduction

The loss of a lending opportunity is a type of loss of commercial opportunity. Thus, in *St George Bank Ltd v Quinerts Pty Ltd*,[19] Nettle JA (with whom Mandie JA and Beach AJA agreed) identified the true nature of a claim for the loss of a lending opportunity as a claim for 'loss of a chance to invest in a more successful transaction' which, depending on the facts of the case, 'may have to be discounted significantly to allow for the vicissitudes of chance.'[20]

A claimant may be entitled to damages for loss of a lending opportunity in contract, tort, or under s 236(1) of the ACL, depending on the cause of action.

General approach to valuation

In a claim for loss of a lending opportunity, the claimant seeks damages calculated by reference to the difference between its actual position, and the position the claimant would have been in if it had entered into an alternative loan.

Typically, the claimant will separate its loss into two discrete components. First, the claimant will seek to claim its 'capital' loss, represented by the shortfall in the amount of the loan principal recovered following the sale of the mortgage security. Secondly, the claimant will seek to claim its 'income' loss, represented by the return the claimant would have generated from investing the loan principal, discounted to reflect

[19] *St George Bank Ltd v Quinerts Pty Ltd* (2009) 25 VR 666.
[20] *St George Bank Ltd v Quinerts Pty Ltd* (2009) 25 VR 666, 675 [25].

the contingencies involved in the realisation of that amount. In *Quinerts*, Nettle JA described the general approach to the valuation of the income loss, *obiter*:[21]

Generally speaking, the value of the chance forgone by a lending institution as the result of entering into an improvident transaction (and thereby forgoing the opportunity of entering into a more beneficial transaction) is the net rate of return or spread which would have been generated upon the alternative transaction after bringing to account the cost of funds and other expenses which would have been incurred in connection with the alternative transaction…Moreover, in order to provide a truly accurate reflex of the damage actually incurred as a result of not entering into a more satisfactory transaction at an identified rate of return, the spread should ordinarily be discounted to allow for possibilities such as that the funds invested in the improvident transaction could not have been placed in another more acceptable transaction; and the risk that, even if so placed, the other borrower might still have defaulted.

The general approach taken by Australian courts to the valuation of loss of a lending opportunity is illustrated by the following cases.

La Trobe

In *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd*,[22] the claimant lent $2.4m to a borrower in reliance on a valuation by the defendant of real property used as security for the loan. The defendant valued the property at $4m. The borrower defaulted on the loan. The property was sold for $2.2m, which was insufficient to cover the principal and interest owing under the loan. The defendant accepted that in valuing the property at $4m, it had breached its duty of care to the claimant, and that the claimant would not have lent any money to the borrower at all if the property had been valued at less than $4m.

At trial, the claimant sought two separate heads of damages. First, the claimant sought $189,036 for its loss of capital, calculated by the difference between its capital outlay (the $2.4m loan) and its capital receipts ($2,210,965, being the net proceeds of sale of the borrower's property and other ancillary amounts). Separately, the claimant sought $196,683.24 for its loss of income, calculated by the difference between its

[21] *St George Bank Ltd v Quinerts Pty Ltd* (2009) 25 VR 666, 676 [27].
[22] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299.

forgone income receipts ($652,143.24, in the form of interest earned on the hypothetical alternative loan) and its actual income receipts ($455,460, in the form of pre-paid and other interest on the $2.4m loan, net of fees).

In framing its damages claim in this way, the claimant attempted to segregate its capital gains and losses from its income gains and losses, rather than allowing all of its gains to be set off against all of its losses. On a segregated approach, if the claimant was unable to prove its claim for forgone interest receipts on the hypothetical loan, the defendant would receive no credit for the actual interest payments made by the borrower on the $2.4m loan, because on this approach those payments are quarantined against the claim for forgone interest, and not set off against the claimant's claim for loss of capital. Accordingly, in this case the claimant would still receive damages for its loss of capital, despite the fact that this loss was more than off set by the borrower's actual interest payments.

The defendant argued that the segregated approach was artificial, and that the Court should instead adopt an aggregated approach to assessing damages. On an aggregated approach, the claimant had suffered no loss by making the loan because the benefits it received from making the loan (in the form of the borrower's interest payments and the net proceeds of sale of its property) were greater than its capital outlay. Furthermore, the claimant was not entitled to damages for loss of income because it had not established by evidence any particular lost chance to make an alternative loan.

Marshall J held that the claimant had not established any loss of capital by reason of entering into the loan.[23] Relying on the High Court's decision in *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd*,[24] his Honour assessed the claimant's loss of capital and income on the loan on an aggregated basis by setting off its loss of capital against the borrower's pre-paid interest. On this basis, Marshall J concluded that, rather than having made a loss, the claimant made a profit on the loan of $266,425.[25] Turning to the loss of income claim, Marshall J held that the claimant had not proved

[23] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* [2010] FCA 250 (18 March 2010), [22].
[24] *I & L Securities Pty Ltd v HTW Valuers (Brisbane) Pty Ltd* (2002) 210 CLR 109.
[25] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* [2010] FCA 250 (18 March 2010), [20].

'the existence of a lost opportunity.'[26] Specifically, the claimant had not established, on the balance of probabilities, 'that there was a particular loan or loans that were not entered into by reason of La Trobe entering into a loan agreement with Jet.'[27]

The Full Federal Court allowed an appeal by the claimant. Two relevant questions arose on the appeal. First, should damages for loss of capital and loss of income be assessed on a segregated or aggregated basis? Secondly, what is the correct approach for assessing whether the claimant suffered a loss from being deprived of a chance to make an alternative investment?

In relation to the first question, Finkelstein J disagreed with the trial judge's reliance on *I & L Securities* as the basis for applying the borrower's interest payments against the claimant's loss of capital claim, while separately assessing the claimant's loss of income as another head of damage.[28] In Finkelstein J's view, '[t]he High Court's approach in I & L Securities indirectly supports an aggregated approach' to assessing both heads of damages.[29] Finkelstein J reasoned that in *I & L Securities* 'capital and income losses were treated as indivisible from a causation perspective' and therefore '[i]t would be a strange result if capital and income were treated as part of the same loss for the purposes of causation, but when assessing damages the losses (and any corresponding benefits) were segregated.'[30] On that basis, Finkelstein J concluded 'La Trobe's damages should be assessed on an aggregated basis so that all the benefits La Trobe received from the loan are to be set off against all its losses.'[31]

In relation to the second question, Finkelstein J identified the true nature of the claim as one for 'the loss of the use of money that was lent to Jet which, but for Hay's

[26] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* [2010] FCA 250 (18 March 2010), [38].
[27] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* [2010] FCA 250 (18 March 2010), [37].
[28] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 304 [21].
[29] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 306 [27].
[30] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 306 [27].
[31] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 306 [29].

negligent valuation, would have been employed in a profitable loan.'[32] Applying *Sellars v Adelaide Petroleum NL*,[33] Finkelstein J held that the claimant had established both the defendant's negligence (by admission), and that the claimant had suffered some loss as a result of that negligence.[34] Specifically, Finkelstein J held that there was 'no doubt' that the claimant had established the hypothesis that 'had money not been lent to Jet, La Trobe would have entered into another loan on the same terms as the Jet loan.'[35] According to Finkelstein J, the fact that the claimant 'could not identify any particular borrower' was 'beside the point.'[36] What was important was that the claimant's evidence of an unsatisfied demand for loans not only established the chance of an alternative loan, but showed that it was likely that such a loan would be made.[37]

Finkelstein J then proceeded to apply a mathematical formula to quantify the claimant's damages.[38] Specifically, Finkelstein J calculated that the maximum net interest income that could have been earned from another loan (M) was determined by multiplying the maximum interest amount ($652,143.24) by the relevant management fee (1.25%), giving a net amount of $643,991.45. The next step was to find the value of the 'lost opportunity' (V), which was calculated as a statistical expected value, $V = M \times (1 - C)$, where C was defined as the estimated probability of default on the alternative loan. Finkelstein J eventually determined that $C = 0$. The last step was to find the net lost opportunity (LO), which was calculated as $LO = P \times V$, where P was defined as the probability that the claimant would have entered into an alternative loan. Finkelstein J concluded that $P = 0.95$, and therefore LO = $611,791.88 (ie, 0.95 × $643,991.45).

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[32] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 316 [76].
[33] *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332.
[34] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 318, [88]–[89].
[35] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 318 [89].
[36] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 320 [96].
[37] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 320–1 [96].
[38] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 321 [97]–[102].

Finkelstein J then added this amount of $611,791.88 to the claimant's 'capital loss' of $189,035 (being the loan principal minus the total amount recovered through selling the mortgaged property). In the result, Finkelstein J gave judgment in favour of the claimant for its net loss in the sum of $351,060.13. This figure comprised the claimant's gross loss of $800,826.88 (a capital loss of $189,035 plus an income loss of $611,791.88) less its net gain from the loan of $449,766.75 (income from the borrower of $455,460 less the 1.25% management fee).

Jacobson and Besanko JJ reached the same conclusion as Finkelstein J, but adopted a slightly different calculation of the claimant's loss of income. Their Honours considered that the trial judge had erred in proceeding 'on the basis that unless an applicant can establish a particular alternative transaction he or she cannot establish a lost commercial opportunity of some value.'[39] Jacobsen and Besanko JJ concluded that while the evidence relied on by the claimant was 'very general', they were satisfied that the claimant had 'established a lost commercial opportunity of some value.'[40] Turning to the value of that loss, their Honours adopted a contingency discount of 5% to reflect the possibility of default on the alternative loan, and a further 15% to reflect 'the fact that an alternative transaction may not have been entered into at the same time and for the same period.'[41] Applying Finkelstein J's equation, Jacobson and Besanko JJ gave judgment in favour of the claimant in the sum of $259,291.35.

Valcorp

La Trobe was applied by the Full Federal Court in *Valcorp Australia Pty Ltd v Angas Securities Ltd*.[42] The claimants lent money to borrowers in reliance on a valuation by the defendant of the property to be used as security for the loans. The valuation report overstated the true value of the property. The borrowers defaulted and the proceeds from the sale of the property were insufficient to cover the principal and interest

[39] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 323 [113].
[40] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 323 [115].
[41] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 324 [116].
[42] *Valcorp Australia Pty Ltd v Angas Securities Ltd* [2012] FCAFC 22 (9 March 2012).

owing under the loans. The claimants contended that they would not have made the loans if they knew the true value of the property, and that they had each suffered a ‘direct’ loss of capital, and a ‘consequential’ loss of interest income that could have been earned on hypothetical alternative loans.

At trial, Besanko J held that the valuation report had been prepared negligently and was misleading, and that the claimants would not have lent any money to the borrowers had they known the true value of the property.[43]

On the claim for loss of capital, Besanko J held that the claimants could recover ‘the full amount of the loss which they sustained on the loans’,[44] being the net shortfall in the loan principal. Applying *Kenny & Good Pty Ltd v MGICA (1992) Ltd*,[45] his Honour held that the defendant, by giving ‘a forced sale value and a rating concerning the specific and market-related risks associated with mortgage lending on the property’ had impliedly represented that ‘whatever the market did there was a low risk that the mortgagee would not recover its loan moneys in full.’[46]

On the claim for loss of income, Besanko J held that the claimant had ‘lost a commercial opportunity of some value.’[47] His Honour rejected the defendant’s argument that the claim should fail because of the fact that the claimant did not adduce evidence of a particular transaction foregone because of an absence of funds.[48] Besanko J accepted evidence given by a director of the claimant, based on his examination of its financial records and his knowledge of its lending opportunities, that it had at all relevant times a substantial demand for its loan funds, particularly after the global financial crisis, and that he was aware of loan opportunities that could not be taken up because of insufficient funds. Turning to the value of that opportunity, Besanko J adopted the mathematical formula developed in *La Trobe* to calculate the claimants’ loss of income, and applied a contingency discount of 5% to reflect the risk of default on the hypothetical loan, and a further discount of 20% to

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[43] *Angas Securities Ltd v Valcorp Australia Pty Ltd* (2011) 277 ALR 538, 560 [132], 561, [137], 562 [142].
[44] *Angas Securities Ltd v Valcorp Australia Pty Ltd* (2011) 277 ALR 538, 570 [185].
[45] *Kenny & Good Pty Ltd v MGICA (1992) Ltd* (1999) 199 CLR 413.
[46] *Angas Securities Ltd v Valcorp Australia Pty Ltd* (2011) 277 ALR 538, 570 [183].
[47] *Angas Securities Ltd v Valcorp Australia Pty Ltd* (2011) 277 ALR 538, 574 [214].
[48] *Angas Securities Ltd v Valcorp Australia Pty Ltd* (2011) 277 ALR 538, 572 [198].

reflect the risk that an alternative transaction would not have been entered into at the same time and for the same period.[49]

The Full Federal Court allowed the defendant's appeal in part, but dismissed the appeal from Besanko J's decision on the claimant's damages for loss of opportunity.[50] The Full Court held that Besanko J did not err in finding that the claimant had proved the loss of a lending opportunity, which was of some value.[51] The Full Court considered that it was open to Besanko J to find on the evidence that the claimant had lost an opportunity of some value, despite the fact that at times the claimant had surplus funds available for lending that exceeded the amount loaned to the defaulting borrowers.[52] The Full Court considered that the evidence of excess funds 'does not demonstrate the absence of loss of an opportunity of some value. Rather, it is relevant to the question of the contingences in assessing the value of the opportunity lost.'[53] The defendant did not, however, seek to impugn Besanko J's assessment of the contingencies, nor did it invite the Full Court to reach a different conclusion on the assessment of the value of the lost opportunity.[54]

The Full Court also upheld Besanko J's use of the mathematical formula developed in *La Trobe* as a means to assess the value of the claimants' lost opportunity.[55] The Full Court considered that the formula included a basis for assessing the relevant contingencies and therefore it was a valid method by which to assess the value of the lost opportunity, but by no means the only method.

Provident Capital

La Trobe was considered in *Provident Capital Limited v John Virtue Pty Ltd (No 2)*.[56] The claimant advanced a net sum of $7.1 million to a borrower. The purpose of the loan was to provide the borrower with bridging finance to complete the purchase of a

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[49] *Angas Securities Ltd v Valcorp Australia Pty Ltd* (2011) 277 ALR 538, 574 [214].
[50] Valcorp did not appeal from Besanko J's decision on the claimant's capital losses.
[51] *Valcorp Australia Pty Ltd v Angas Securities Ltd* [2012] FCAFC 22 (9 March 2012), [168].
[52] *Valcorp Australia Pty Ltd v Angas Securities Ltd* [2012] FCAFC 22 (9 March 2012), [170]–[171].
[53] *Valcorp Australia Pty Ltd v Angas Securities Ltd* [2012] FCAFC 22 (9 March 2012), [172].
[54] *Valcorp Australia Pty Ltd v Angas Securities Ltd* [2012] FCAFC 22 (9 March 2012), [182].
[55] *Valcorp Australia Pty Ltd v Angas Securities Ltd* [2012] FCAFC 22 (9 March 2012), [181].
[56] *Provident Capital Limited v John Virtue Pty Ltd (No 2)* [2012] NSWSC 319 (13 April 2012).

commercial development site. The claimant advanced the funds in reliance on a valuation by the defendant of the site, which was used as security for the loan. The site was valued at $12 million with development consent. The borrower defaulted on the loan and the claimant took possession of the property. The claimant subsequently incurred expenses of approximately $3.3 million in order to maintain the development application and recover its security. The property was ultimately sold for $12.5 million.

The claimant alleged the valuation was negligent, that it would not have lent any money to the borrower if the claimant knew the true value of the land, and that as a result the claimant had lost the opportunity to earn interest and other fees it would have made if it had been able to lend to a hypothetical alternative borrower, the sums advanced to the borrower. In contrast to *La Trobe* and *Valcorp*, the claimant did not seek damages for any loss of capital. Presumably this was because the claimant managed to sell the site for a sum ($12.5 million) greater than its total 'capital' outlay ($10.4 million). The parties appeared to accept, at least on the basis of the claimant's counterfactual, that the claimant would have recovered its capital outlay in full from a hypothetical alternative borrower.

Harrison AsJ held that the defendant was not liable, but considered the damages claim. Her Honour identified the claim for interest as a claim for damages for 'loss of commercial opportunity.'[57] Harrison AsJ observed that, according to the Full Court in *La Trobe*, the proper approach in a case such as the present was to award the claimant 'a rate of interest on the funds it would not have lent to MMT reflecting Provident Capital's normal return from the investment of its funds for the three years that it was without it.'[58] Her Honour concluded that the claimant had 'lost an opportunity to proceed with an alternative commercial transaction.'[59] In assessing that loss, Harrison AsJ would have awarded the claimant damages for the income forgone on the net loan funds, discounted by 50% for contingencies; and for the income forgone on the recovery expenses in full. Her Honour reached this conclusion

[57] *Provident Capital Limited v John Virtue Pty Ltd (No 2)* [2012] NSWSC 319 (13 April 2012), [209].
[58] *Provident Capital Limited v John Virtue Pty Ltd (No 2)* [2012] NSWSC 319 (13 April 2012), [211].
[59] *Provident Capital Limited v John Virtue Pty Ltd (No 2)* [2012] NSWSC 319 (13 April 2012), [219].

despite the fact that the claimant's balance sheet appeared to show that, at all relevant times, it had sufficient cash on hand to make further loans.[60]

Application of valuation framework

Introduction

This section of the chapter applies the valuation framework developed in Parts one and two of the thesis to the illustrative cases. The section will show that the approach taken in these cases is not consistent with the valuation framework. This approach leads to the misapplication of the loss of commercial opportunity doctrine, and to erroneous damages awards in claims for loss of a lending opportunity.

Fact of loss

Evidentiary foundation

Chapter four demonstrated that the claimant must prove the fact of loss of a commercial opportunity on the balance of probabilities. In particular, the claimant must prove the existence of such a loss by adducing evidence that enables a court to form a rational assessment that the opportunity has some value.

In *St George Bank Ltd v Quinerts Pty Ltd*,[61] the Victorian Court of Appeal appeared to adopt a high standard in relation to the evidence required to prove the fact of loss of a lending opportunity. Nettle JA (with whom Mandie JA and Beach AJA agreed) rejected the lender's claim in circumstances where it led no evidence as to what it would have done with its money if it had not lent it to the defaulting borrower. His Honour held that the loss of a lending opportunity 'must be proved' and that it was 'not enough for a party like the bank simply to assert that, because it is in the business of lending money, it must follow that it has suffered a loss equal to the return on funds which it might have achieved if it had entered into a successful transaction at the same rate of return as the failed transaction.'[62]

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[60] *Provident Capital Limited v John Virtue Pty Ltd (No 2)* [2012] NSWSC 319 (13 April 2012), [214].
[61] *St George Bank Ltd v Quinerts Pty Ltd* (2009) 25 VR 666.
[62] *St George Bank Ltd v Quinerts Pty Ltd* (2009) 25 VR 666, 675 [25]. See also, *State Bank of New South Wales v Yee* (1994) 33 NSWLR 618.

Nettle JA observed that a lender, being sophisticated and well resourced, would be expected to quickly and easily produce relevant documentary evidence of the fact (and value) of its loss:[63]

> It is difficult to conceive of a litigant better equipped or better qualified than a bank or other lending institution to produce at very short notice and with relative ease and economy its cost of funds for particular classes of transactions, percentage probabilities of placing funds at specified rates of return and default rates and profit consequences for given classes of business. Indeed, I should be surprised if that sort of information were not already produced or capable of being produced routinely as part of the bank's own management accounting system.

In *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd*[64] the Full Federal Court held that the claimant had proved the fact of loss of a lending opportunity, despite failing to identify any specific loan opportunities that were forgone as a result of lending to the defaulting borrower. The Full Court reached a similar conclusion in *Valcorp Australia Pty Ltd v Angas Securities Ltd*,[65] not only in the absence of evidence of specific loan opportunities foregone, but also in circumstances where the evidence suggested that the demand for the claimant's funds did not at all relevant times exceed the supply of those funds. In *Provident Capital Ltd v John Virtue Pty Ltd (No 2)*[66] Harrison AsJ considered, *obiter*, that the claimant had proved the fact of loss of a lending opportunity despite apparently unchallenged evidence that at all relevant times the claimant's supply of funds exceeded the demand for those funds.

While *La Trobe*, *Valcorp* and *Provident Capital* appear inconsistent with *Quinerts*, that inconsistency is superficial only. The answer to the question whether a claimant has proved the fact of loss of a lending opportunity will depend on all of the relevant circumstances and evidence, and the inferences that can be drawn from those matters. In *La Trobe*, *Valcorp* and *Provident Capital*, the court was prepared to draw a stronger inference, based on the evidence and circumstances, of the fact of loss of a

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[63] *St George Bank Ltd v Quinerts Pty Ltd* (2009) 25 VR 666, 676 [30].
[64] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299.
[65] *Valcorp Australia Pty Ltd v Angas Securities Ltd* [2012] FCAFC 22 (9 March 2012).
[66] *Provident Capital Limited v John Virtue Pty Ltd (No 2)* [2012] NSWSC 319 (13 April 2012).

lending opportunity. This approach appears to be open, at least in relation to the existence of such an opportunity, given that the court only needs to be satisfied, on the balance of probabilities, of the existence of an opportunity of *some* value.

The evidentiary shortcomings in *La Trobe*, *Valcorp* and *Provident Capital* did not prevent the claimants in those cases from proving the fact of loss of a lending opportunity. However, those shortcomings are important to the value of that loss. This issue is addressed further below.

Character of loss

Single undivided loss

Chapter five demonstrated that a commercial opportunity is an asset, and therefore the loss of such an opportunity represents the loss of the chance of an anticipated future cash flow. Chapter five also demonstrated that such a loss is indivisible, and cannot be separated into a loss of 'capital' and a loss of 'income'.

In *La Trobe*, *Valcorp* and *Provident Capital*, the claimant was treated as having suffered two different types of loss: a 'direct' loss of capital (the outstanding principal owed by the defaulting borrower under the loan made in fact); and a 'consequential' loss of income (the interest forgone by the claimant under the hypothetical loan).[67] Further, each of these types of loss was assessed on a different counterfactual. The loss of capital was calculated on the counterfactual that, but for the defendant's wrong, the claimant would not have made any loan at all to the defaulting borrower. The claimant was therefore awarded damages equal to the capital shortfall on the defaulting loan, in full and without any contingency discount.[68] The loss of income, on the other hand, was calculated on the counterfactual that, but for the defendant's wrong, the claimant would have entered into a profitable loan with a third party. The claimant was therefore awarded damages equal to the net return on that loan in the

[67] Ironically, in *La Trobe*, the Full Federal Court stated that any distinction in that case between capital and income was artificial, but failed to apply this reasoning to the nature of the losses it was considering.

[68] In *Valcorp*, the defendant was held to have impliedly represented that the claimant would recover its loan principal from the defaulting borrower, and on that basis the claimant was entitled to recover the shortfall in its loan principal in full.

form of interest, discounted to reflect the contingencies affecting the realisation of that return.

The obvious problem with this approach, however, is that the two counterfactuals are inconsistent and the claimant is therefore overcompensated: the claimant is awarded the shortfall on the principal lent, and the return on that principal but without any discount to reflect the fact that the principal is lent at risk.

Properly understood, a claim for loss of a lending opportunity represents a claim for the loss of an opportunity to receive a single undivided anticipated future cash flow (comprising a sequence of payments made up of both principal and interest) under a hypothetical loan. It follows that the claim should not be segregated into separate claims for loss of capital and loss of income. Further, the whole of the claimant's loss should be assessed on a loss of opportunity basis, and not just the loss of interest component. In particular, any contingency discount should be applied to the whole of the claimant's loss.

Viewed in this way, the problem of overcompensating the claimant is avoided. The claimant suffers only one type of loss: a direct loss of an opportunity to receive a single undivided anticipated future cash flow under a hypothetical loan. Compensation for that loss is calculated on the single counterfactual that, but for the defendant's wrong, the claimant would have entered into a profitable loan with a third party. The claimant is awarded damages by reference to the present value of its anticipated future net cash flow under the hypothetical loan, discounted to reflect the chance of realising that cash flow.

Valuation of loss

Probability of the opportunity

Chapter six demonstrated that estimating the market value of the loss of a commercial opportunity using the simple probability approach involves two primary steps. First, the market value of the object of the opportunity is determined. Secondly, the probability of the opportunity is assessed and the market value of the object is then adjusted to reflect that probability. In general, this assessment is subjective, or personalistic.

In a claim for loss of a lending opportunity, assessing the probability of successfully obtaining or realising the object of the opportunity involves assessing the probability distributions of the cash flows that might have been received by the claimant under the hypothetical loan. At a general level, a court must assess both the probability that the claimant could enter into the hypothetical loan, and the risk of default under that loan. This assessment will be shaped by external factors, such as general economic conditions and the state of the debt capital markets, as well as internal factors, such as the demand for loans from the claimant and its access to funds, the nature and terms of the loans made by the claimant, and the historical patterns of bad debts relating to those loans.

In both *La Trobe* and *Valcorp*, the court identified two key contingencies affecting the value of the claimant's loss: the probability that the claimant could have entered into the hypothetical loan, and the probability of default on that loan. In each case, slightly different contingency discounts were applied to the value of the claimant's loss to reflect these risks. In *La Trobe*, the Full Court applied a discount ranging from 5% to 15% to reflect the risk that the hypothetical loan may not have been made at the relevant time; and a discount ranging from zero to 5% to reflect the risk of default on the hypothetical loan. In *Valcorp*, Besanko J applied a discount of 20% to reflect the risk of securing the hypothetical loan, and a further discount of 5% to reflect the risk of default.[69]

However, in both *La Trobe* and *Valcorp*, two aspects of the evidence indicate that a greater discount should have been applied to the value of the claimant's loss to reflect the contingencies affecting that loss: first, the claimant's lack of evidence of specific loan opportunities; and second, the assumed high rates of interest charged under the hypothetical loans. These aspects are considered below.

[69] In *Valcorp*, the defendant did not appeal the contingency discount applied by Besanko J, preferring instead to take the all or nothing approach of arguing that the claimant had failed to establish *any* loss on the balance of probabilities.

Evidence of specific loan opportunities

In both *La Trobe* and *Valcorp*, one of the central issues was the sufficiency of the claimant's evidence that it had forgone opportunities to lend to other borrowers. In each case, the Full Court held that the claimant had proved the fact of loss of a lending opportunity, despite failing to produce evidence of any specific loan opportunities that were forgone as a result of lending to the defaulting borrower, and despite the fact that in *Valcorp* the evidence suggested that the demand for the claimant's funds did not at all relevant times exceed the supply of those funds.

In *Valcorp*, the Full Federal Court observed that evidence of specific loan opportunities is relevant both to proof of the fact of loss, and to the value of that loss.[70] The absence of such evidence may not be fatal to the proof of loss, but it must affect to a substantial degree a court's subjective probability assessment of the likelihood of the hypothetical loan.[71] In both *La Trobe* and *Valcorp*, the claimant's evidence of the availability of a hypothetical loan was deficient relative to what might be typical or expected within a highly developed commercial environment, and justified the adoption in each case of a significantly higher contingency discount to reflect the likelihood of the claimant entering into the hypothetical loan. Presumably, if any opportunities were available, it would be relatively easy for a professional lender to produce documentary material relevant to those opportunities. It is difficult to accept that, having decided to lend to the defaulting borrower, the claimant destroyed or discarded all documentary evidence of loan opportunities available at or around the time of the loan to the defaulting borrower.

High interest rates

In both *La Trobe* and *Valcorp*, the claimant operated in a non-traditional lending market. The claimant provided short-term loans at high interest rates to borrowers who would otherwise find it difficult to obtain finance. In *La Trobe*, the interest rate charged to the defaulting borrower was 9.5% per annum, while in *Valcorp* the interest

[70] *Valcorp Australia Pty Ltd v Angas Securities Ltd* [2012] FCAFC 22 (9 March 2012), [172].
[71] For an express acknowledgment of this relationship, see *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 324 [116] (Jacobson and Besanko JJ).

rate charged by the various claimants was 13.53%, 22.67% and 23% per annum respectively.

In both *La Trobe* and *Valcorp*, the claimant adopted the high interest rate charged to the defaulting borrower as the assumed interest rate charged under the hypothetical loan.[72] However, in valuing the claimant's lost opportunity in each case, the court failed to adopt a contingency discount reflecting the material risk of default involved in making hypothetical loans at such high interest rates. The discounts applied in each case to reflect this risk were statistically small, ranging from zero to 5%. Further, in *Valcorp*, Besanko J applied the same percentage discount to each loan despite the differing hypothetical interest rates.

It appears from both *La Trobe* and *Valcorp* that the risk of default was addressed by considering the level of bad debts incurred by the claimant in relation to similar classes of loans in the financial years in which the loans in question were made.[73] Clearly, this is one important factor in any consideration of default, however it assumes that all loans are made on the same terms and that all loans have an equal chance of default. In practice, however, some loans are inherently more likely to fail, particularly mezzanine loans at high rates of interest secured by second and third ranking securities like some of the loans in *Valcorp*. For this reason, the interest rate charged on the hypothetical loan is likely to be a more reliable indicator of the risk profile attached to that loan because it is particular to the type of borrower in question, and the specific loan terms and security.

The contingency discount must reflect the risk of default on the hypothetical loan. The best proxy for this risk is the rate of interest charged by the claimant, which in turn reflects the claimant's own assessment of the risk inherent in the loans. The

[72] This required the claimant to prove that, but for the defendant's wrong, the claimant would (or there was a chance that it would) have lent the principal to a hypothetical borrower at the same rate of interest charged to the defaulting borrower: see, *Swingcastle v Gibson (a firm)* [1991] 2 AC 223; *State Bank of New South Wales v Yee* (1994) 33 NSWLR 618, 636 (Giles J).

[73] *La Trobe Capital & Mortgage Corporation Ltd v Hay Property Consultants Pty Ltd* (2011) 190 FCR 299, 321 [99] (Finkelstein J), 324 [116] (Jacobson and Besanko JJ); *Angas Securities Ltd v Valcorp Australia Pty Ltd* (2011) 277 ALR 538, 574 [213] (Besanko J). See also, *Provident Capital Limited v John Virtue Pty Ltd (No 2)* [2012] NSWSC 319 (13 April 2012), [219] (Harrison AsJ).

higher the interest rate charged, the greater the contingency discount that should be applied to the value of the claimant's loss.

Accounting for benefits received

Chapter six demonstrated that, if a claimant has received a benefit as a result of the defendant's wrong, the claimant must account to the defendant for that benefit *before* any contingency discount is applied. This means that the value of the benefit received must *first* be subtracted from the value of the object of the opportunity, and then the contingency discount is applied to the resulting sum. In other words, the contingency discount is applied to the difference between the value of the object of the opportunity, and the value of the benefit received by the claimant as a result of the defendant's wrong.

In both *La Trobe* and *Valcorp*, the claimant received a benefit as a result of the defendant's wrong, in the form of the repayments made by the defaulting borrower under the loan made in fact. However, in each case, the court first applied the contingency discount to the value of the object of the chance (the repayments under the hypothetical loan), and then subtracted the value of the benefits received by the claimant (the repayments made by the defaulting borrower). In other words, the court incorrectly applied the contingency discount to the value of the repayments under the hypothetical loan, rather than to the difference between that value and the value of the repayments made by the defaulting borrower.

For example, in *La Trobe*, Finkelstein J applied his total contingency discount of 5% to the sum of \$643,991.45, being the net interest income that would have been generated on the hypothetical loan, resulting in the figure of \$611,791.88. His Honour then added to that figure the lender's capital loss of \$189,035, and then subtracted the sum of \$449,766.75, being the net interest income received from the defaulting borrower, leaving a net loss of \$351,060.13. In fact, Finkelstein J should have applied his discount of 5% to the sum of \$194,224.70, being the difference between the maximum net interest income (\$643,991.45), and the net interest income actually received by the lender from the defaulting borrower (\$449,766.75). This gives a figure of $184,513.46, which, when added to the lender's capital loss, gives a total net loss of $373,548.46.

More importantly, once it is recognised that the lender has suffered a single indivisible loss of cash flow, the discount of 5% should have been applied to the figure of $383,259.70, being the difference between the value of the lender's total expected hypothetical net cash receipts ($2,400,000 loan principal + $643,991.45 net interest = $3,043,991.40) and the lender's actual net cash receipts ($2,210,965 recovered from sale of property + $449,766.75 net interest = $2,660,731.70). On this basis, the lender's total net loss was $364,096.71 (using Finkelstein J's 5% contingency discount), or $309,482.20 (using Jacobson and Besanko JJ's combined contingency discount of 19.25%).

An alternative model

Introduction

This section of the chapter sets out a basic model for the valuation of loss of a lending opportunity. This model is based on the valuation framework developed in Parts one and two of the thesis, and the analysis contained in this chapter.

This model can be used as a guide for the application of the framework in this context. The model is more coherent, and economically complete, than the model of loss developed in the illustrative cases. The most obvious difference of principle is that this model computes damages in a single coherent calculation making no conceptual or semantic distinction between capital and income. Loss is interpreted as a deficit of cash flows relative to what was reasonably expected, and is assessed with respect to the timing and riskiness of those various cash flows (those expected and those actually realised). A more elaborate financial model would proceed on the same general foundations, but would pay more detailed and formal attention to the appropriate discount rate and to the subjective probability distributions of all the possible outcomes.

Three aspects of this valuation model should be observed at the outset. First, the aim of this model is to put the lender in the same position that it would have been in had the relevant wrong not occurred, consistent with the compensatory principle.[74] Secondly, the model uses DCF analysis to estimate the market value of the object of the opportunity, being the anticipated future cash flow under the hypothetical loan. Thirdly, the model assumes that loss is assessed at the time of the trial; and, at that time, the loss being valued is the loss of (a chance of) pre-trial uncertain net cash flow. This is consistent with the illustrative cases analysed in this chapter.

To allow correctly for the time value of money, all cash flows are accumulated or discounted by reference to exactly when they occur, or when they are supposed to occur.

Elementary model

Scenario

At $t = 0$, a lender (claimant) advances to a borrower, by way of loan, \$100 secured by a mortgage over the borrower's property. The claimant makes the loan relying on a valuation of the borrower's property given by a valuer (defendant).

The loan is made at an effective annual interest rate of 20%, with annual payments in arrears and a term of $t = 2$ years. The claimant's cost of finance is 10%. At all times, the claimant had the opportunity to make equivalent loans to other borrowers. Accordingly, the claimant's opportunity cost of capital is 20%. This means that the best thing that the claimant can do with any cash inflows received during the term of the loan is to re-lend those amounts to other borrowers at 20% interest. Interest on mortgage loans is typically compounded at least annually,[75] and therefore all interest rates are effective annual compound rates.

At $t = 1$, the borrower fails to pay the first annual interest payment, and the claimant as mortgagee sells the mortgaged property and realises a net amount of \$50. The

[74] See above, Part one, ch 3.
[75] See Thierry J Senechal and John Y Gotanda, 'Interest as Damages' (2009) 47(3) *Columbia Journal of Transnational Law* 491, 534.

claimant sues the defendant for damages for loss of an opportunity to lend the loan principal to a third party.

Assume that the lender's loss arose at $t = 0$, and that damages are assessed at $t = 2$, the date of the trial.

Value of the object of the opportunity

The first step in valuing the claimant's loss is to calculate the value of the net cash flow under the hypothetical loan at time $t = 2$. As the claimant's loss constitutes a pre-trial loss of anticipated cash flow, that loss must be accumulated to $t = 2$.

At $t = 1$, the claimant would have received a known cash inflow of \$20, being the first interest payment on the hypothetical loan. If this inflow is compounded to the date of trial at the claimant's cost of capital, the value of this inflow in $t = 2$ dollars is:

$$20 \times 1.20 = 24$$

At $t = 2$, the claimant would have received a known cash inflow of \$120, being the second interest payment, together with the repayment of the loan principal. Accordingly, the value of the claimant's cash inflow under the hypothetical loan in $t = 2$ dollars is:

$$24 + 120 = 144$$

At $t = 1$, the claimant would have incurred a known cash outflow of \$10, being the first interest payment to its financier. The value of this outflow in $t = 2$ dollars (compounded at the claimant's cost of capital) is:

$$10 \times 1.20 = 12$$

At $t = 2$, the claimant would have incurred its final known cash outflow of \$110, being its second interest payment and the repayment of its loan principal. Accordingly, the value of the claimant's total cash outflow in $t = 2$ dollars is:

$$12 + 110 = 122$$

It follows that the value of the claimant's net cash inflow under the hypothetical loan in $t = 2$ dollars is:

$$144 - 122 = \$22$$

Accounting for benefits received

The second step in valuing the claimant's loss is to compute its actual position at $t = 2$, having made the loan to the defaulting borrower. From the first step above, we can see that the cost to the claimant of borrowing $100 from its financier to lend to the defaulting borrower is $122, in $t = 2$ dollars.

The claimant must then account to the defendant for the value of any benefit received by the claimant as a result of the defendant's wrong. Any pre-trial benefits received by the claimant must be accumulated to the date of trial at the claimant's cost of capital.

At $t = 1$, the claimant sold the property used to secure the loan, and realised a net amount of $50. The value of this cash inflow in $t = 2$ dollars (compounded at the claimant's cost of capital) is:

$$50 \times 1.20 = 60$$

Accordingly, the value of the claimant's net cash outflow under the actual loan in $t = 2$ dollars is:

$$(122) + 60 = \$(62)$$

If it is assumed that the net cash inflow under the hypothetical loan is certain, then the claimant's loss would be the difference between the net cash inflow under the hypothetical loan, and the net cash outflow under the actual loan:

$$22 - (62) = \$84$$

By awarding this amount to the claimant, it would effectively be left with \$144, or a net amount of 144 – 122 = \$22, at $t = 2$.

Assessing the probability of the opportunity

The final step involves assessing the probability of the object of the opportunity. This step reflects the fact that the claimant has lost the chance or opportunity of receiving the net cash inflow under the hypothetical loan, not the net cash inflow itself.

More precisely, taking into account the claimant's actual position (including having received the $t = 2$ value of the proceeds of sale of the mortgage security), the relevant opportunity to be assessed is the claimant's opportunity of receiving the difference between the net cash inflow under the hypothetical loan, and the net cash outflow under the actual loan:

$$22 - (62) = \$84$$

Assessing probability in this context requires the court to make a subjective probability assessment. In some cases this assessment may be made on objective evidence, however in the majority of cases this assessment will have to be made intuitively. For example, for the purpose of valuing the loss of a lending opportunity, it may be possible to obtain very sound empirical evidence concerning the default rate of a certain class of loans (eg, home mortgages) but there may be little if any systematic evidence available to assess the probability that a particular claimant would have been able to find an alternative and equivalent borrower at the time it made a given loan.

In assessing the probability of the object of the opportunity, the court should pay particular attention to the assumed interest rate on the hypothetical loan. The court's assessment of the chance of default under the hypothetical loan should be commensurate with the claimant's own assessment of that risk, as reflected in the assumed interest rate on the loan. If it is assumed that the hypothetical loan would have been made at a relatively high interest rate such as 20%, it must also be assumed that there is a material or significant chance of default by the hypothetical borrower.

The simplest way for a court to assess the probability of the object of the opportunity is to ascribe a percentage value to that chance. The court may, for example, adopt an intuitive approach, and assess the claimant's chance at 95%. In this case, the claimant's damages would be:

$$84 \times 0.95 = \$79.80$$

By awarding this sum to the claimant, it is left with the equivalent of \$139.80 (ie, 60 + 79.80) at $t = 2$.

An alternative approach is to assess the chance by assessing the value of the hypothetical loan akin to a risk-adjusted market price. To allow for lending being inherently risky, the court would consider a subjective probability distribution over the range of plausible future ($t = 2$) values of all uncertain cash flows. The shape of this probability distribution can be determined by considering plausible patterns of default and compounding the cash flows from these through to the expiry of $t = 2$. The maximum feasible net future value might be set at \$22, but lower values (based on full or partial default) should also be assigned a probability greater than zero. If it is assumed that the claimant will at least get its money back (ie, the loan principal plus an amount to compensate the claimant for its cost of funds) then the lowest possible net future value will be zero. However, even this is not assured. If there is evidence that the claimant would have made a spectacularly unsuccessful investment (eg, in the context of a property market collapse where it can be seen that many investments failed), the claimant may have lost the entire loan, or only recovered a small fraction of its principal and interest. In those circumstances, the lowest possible net future value will be negative (–L), indicating that the hypothetical loan results in a loss that would not have been incurred had that loan never been made.[76]

[76] If the estimated net future value of the hypothetical alternative loan is negative (ie, the lender would recover less than the future ($t = 2$) value of its own cash outlay on the hypothetical alternative loan) then it may not be worthwhile for the lender to make an opportunity claim against the defendant. The

In making the hypothetical loan, the claimant is effectively buying a lottery ticket that will pay the equivalent of somewhere between –L and 22 at expiry. At t = 2, the certain receipt of a particular net amount A, where:

$$-L < A < 22$$

represents a fair exchange for holding such a lottery ticket (the more certain the lottery to pay 22, the nearer A is to 22). This is exactly the kind of consideration that occurs in financial markets when a loan is on-sold. The buyer acquires the lottery ticket that is called a loan, and pays a certain amount for it. The seller gives up the chance to make a net future value of 22 for some lesser but completely certain (risk-free) receipt. For example, if the loan is highly risky, then the seller might accept a net future value of A = $5 or even less for it, whereas if it is highly secure then the exchange price might be much closer to $22. The essential difference between a loan and a lottery ticket is that the payoff of a lottery ticket has a known (objective) probability distribution, whereas the corresponding probability distribution for the loan is much more subjective.

Under this approach, if, for example, the court determines that A = 20.9 is the fair exchange price for the hypothetical loan at t = 2 (ie, 95% of the full value of the net cash flow under the hypothetical loan), then the claimant's damages (after discounting both sides of the equation) are:

$$20.9 - ((62) \times 0.95) = \$79.80$$

In other words, under this approach, the court assesses the claimant's chance in proportion to the estimated discounted market value of the hypothetical loan at t = 2.

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lender may be better served simply by claiming from the defendant the lender's actual capital shortfall on the defaulting loan in accordance with the conventional rules as to proof and measure of damage in a no-transaction context. If the lender is able to prove that it would not have entered into the defaulting loan but for the defendant's negligence, the lender is prima facie entitled to recover its entire capital shortfall on the defaulting loan without the need to prove what else it would have done with its money.

Conclusion

This chapter examined the valuation of loss of a lending opportunity.

The chapter commenced with an introduction to claims for the negligent valuation of mortgage securities, and indentified the claim for loss of a lending opportunity within a taxonomy of different types of claims. It then identified the general approach taken by courts in valuing such a loss, and examined the leading cases that illustrate that approach.

The valuation framework developed in Parts one and two of the thesis was then applied to these cases. This demonstrated the utility of the valuation framework by exposing the errors that have been made by courts in valuing the loss of a lending opportunity. Specifically, the chapter demonstrated that the approach taken in the illustrative cases fails to properly characterise the true nature of the claimant's loss as a single undivided loss of anticipated future cash flow; fails to properly value the contingencies affecting that loss and fails to properly account for the benefits received by the claimant. These failures lead to the misapplication of the loss of commercial opportunity doctrine, and to erroneous damages awards in claims for loss of a lending opportunity. The chapter concluded by developing a basic model for the valuation of loss of a lending opportunity, based on the valuation framework. This model can be used as a guide for the application of the framework in this context.

More generally, this chapter demonstrated the importance of finance theory in providing a coherent and rigourous theoretical framework with which to value the loss of a commercial opportunity. The use of such a framework assists in rooting out errors of economic logic that can be made when the task of valuing loss is approached on an *ad hoc* basis. These errors include not only obvious mistakes such as double counting the same element of loss in different guises (eg, as both 'capital' and 'income'), but also the many more subtle errors that occur in instinctive patterns of reasoning regarding money and probability.

Part 4

Conclusion

Chapter 8

Conclusion

Introduction

Purpose and object

This chapter concludes the thesis. The object of the chapter is to recapitulate the thesis and to validate the thesis argument.

The thesis

Validation of thesis argument

Recapitulation of thesis

This thesis has examined the valuation of loss of a commercial opportunity in a damages context. The justification for the inquiry has been the importance of claims for damages for loss of a commercial opportunity in modern commercial litigation. This topic has not been the subject of any extensive and thorough academic treatment in Australian law. The thesis examined the legal doctrine of loss of a commercial opportunity and developed a general legal framework for the valuation of this type of loss that is based on, and consistent with, the modern portfolio theory (CAPM) based financial theory of valuation.

The thesis comprised three main Parts. Part one of the thesis examined two things by way of introduction: the role of financial valuation theory in the assessment of damages for economic loss in a damages context, and the legal doctrine of loss of a commercial opportunity. This provided the foundation for the analysis contained in Parts two and three of the thesis.

Part two of the thesis examined the legal principles relevant to the fact, character and valuation of the loss of a commercial opportunity. This Part of the thesis developed a legal framework for the valuation of loss of a commercial opportunity that is based on, and consistent with, financial valuation theory. It also serves as a survey of the relevant legal framework within which expert witnesses undertake financial analyses, and hence is valuable to finance professionals as well as legal practitioners.

Part three of the thesis comprised a case study. This case study applied the valuation framework developed in Parts one and two of the thesis to the loss of a lending opportunity, being a particular type of loss of commercial opportunity. It gives a concrete illustration of how financial reasoning can contribute to existing legal methodology and reasoning in the valuation process.

Validation of thesis argument

Thesis argument

This thesis argued that the loss of a commercial opportunity should be valued by reference to its market value. In modern finance theory, market value is determined by reference to the discounted present value of projected cash flows, discounted at a risk adjusted (CAPM-based) interest rate. In some circumstances, market values are directly observable and in others they are estimated by DCF calculations. In modern finance theory, exchange values in markets are understood as market estimates of discounted present value, so fundamentally the valuation basis presumed throughout this thesis is DCF. A recurrent theme is that DCF valuation is generally a subjective process. Observable market values, where they exist, will alleviate this subjectivity, and provide some guidance in valuing the loss of a commercial opportunity.

Chapter two demonstrated that, in a damages context, the value (or loss in value) of an asset is generally determined by reference to its market value. Market value, in this context, means the hypothetical exchange price of an asset. The particular methodology used to determine the market value of an asset will depend on the precise legal and factual circumstances. Financial valuation theory is an accepted methodology for determining market value in this context. In financial valuation theory, market value (or a proxy for market value) is determined by reference to the discounted present value of projected cash flows. Chapter two outlined the principles of financial valuation theory relevant to the valuation of loss, and demonstrated how they can be used to determine the present value of a claimant's loss.

Chapter four showed that, in order to form the subject matter of a compensable loss, a commercial opportunity must have a non-negligible monetary value. This comprises two inter-related elements. First, the object of the opportunity must have a non-negligible monetary value. This may represent an expected benefit, or avoiding, reducing or deferring a detriment. Secondly, the probability of successfully obtaining or realising that object must be non-negligible.

Chapter five demonstrated that a commercial opportunity is an asset. This follows from the analysis in chapter four. A chance with a non-negligible monetary value constitutes an asset, because it represents the chance of an anticipated future cash flow. The loss of a commercial opportunity therefore represents the loss of an asset, being the chance or opportunity of an anticipated future cash flow. That cash flow may consist of the receipt of an anticipated cash inflow, such as an expected benefit, or avoiding, reducing or deferring an anticipated cash outflow, such as an expected detriment.

Chapter six showed that, in principle, the loss of a commercial opportunity should be valued by reference to its market value, being the discounted present value of projected cash flows. This follows from the analysis in chapters two and five. Chapter five demonstrated that a commercial opportunity is an asset, in the sense that it is what economists call a 'lottery' or random payoff; chapter two showed that the value (or loss in value) of an asset is measured conceptually by reference to its hypothetical or actual market value. Theoretically, the market value approach applies to all types of lost opportunity, including loss of a cause of action.

Valuation framework

The thesis argument served as the foundation for the construction of a legal framework for the valuation of loss of a commercial opportunity. This framework is based on, and consistent with, the principles of financial valuation theory outlined in chapter two.

Chapter six identified the 'simple probability' approach as the general approach taken by courts to the valuation of loss of a commercial opportunity. The simple probability approach was applied to construct a framework for determining the market value of the loss of a commercial opportunity. This framework consists of three steps. The first step is to determine the market value of the object of the opportunity. This can be done using either a formal valuation methodology, such as DCF analysis or the comparable market price methodology; or an informal methodology, involving an intuitive or 'broad brush' (ie, *ad hoc*) approach. Theoretically, the loss of a commercial opportunity should be valued using DCF analysis. This follows from the analysis in chapters two and five. The loss of a commercial opportunity represents the loss of a chance of an anticipated future cash flow, and DCF analysis (using mathematical models such as the CAPM) is the normatively accepted method for valuing future cash flow in finance theory.

The second step is to assess the probability of the opportunity (ie, of its realisation) and to adjust the market value of the object according to that probability. The most common way to assess this probability is to select a percentage figure that reflects the contingencies affecting the successful realisation of the object of the opportunity. This percentage figure is then used to adjust the market value of the object of the opportunity.

The final step is to account for any benefits received by the claimant as a result of the defendant's wrong. The claimant must account to the defendant for the value of any such benefit before the market value of the object of the opportunity is adjusted to reflect the probability of the opportunity. This requires the court to first subtract the value of the benefit from the market value of the object, and then to adjust the resulting sum. In other words, the adjustment (eg, discount) should be applied to the difference between the market value of the object of the opportunity, and the value of the benefit received by the claimant as a result of the defendant's wrong.

Utility of valuation framework

A case study was used to demonstrate the utility of the valuation framework. The application of this framework exposed the errors of financial logic that are commonly made by courts in valuing loss of a lending opportunity. Specifically, the case study demonstrated that the approach adopted by courts to the valuation of this type of loss fails to properly characterise the true nature of the claimant's loss as a single undivided loss of anticipated future cash flow; fails to properly value the contingencies affecting that loss and fails to properly account for the benefits received by the claimant. These failures lead to the misapplication of the loss of commercial opportunity doctrine, and to erroneous damages awards in claims for loss of a lending opportunity.

Limitations of thesis argument

The thesis argument is intended to serve as an organising principle for the valuation of loss of a commercial opportunity. The valuation framework developed in the body of the thesis is based on the thesis argument. It is hoped that this framework will serve as a useful guide for courts, tribunals and other decision makers, as well as legal practitioners, in valuing the loss of a commercial opportunity in a damages context. A less obvious but valuable role of this thesis is to provide finance experts with an overview of the relevant legal principles for the valuation of loss. It is hoped this introduction will assist finance experts to relate their work to the legal principles that govern the valuation of loss. This in turn will lead to expert evidence that is informed, accurate, and relevant, as well as being comprehensible to a decision maker with limited finance training.

The analysis in the thesis has inevitable limitations. First, it may be argued that the market value approach does not apply to the valuation of the loss of all types of lost commercial opportunity. In particular, it may be argued that it does not apply to the valuation of lost opportunities that involve highly subjective or policy driven considerations, such as loss of a cause of action. This may limit the practical utility of any general theory of the value of a lost opportunity.

Secondly, the valuation framework proposed in chapter six is quite general. In particular, the methodologies used to estimate the market value of the object of a commercial opportunity are described in general theoretical terms. In any particular case, the precise methodology to be used will depend on the legal and factual context. The innate subjectivity of this exercise is emphasised throughout the thesis. Finance theory is extremely robust in terms of its conceptual development and content, but its application in any instance is always subjective. Subjectivity is of course inevitable since financial valuation involves an informed estimation about what cash flows will happen in the future or would have happened under different circumstances. Finance valuation models do not offer unique objective valuations, and subjective assessments will remain no matter how technically advanced the finance models applied. In this regard, courts must continue to scrutinise this evidence carefully, and make considered allowance for both the conceptual insights and the practical limitations that DCF techniques have to offer.

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