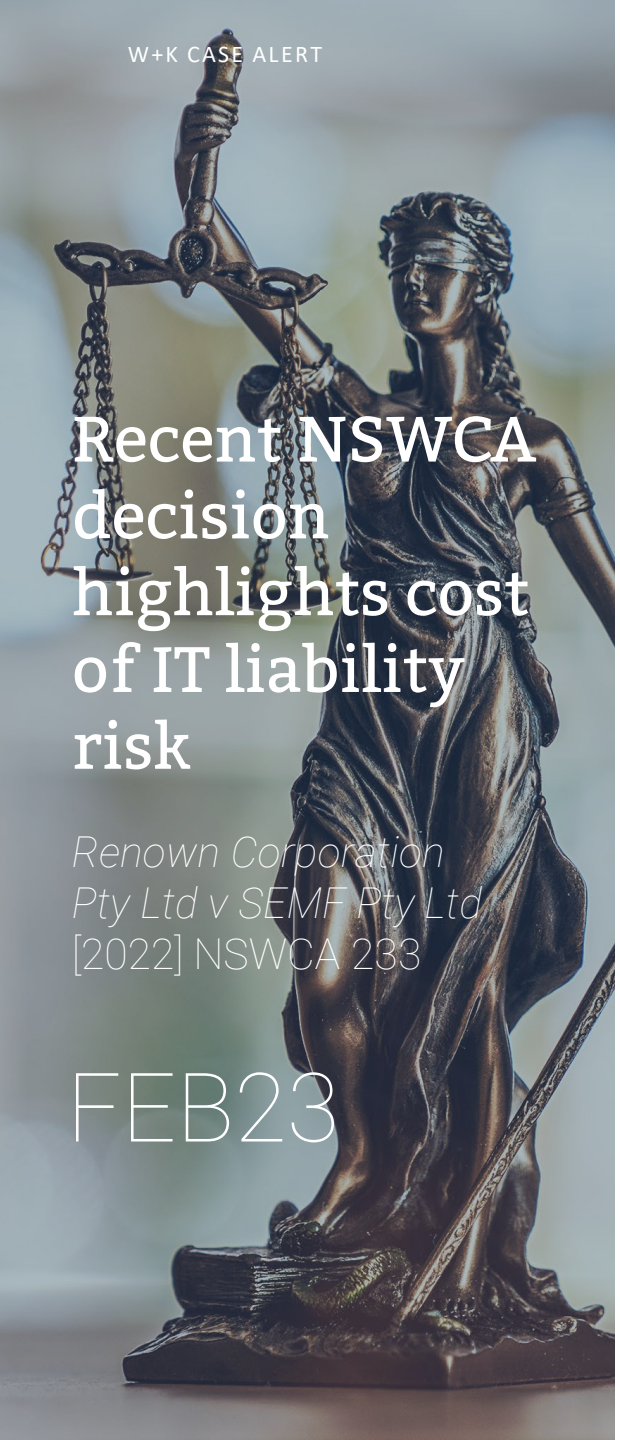


W+K CASE ALERT

Recent NSWCA decision highlights cost of IT liability risk

Renown Corporation Pty Ltd v SEMF Pty Ltd [2022] NSWCA 233

FEB23

Authors: Kieran Doyle (Partner), Stephen Morrissey (Special Counsel), Kaila Hart (Associate)

wotton kearney

A founding member of LEGALIGN GLOBAL

At a glance

- In *Renown*, the NSW Court of Appeal (NSWCA) affirmed an award of damages for the costs of replacing a defective software system with an upgraded version.
- *Renown* highlights the potential for IT providers that breach supply and installation contracts – and their insurers – to end up paying out higher damages awards.
- Notably, the NSWCA found that the proper measure of damages for breach of contract for the supply and installation of a software package involved assessing the reasonable costs when they were actually incurred or, if not incurred already, the reasonable costs as proved as at the trial.

In *Renown Corporation Pty Ltd v SEMF Pty Ltd* [2022] NSWCA 233, an IT provider was found to have breached supply and installation contracts. This appeal decision provides useful guidance for IT providers (particularly software developers and suppliers) and their insurers regarding the assessment of damages where a breach of a supply and installation contract is established.

Background to the dispute

SEMF Pty Ltd (SEMF), the respondent in this case, operates an engineering/project management business. In early 2013, it contracted with the first appellant, Renown Corporation Pty Ltd (Renown), to supply and install a software package "to deal with and to provide reports in relation to GST" (the Renown System).

When the Renown System was installed, it was alleged to be defective as it did not provide the functions as promised, including that it did not enable "SEMF employees to generate certain real time reports in relation to project invoicing and other project enquiries using a software module known as Microsoft Business Portal for Dynamics SL 2011". SEMF subsequently sued Renown for damages – claiming the costs of replacing the Renown System with an upgraded version (the 2018 Suite), the costs of attempting to remediate the defects, and time its employees spent dealing with the problems arising from the defects.

The primary judge, Ball J, awarded damages to SEMF of $662,344, which relevantly included the costs of installing the new system and the amount paid to one of SEMF's casual employees who specifically worked on remediating the problems arising from the Renown System.

Renown appealed this decision to the NSW Court of Appeal, challenging the damages awarded to SEMF. Renown argued that damages are to be assessed at the date of the breach and that SEMF did not provide evidence of the costs of rectification at the date of the breach, and therefore failed to establish that it suffered loss to entitle it to damages.

Renown also contended that, in the alternative, any damages awarded to SEMF should be substantially discounted to account for betterment. As to the payments made to SEMF's casual employee, Renown disputed that the employee was not specifically engaged to find solutions to the issues with the Renown System and, therefore, the claim regarding him should have failed for the same reasons it did in respect of the other employees.

The issues

The issues for determination by the NSWCA were:

1) the timing for the assessment of damages

2) the damages based on the costs of replacing the Renown System with an updated system

3) whether betterment should be considered in awarding the damages, and

4) whether the payments SEMF made to its casual employee for investigating solutions to the issues with the Renown System were recoverable.

The decision

On 15 November 2022, the Court dismissed the appeal, with costs.

The NSWCA relevantly found that:

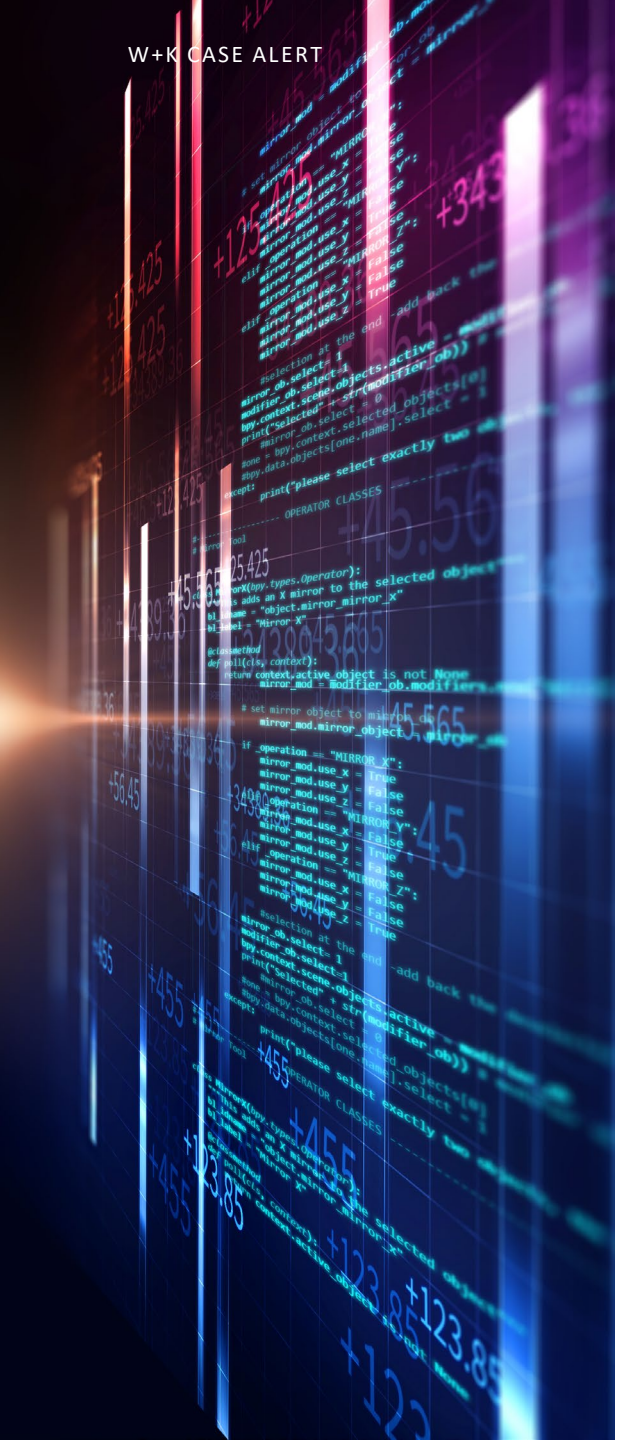
1) The timing for the assessment of damages – contracts for the supply and installation of computer systems are analogous to construction contracts and the correct measure of damages for a breach of contract as such "is the reasonable costs of rectification, which will be the costs when they were actually incurred (if they have been incurred by the date of trial), so long as they are not unreasonable; or (if they have not been incurred already), the reasonable costs as proved as at the trial, unless it is established that by not conducting rectification works earlier, the plaintiff has unreasonably failed to mitigate its loss".

   Further, as there was no indication "that by deferring rectification, SEMF unreasonably failed to mitigate its damages", the primary judge was correct to assess damages as at the hearing date.

2) The damages based on the costs of replacing the Renown System with an updated system – in cases where experts agree that "it would be more efficient and cost effective to upgrade" the defective system than to rectify the identified defects, the primary judge did not err in awarding damages for the costs of that replacement.

3) Whether betterment should be considered in awarding the damages – it may be the case that "SEMF saved the cost of work that would have been required to migrate the "add-ons" or "third party modules"" in updating its system to a newer one (i.e. the 2018 Suite). This saving invokes the "avoided loss principle" – under which Renown may have been entitled to an allowance for the benefit obtained by SEMF from that action[1]. However, Renown "bore the onus of proof" in demonstrating if any saving was involved, but failed to do so.

[1] *Ruthol Pty Ltd v Tricon (Australia) Pty Ltd* at [40] cited in the Judgment at [35]



4) Whether the payments SEMF made to its employee in investigating solutions for the issues with the Renown System were recoverable – SEMF's employee was initially employed on a casual basis to work on a database project (unrelated to the Renown System issues). However, he was later engaged to work on "the implementation and attempted rectification" of the Renown System and "during the period in respect of which a claim was made for his remuneration, he was employed specifically to work on a solution to the problems with the Renown System". As he was solely working on the Renown System, "he fell in a different category from the other employees in respect of whom "diversion of time" was claimed but not allowed." Accordingly, the primary judge did not err in allowing the remuneration paid to the casual employee to be recovered as part of SEMF's damages.

[2] Ibid.

Implications for insurers

In this matter, the NSWCA affirmed an award of damages against Renown for the costs of replacing a defective software system with an upgraded version. This decision highlights the potential for IT providers that are found to have breached supply and installation contracts – and their insurers – to end up paying out higher damages awards.

In litigated cases with similar circumstances, insurers and insured IT providers should be aware that:

- damages for loss incurred due to defective IT systems/products may be assessed as at the date of hearing
- replacement costs of a defective IT system/product may be paid out in circumstances where this is more economical than remediating the defective system
- even if "the guilty party is entitled to an allowance for the benefit to the innocent party from that action (the avoided loss principle)"[2], this saving by way of 'betterment' will only be accounted for in damages awarded if the saving is substantiated by the 'guilty' party via expert evidence, and
- casual and temporary employees' remuneration may be included in the award of damages where the nature of the employees' employment solely relates to working on solutions to resolving issues with defective IT systems/products. However, this case demonstrates that damages for diversion of time for ordinary employees are unlikely to be recoverable.

Australian offices

Adelaide
Level 1, 25 Grenfell Street
Adelaide, SA 5000
T: +61 8 8473 8000

Brisbane
Level 23, 111 Eagle Street
Brisbane, QLD 4000
T: +61 7 3236 8700

Canberra
Suite 4.01, 17 Moore Street
Canberra, ACT 2601
T: +61 2 5114 2300

Melbourne
Level 15, 600 Bourke Street
Melbourne, VIC 3000
T: +61 3 9604 7900

Melbourne – Health
Level 36, Central Tower
360 Elizabeth Street, Melbourne, VIC 3000
T: +61 3 9604 7900

Perth
Level 49, 108 St Georges Terrace
Perth, WA 6000
T: +61 8 9222 6900

Sydney
Level 26, 85 Castlereagh Street
Sydney, NSW 2000
T: +61 2 8273 9900

New Zealand offices

Auckland
Level 18, Crombie Lockwood Tower
191 Queen Street, Auckland 1010
T: +64 9 377 1854

Wellington
Level 13, Harbour Tower
2 Hunter Street, Wellington 6011
T: +64 4 499 5589

www.wottonkearney.com.au

wotton kearney

Need to know more?

For more information, contact our authors, **Technology Liability** specialists.

Kieran Doyle
Head of Cyber + Technology, Sydney
T: +61 2 8273 9828
kieran.doyle@wottonkearney.com.au

Stephen Morrissey
Special Counsel, Sydney
T: +61 2 8273 9817
stephen.morrissey@wottonkearney.com.au

Kaila Hart
Associate, Sydney
T: +61 2 8273 9838
kaila.hart@wottonkearney.com.au

For more insights on the latest developments and updates in the technology liability industry, click here.