

## **“FUNDAMENTAL BREACH” & DAMAGES**

In commercial situations a breach of a Contract can have serious consequences, both for the “promisor” (the party agreeing to provide goods/services) and the “promisee” (the party accepting and paying for those goods/services).

### **Breaches of Contract and Effects**

Breaches of obligations in a contract will give rise to a further obligation to the party in default, namely to pay “damages” to the innocent party, and in many cases rights to the innocent party to terminate the contract. These rights will usually arise either from the terms of the contract itself, or from the common law.

Where a party fails to perform a certain obligation in the contract, a breach will arise.

- The breach can be classified as;
- A breach of a term of the contract or of a warranty;
  - a breach of a condition;
  - a “fundamental breach” of an “essential” or “fundamental term” of a contract.

The extent of the innocent party’s right to recover damages will depend on the nature of the breach, the circumstances surrounding termination and the terms of the contract itself.

### **Fundamental Breach and Breach of Fundamental Terms**

Where a party breaches an essential or “fundamental” term, a “fundamental breach” is said to have occurred, giving the innocent party a right to terminate the Contract and sue for damages.

A fundamental breach can be described as a failure so serious that it has the effect of depriving the other party of substantially the whole benefit of the contract - or that the breach “goes so much to the root of the contract that it makes commercial performance of it impossible” (*Progressive Mailing House Pty Ltd v Tabali Pty Ltd* (1985) 157 CLR 17).

### **Repudiation**

A party in default will have been taken to have “repudiated” the contract where that party has demonstrated an absence of readiness or willingness to perform the contract. The breach in question must be serious - and in a manner “substantially inconsistent with the obligations” (*Progressive Mailing House Pty Ltd v Tabali Pty Ltd*).

The innocent party may then “accept” the repudiation, terminate the contract and sue for damages.

### **Election to Terminate**

Many contracts contain clauses which allow an innocent party to elect to terminate the contract where certain terms of the contract have not been complied with.

In this scenario, where the specified term has not been complied with, the innocent party invokes their right to elect to terminate the contract and prevent the party in default from further performance of the contract. The innocent party may then sue for damages. This is distinct from the party in default having “fundamentally breached”, or “repudiated”, the contract.

### **Damages**

The crucial issue where a contract has not been performed to a party’s satisfaction will of course be “How much can I recover?”.

This depends on the type of default, and the manner in which the contract is terminated becomes crucial.

The purpose of a Court awarding general damages to an “innocent” party following the breach of a contract is in order to put that party in the position they would have been had it not been for the breach of the contract. That is, in the absence of specific terms in a contract to the contrary, a party’s “actual” loss is what is compensated.

*Loss of Bargain Damages*, on the other hand, are the damages assessed by reference to the difference between the “value” of the contract at the time of breach and the price expressed in the contract. For example, where a contract is for services to be provided over a period of time, with payments made by instalments accordingly, loss of bargain damages would be equivalent to the amount payable for the whole term, as opposed to the amount for services provided up to the time of “default”.

Loss of Bargain damages will only be recoverable where;

1. there has been a “fundamental breach” or “essential term” of the contract;
2. the defaulting party has repudiated the contract;
3. where the innocent party has exercised a contractual right to terminate the contract, BUT only if the defaulter:
  - a) has breached an essential term;
  - b) has committed a fundamental breach;
  - c) has repudiated the contract.

Therefore, if a contract provides a right to the innocent party to terminate the contract, it is crucial that it first be established that the defendant is in default in the manners specified in (3) above. Otherwise, only nominal damages may be recoverable.

### Mitigation and Reinstatement Damages

An important concept in the law of contract is that of “mitigation of loss” or mitigation of damages. This means that the innocent party has a duty to *mitigate* or take active steps to reduce the loss which they will experience as a result of the other party’s default.

So, for example, where a lessee breaches an essential term of a lease, and the lessor exercises their right of re-entry and sues for damages, the lessor will not recover full loss of bargain damages for the rent payable pursuant to the lease for the remainder of the term, if the lessor did not take active steps to find another suitable tenant and recover some rent.

Another form of damages typical to building or repair contracts is known as “reinstatement damages”.

Where defective work has been done, or where the defendant’s breach has caused damage to the innocent party’s property, the damages awarded will be equivalent to the cost to remedy the defective works or assessed on a reinstatement basis. This is in contrast to an assessment based on the difference of the value of the work done and what the value of the work would have been if it had been in accordance with the contract.

### Case Studies

1. In *Shevill v Builders Licensing Board* (1982) 149 CLR 620, a lessee had failed to pay rent for a period of 14 days. The lease provided the lessor with a right to re-enter the premises and terminate the contract where rent was outstanding for 14 days, “without prejudice to any other remedy which the lessor has...for damages as a result...”. The lessor exercised its right of re-entry and sued for loss of bargain damages for the remainder of the lease term. The High Court found that as there was no breach of an essential term, no repudiation or no serious breach on the part of the lessee, the lessor could only recover nominal damages as it had on its own initiative elected to terminate the contract.

2. In *Progressive Mailing House Pty Ltd v Tabali Pty Ltd*, not only had the lessee failed to pay rent for 4 months, but had also failed to maintain and repair the premises and had also sub-let the premises contrary to the terms of the lease. The lessor elected its right to re-enter the premises and terminated the contract.

The High Court found that although none of the breaches of the lessee in isolation could be viewed as breaches of essential terms, as a whole the lessee had repudiated the contract or fundamentally breached its obligations. The lessor was therefore entitled to loss of bargain damages for the remainder of the term of the lease.

3. In *Harbutt’s ‘Plasticine’ Ltd v Wayne Tank and Pump Co Ltd* [1970] 1 QB 447, a contract provided for the design of a system for moving molten plasticine at a factory. A breach of the contract caused a fire in the factory. The Court found that the defendant was liable for damages for the cost of rebuilding the plaintiff’s factory damaged by the fire (i.e. reinstatement damages).

For further information please don’t hesitate to contact

Grahame Jackson BEc.LLB  
[grahamejackson@gjalaw.com](mailto:grahamejackson@gjalaw.com)

**Tel: 9908 1700**

Fax: 9908 1755

Grahame Jackson & Associates  
Attorneys at Law

Suite 4, 3-7 Grosvenor Street  
Neutral Bay NSW 2089

ABN: 31 099 497 551