

➤ Allens Contract Law Update 2014

➤ Introduction

This is the third edition of the annual Allens Contract Law Update. In these updates, we summarise important contract law judgments handed down by Australian appellate courts during the previous 12 months.

Our first *Contract Law Update* referred to the special leave determination by the High Court in *Western Export Services*¹. That case sparked much debate as to when extrinsic evidence would be admissible for the purpose of interpreting a contract. As will be seen in this update, following the more recent High Court decision in *Electricity Generation Corporation v Woodside Energy Ltd*², appellate courts in Australia are now taking different approaches to this important question. These inconsistencies are likely to continue until the High Court expressly resolves the issue.

Our first *Contract Law Update* also contained a summary of the High Court's judgment on penalties in the *Bank Fees Class Action*³. This update contains a further appellate judgment in the area of penalties, although there are many implications of the High Court's judgment in the *Bank Fees Class Action* that are still to be explored by appellate courts in Australia.

This update includes summaries of a number of important High Court cases. In *Commonwealth Bank of Australia v Barker*⁴, the High Court confirmed an orthodox approach to the implication of terms at law and, in the process, denied the existence of an implied term of mutual trust and confidence in employment contracts. In *Clark v Macourt*, the High Court adopted an approach to the calculation of damages for breach of warranty which, in confirming that damages should be calculated as at the date of the breach of contract, arguably allowed the plaintiff to receive a windfall. The High Court's judgment in *Electricity Generation Corporation* has also attracted a lot of comment for its restrictive reading of an obligation to use 'reasonable endeavours'.

Other issues considered in judgments covered by this update include: what clauses survive termination of a contract; when will a party be held to have waived rights under a contract; and whether a settlement deed can be set aside due to earlier fraudulent misrepresentations. In relation to this last issue, the decision of the New South Wales Court of Appeal in *Taheri*⁵ takes a strong line against fraudulent misrepresentations, but does, in the process, undermine the finality of settlements.

We hope you enjoy this year's update.

1. *Western Export Services Inc v Jireh International Pty Ltd*, [2011] HCA 45.
2. [2014] 306 ALR 25.
3. *Andrews v Australian and New Zealand Banking Ltd* [2012] HCA 30.
4. [2014] HCA 32.
5. *Taheri v Vitek* [2014] NSWCA 209.

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➤ Chapter 1: Evidence of surrounding circumstances

During the past 12 months, a number of appellate courts in Australia have wrestled with the apparently simple question: when interpreting a contract, may a court consider evidence of surrounding circumstances if the contract is not on its face ambiguous?

In 2011, three judges of the High Court stated, on a special leave application in *Western Export Services Inc v Jireh International Pty Ltd*⁶, that consideration of surrounding circumstances can only be given where the contract is ambiguous. However, a number of earlier and subsequent High Court judgments have referred to the consideration of surrounding circumstances, for the purpose of interpreting a contract, without expressly stating that such circumstances should only be considered if the contract is, on its face, ambiguous. Somewhat confusingly, though, the High Court has also stated that its decision in *Codelfa*⁷ and, in particular, the so-called ‘true rule’ of contract interpretation as stated by Justice Mason (as his Honour then was) remains binding on intermediate appellate courts. *Codelfa* is frequently cited as authority for the proposition that regard may only be had to surrounding circumstances if a contract is, on its face, ambiguous – although it is not clear whether *Codelfa* is in fact authority for this proposition.

6 *Western Export Services Inc v Jireh International Pty Ltd* [2011] HCA 45.

7 *Codelfa Construction Pty Ltd v State Rail Authority of NSW* [1982] 149 CLR 337, particularly at 352.

8 [2014] 306 ALR 25.

In *Electricity Generation Corporation v Woodside Energy Ltd*⁸, the majority of the High Court stated that interpretation of a commercial contract ‘requires’ consideration of surrounding circumstances known to the parties. The majority did not limit this statement to the interpretation of contracts that are ambiguous on their face. However, no reference was made in the judgment to the statements in *Western Export Services* or to the long-standing controversy on this issue.

In *Maintek Services*⁹, the NSW Court of Appeal considered the conflicting authorities and held that evidence of surrounding circumstances is admissible even if there is no ambiguity on the face of the contract. The Full Court of the Federal Court came to the same conclusion in *Stratton Finance v Webb*¹⁰. The Full Court agreed with the NSW Court of Appeal that *Electricity Generation Corporation*¹¹ implicitly repudiated the statements in *Western Export Services* to the effect that ambiguity was required before regard could be had to evidence of surrounding circumstances.

9 *Maintek Services Pty Ltd v Stein Heurtey SA* [2014] NSWCA 184.

10 [2014] FCAFC 110.

11 *Electricity Generation Corporation v Woodside Energy Ltd* [2014] 306 ALR 25.

By contrast, the Western Australia Court of Appeal in *Technomin Australia Pty Ltd v Xstrata Nickel Australasia Operations Pty Ltd*¹² has taken a different approach and held that ambiguity remains a pre-condition to consideration of surrounding circumstances, subject to some limited exceptions, until the High Court states otherwise.

There will therefore be continuing uncertainty and differing approaches among superior courts concerning the admissibility of surrounding circumstances until this issue is expressly and clearly addressed by the High Court.

The last case considered in this section – *Johnston*¹³ confirms two important rules relating to the admissibility of post-contractual conduct:

- evidence of such conduct is not admissible for the purpose of interpreting the terms of a contract; but
- evidence of such conduct is admissible for the purpose of ascertaining the terms of a contract or, as in this case, the terms of a variation to a contract.

In relation to the second rule, the court observed that evidence of subsequent conduct may not be admissible if identifying the terms of a contract is a question of mixed fact and law. This potentially raises some interesting issues – such as when will the identification of terms of a contract be a question of law – but the court did not need to elaborate on that point in this case.

¹² [2014] WASCA 164.

¹³ *Johnston v Brightstars Holding Company Pty Ltd* [2014] NSWCA 150.

Mainteck Services Pty Ltd v Stein Heurtey SA [2014] NSWCA 184

- › Admissibility of extrinsic evidence
- › Ambiguity

In this decision, the NSW Court of Appeal considered the admissibility of extrinsic evidence in interpreting ambiguous language in commercial contracts.

The NSW Court of Appeal continued the approach taken in *Franklins Pty Ltd v Metcash Trading Ltd* [2009] NSWCA 407 and *OneSteel Manufacturing Pty Limited v BlueScope Steel (AIS) Pty Limited* [2013] NSWCA 27, to admit extrinsic evidence in interpreting commercial contracts, even if there is no ambiguity on the face of the contract.

Given the different approaches to the admissibility of extrinsic materials taken by different state and federal appellate courts, there exists a possibility of forum-shopping for a different outcome where extrinsic material is needed to adduce evidence to support a particular interpretation of contract.

Facts

Mainteck was a subcontractor under a consortial agreement with Stein Heurtey SA (**SHSA**), a French entity, to design, supply and install a furnace as part of SHSA's works under its principal contract with BlueScope Steel (AIS) Pty Ltd. Mainteck alleged that it had supplied equipment and services outside the agreed scope of works under the consortial agreement in connection with SHSA's principal contract with BlueScope.

Mainteck commenced proceedings against SHSA and its Australian entity, SH Australia, for misleading or deceptive conduct, breach of fiduciary obligations, and breach of contract. The dispute was referred to the Honourable R L Hunter QC who acted as referee and produced a series of expert reports (the **Hunter Reports**). The court at first instance ordered that specific paragraphs from these reports be adopted, but 'specifically... did not adopt the finding made by Mr Hunter that the scope of work under the Consortial Agreement was void for uncertainty'. Mainteck appealed against the primary judge's findings on a number of grounds, including the use of extrinsic materials in the construction of the contract.

Judgment

The NSW Court of Appeal noted that the language at parts of the consortial agreement '[exhibited] considerable ambiguity, both on its own and in the context of the Principal Contract to which it [referred]'. The ambiguity arises primarily as 'the English text [of the Consortial Agreement] resulted from a translation of French text', and resulted in terminology borrowed from civil law that did not fit comfortably with established terms under common law. Of note, the court held the use of the term 'turnkey' to designate responsibility under the contract was unproductive, and '[did] not of itself assist in identifying the legal rights, privileges, powers and immunities enjoyed by the parties'. The court further noted that 'it is far from clear that there is a settled understanding of "turnkey"'.

The NSW Court of Appeal, however, unanimously observed that there was a clear mismatch of approaches taken in the two High Court cases of *Western Export Services Inc v Jireh International Pty Ltd* (2011) 282 ALR 604 (**Jireh**) and *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 306 ALR 25 (**Woodside**).

Justice Leeming observed that:

To the extent that what was said in *Jireh* supports a proposition that 'ambiguity' can be evaluated without regard to surrounding circumstances and commercial purpose or objects, it is clear that it is inconsistent with what was said in *Woodside* at [35]. The judgment confirms that not only will the language used 'require consideration' but so too will the surrounding circumstances and the commercial purpose or objects.

The relevant paragraph of the judgment in *Woodside* is as follows (with footnotes removed):

... this court has reaffirmed the objective approach to be adopted in determining the rights and liabilities of parties to a contract. The meaning of the terms of a commercial contract is to be determined by what a reasonable businessperson would have understood those terms to mean... As reaffirmed, **it will require consideration** of the language used

by the parties, the surrounding circumstances known to them and the commercial purpose or objects to be secured by the contract. Appreciation of the commercial purpose or objects is facilitated by an understanding 'of the genesis of the transaction, the background, the context [and] the market in which the parties are operating'. [emphasis added]

Justice Leeming pointed to the use of the words 'it will require consideration' in *Woodside* and noted the 'mandatory' nature of these words. Further, his Honour observed that *Woodside* was grounded in a consistent approach taken by the High Court in the cases of *Pacific Carriers Ltd v BNP Paribas* (2004) 218 CLR 451, *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165 and *Byrnes v Kendle* (2011) 2434 CLR 253. The court then went on to observe that Chief Justice Allsop's approach in *Franklins* was not inconsistent with 'the true rule' in *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337, which Justice Mason states as:

The true rule is that evidence of surrounding circumstances is admissible to assist in the interpretation of the contract if the language is ambiguous or susceptible of more than one meaning. But it is not admissible to contradict the language of the contract when it has a plain meaning.

Justice Leeming held that there was no inconsistency between *Codelfa* and *Franklins* as the 'plain meaning' of words in a contract requires judicial assessment of the contractual context. However, while the NSW Court of Appeal preferred the expansive approach, and would have considered extrinsic materials in construing the contract, the materials ultimately were of no assistance to Mainteck.

Stratton Finance Pty Limited v Webb [2014] FCAFC 110

- › Contractual interpretation
- › Approach to contractual interpretation
- › Breach of contract

In this judgment, the Full Court of the Federal Court of Australia dealt with the interpretation of remuneration provisions in an employment agreement.

Their Honours held that the employer, Stratton Finance, had breached the employment agreement and the *Fair Work Act 2009* (Cth) by underpaying commissions to its employee, Mr Webb, and by failing to pay him leave and superannuation entitlements.

The Full Court of the Federal Court followed the ‘objective approach’ to contractual interpretation adopted by the High Court in *Woodside*, stating that legitimate contextual surrounding circumstances may be looked to for the purposes of contractual interpretation, even if the words of the agreement are not ambiguous.

This approach led the court to find that ‘claw-back’ payments made to financiers on the default of a loan could not be deducted without limitation from the commissions paid to an employee.

Facts

The respondent, Mr Webb, was employed by Stratton Finance as a consultant selling car finance (provided by separate financiers) to customers. Despite using the term ‘Contractor’ to refer to Mr Webb, his employment contract clearly indicated that he was an employee. Stratton Finance agreed that it had failed to pay various amounts owing to Mr Webb as an employee, including sick leave, annual leave, leave loading and superannuation.

The main contractual question in the case concerned the proper construction of the remuneration clause in the employment agreement. This clause provided for a 40 per cent gross commission on all deals settled by Mr Webb to be paid as salary in weekly amounts of \$650, reconciled monthly.

Stratton Finance deducted two categories of money from Mr Webb’s weekly remuneration:

- ‘introduction fees’ paid to customers that led to deals settled by Mr Webb; and
- ‘claw-back amounts’ claimed by financiers from Stratton Finance where a customer ended or defaulted on a loan.

Mr Webb claimed that neither the introduction fees nor claw-back amounts should have been deducted from his salary. Stratton Finance argued that deduction of these amounts formed part of the monthly reconciliation process (in the case of introduction fees) or was part of a ‘normal’ broker arrangement (in the case of claw-back amounts).

Judgment

On the contractual question, the Full Court found for Mr Webb with respect to both categories of money.

The court looked at contemporaneous business records to determine that the introduction fees were a direct cost to Mr Webb, not a deduction to be made from his remuneration. It said ‘there was no evidence of context, market practice or other objective material which would provide a basis’ for a finding that the fees fell within the monthly reconciliation process, as argued by Stratton Finance.

With respect to the claw-back amounts, the court said they should properly be construed as refunds of commissions provisionally paid. In the employment contract context, it was unlikely that the parties would have agreed to ongoing deduction of claw-back amounts, as this would make Mr Webb’s salary variable over years. The monthly reconciliation process applied only to refunds of commission payable within that month, and not beyond.

In making these findings, the court briefly canvassed the recent history of using contextual information for contractual interpretation. It commented that the recent High Court case of *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 306 ALR 25 was inconsistent with the statements made in *Western Export Services Inc v Jireh International Pty Ltd* (2011) 86 ALJR 1 to the effect that using surrounding circumstances for contractual construction was legally impermissible in the absence of ambiguity.

The court followed High Court's 'objective approach' in *Woodside* of having regard to surrounding circumstances to determine the reasonable business meaning of contractual terms, before the exercise of examining ambiguous words is commenced. It agreed with the position of the NSW Court of Appeal in *Mainteck Services Pty Ltd v Stein Heurtey SA* [2014] NSWCA 184 in finding that this approach is not inconsistent with the principles set out in *Codelfa*.

Technomin Australia Pty Ltd v Xstrata Nickel Australasia Operations Pty Ltd [2014] WASCA 164

- › Contractual interpretation
- › Admissibility and scope of surrounding circumstances
- › Entitlement to royalties from mining

This decision of the Western Australia Court of Appeal dealt with the interpretation of a royalty payment deed and the extent to which evidence of surrounding circumstances was admissible in interpreting the deed.

In dismissing the appeal, their Honours held that the provision in question was ambiguous and susceptible of more than one meaning and that the trial judge had correctly relied on surrounding circumstances as an aid to interpretation.

The Western Australia Court of Appeal confirmed that, until the High Court expressly states otherwise, it will continue to apply the ‘true rule’ of *Codelfa Construction Pty Ltd v State Rail Authority of NSW* [1982] HCA 24 that evidence of surrounding circumstances can only be considered if the language of the contract is ambiguous or susceptible of more than one meaning. In doing so, the court did not accept that the decision in *Electricity Generation Corporation v Woodside Energy Ltd* [2014] HCA 7 had impliedly overruled *Codelfa* to remove the requirement of ambiguity.

The court, however, also suggested that the true rule allows evidence of background facts forming part of the ‘factual matrix’ and material establishing the legal context to be considered without needing to first establish ambiguity. On this basis, it may be open to practitioners to argue that, even where *Codelfa* is followed, its rule should not be applied in an unduly restrictive way.

Facts

A company sold its interest under two mining joint venture agreements and a mining tenement to Xstrata Nickel Australasia Operations Pty Ltd in return for payment of a royalty on the gross proceeds received from production on the mining tenements, under a gross production royalty deed (the **deed**). The company then assigned its right to royalty payments under the deed to the appellant, Technomin Australia Pty Ltd.

Following the deed’s execution, Xstrata was granted a mining lease that amalgamated one of the tenements subject to the deed with further, unrelated, tenements. A dispute arose as to whether Technomin’s entitlement to royalty payments extended to proceeds from production on the new, further tenements in Xstrata’s mining lease or whether the royalty was limited to proceeds from production from the areas covered by the original mining tenements as at the deed’s effective date.

The dispute turned on the definition of ‘Tenements’ in the deed, which governed what tenements the royalty would be derived from:

Tenements means the [original tenements] and any extension or variation or addition or replacement or substitution of any of them (whether or not also affecting other tenements or land outside the Area). (emphasis added)

Technomin argued that it was entitled to royalty payments on all production from the Xstrata mining lease in its entirety on the basis that the words emphasised in italics above amplified the definition, so that ‘Tenements’ extended to encompass all of the area covered by any extension, variation, addition, replacement or substitution of the original tenements.

Xstrata argued that the emphasised words did not amplify but rather clarified the definition, simply making clear that the royalty would still be payable on production from the original tenement areas, regardless of whether the original tenements were extended, varied, added to, replaced or substituted.

The trial judge found in Xstrata’s favour, holding that the royalty payment was confined to production from the original tenements. In so finding, the trial judge had regard to surrounding circumstances in interpreting the definition. He also took into account the commercial unreasonableness of Technomin’s interpretation, which would give Technomin increased royalty payments simply as a result of Xstrata choosing to amalgamate its tenements, allowing Technomin a windfall as a result of events that had no commercial connection to the original transaction.

Judgment

On appeal, Technomin claimed that the trial judge erred in having regard to surrounding circumstances in interpreting the deed.

President McLure, with whom Justice Newnes agreed, considered that, as a 'gateway requirement', the language of the deed must be ambiguous or susceptible of more than one meaning before regard could be had to surrounding circumstances. President McLure considered that the court should continue to apply this 'true rule' of *Codelfa* until the High Court expressly states a different position.

President McLure did not accept that the High Court, in its recent decision of *Electricity Generation Corporation*, had impliedly overruled *Codelfa* and *Western Export Services Inc v Jireh International Pty Ltd* (2011) 282 ALR 604 (in which the High Court had affirmed *Codelfa* as good law) to uphold the position adopted by some appellate courts that ambiguity was not required before evidence of surrounding circumstances could be considered.

Interestingly, President McLure stated that the true rule allows some exceptions to the gateway requirement. Her Honour considered that the court could take into account the following matters without having to first establish ambiguity:

- the terms of related agreements; and
- the statutory framework governing tenement interests.

President McLure regarded these as contextual matters that were part of an integrated contractual scheme, noting that they were expressly referred to in the deed.

Further, President McLure expressed the view that ambiguity was not required for the court to consider 'background facts forming part of the factual matrix that enlivens the issue of contractual construction for determination.' Her Honour placed the history and location of the mining tenements in that category.

But despite these statements, in considering whether the definition of 'Tenements' was in fact ambiguous, President McLure expressly confined herself to considering only the language of the deed and the framework of the WA Mining Act.

In a separate judgment, Justice Murphy reviewed the authorities in detail and opined that none of the High Court authorities since *Codelfa* appeared to provide a departure from the requirement of ambiguity and that it is unlikely that *Codelfa* could have been impliedly overruled in *Electricity Generation Corporation*. However, he did not need to reach a final view on the issue as he found the deed to be ambiguous.

All the judges found that the definition of 'Tenements' was ambiguous and susceptible of more than one meaning and that the trial judge was therefore correct to have regard to surrounding circumstances. The court took into account the following surrounding circumstances:

- the terms of related agreements;
- the history and extent of the existing adjoining tenement interests in the area; and
- the fact that the amalgamation of mining tenements was common industry practice.

The court found, having regard to:

- the language and purpose of the deed;
- the surrounding circumstances; and
- the consideration of avoiding an commercially unreasonable result, that the definition of 'Tenements' only covered the area of the original tenements as at the effective date. The royalty was payable only on production from land the subject of the original tenements.

Since the court found the language to be ambiguous, its statements regarding the correct rule to follow for allowing evidence of surrounding circumstances should, on a strict approach, be considered at best persuasive dicta. Nonetheless, the court's comments indicate that the Western Australia Court of Appeal will not allow wholesale reception of evidence of surrounding circumstances regardless of the existence of ambiguity in a contract's language.

Johnston v Brightstars Holding Company Pty Ltd [2014] NSWCA 150

- › Post-contractual conduct and admissions
- › Variation of contract
- › Admissibility of external evidence
- › Contractual interpretation

In this judgment, the NSW Court of Appeal considered the admissibility of post-contractual conduct in determining the terms of a variation to a deed of settlement.

The court held, having regard to subsequent conduct, that the variation of the deed of settlement agreed to between the parties was that the appellants' obligation to pay \$170,000 to the respondent's solicitor was delayed rather than expunged.

This case is a reminder that correspondence or conversations subsequent to the formation of a contract – particularly if constituting an admission – can be used as evidence of whether the terms of the contract have been varied (although they cannot be used to 'interpret' the contract).

Facts

The second respondent, Mr Wilson, and the appellants (in addition to several other individuals) had established a number of childcare centres, trading as Brightstars Early Learning Centres. Disputes among these parties led to litigation in the Supreme Court (the details of that dispute are immaterial for the purposes of this summary), which was settled by two agreements dated 12 May 2011: a deed of settlement and a share sale agreement.

The payment arrangements surrounding the two deeds are convoluted, but the salient fact is that under the deed of settlement the appellants agreed, inter alia, to pay \$170,000 to the respondents' solicitors. The deed was subsequently varied by agreement of the parties. The dispute concerned the terms of that variation. The appellants contended that the variation was to expunge their liability for payment of the \$170,000, and the respondents argued that the appellants' liability was merely deferred and payment was to be made to either or both of the respondents.

The evidence that the respondents relied upon to support the variation for which they contended included the unchallenged evidence of their solicitor of conversations he had had with the appellants' solicitor, as well as post-contractual statements made by the appellants that were said to constitute admissions. On the other hand, the appellants relied largely on communications with their own solicitor subsequent to the variation.

At first instance, Justice Stevenson found that the variation agreed to by the parties was a deferral of the time of payment of the \$170,000 and an implied term of that agreement was that payment was required on the giving of reasonable notice by the respondents (which had been given).

Judgment

The parties agreed that the deed of settlement had been varied. The dispute related only to the form of that variation and not its existence.

President Beazley and Justice Basten both endorsed the 'objective theory of contract', the former stating that both parties were correct not to rely on any conduct or communications in October 2011 (before the variation). Her Honour clarified that such communications would be admissible only as surrounding circumstances and not to prove or support the proof of a variation of contract in the terms alleged by either party (at [48]-[50]).

Subsequent conduct inadmissible as an aid to construction

President Beazley stated that while the 'status of post-contractual conduct may not be finally settled, it is clear that Australian law does not recognise the subjective intentions of the parties as relevant to the construction of the contract actually formed' (at [56]). Her Honour appeared to endorse the statement in *James Miller & Partners Ltd v*

Whitworth Street Estates (Manchester) Ltd [1970] AC 583 at 603 that ‘...it is not legitimate to use as an aid in the construction of [a] contract anything which the parties said or did after it was made’ (at [56]) and found that, in this case, events subsequent to the amendment of the deed of settlement were irrelevant as an aid to construction of the terms agreed to (at [58]).

Justice Basten was unequivocal in his view of events subsequent to the formation of a contract: citing the High Court’s decision in *Agricultural and Rural Finance Pty Ltd v Gardiner* [2008] HCA 57, his Honour stated that ‘it is an accepted principle that anything which the parties said or did after a contract was made cannot be used “as an aid in the construction of” the contract’ (at [120]).

Subsequent admissions admissible as evidence of facts

Both President Beazley and Justice Basten held that whether the terms of the variation were as alleged by the appellants or by the respondents was a question of fact and, as a result, post-contractual conduct and communications, in particular certain admissions, were admissible as evidence of that fact (at [84] and [121]).

Justice Basten, however, did make one important qualification: his Honour stated that (at [124]):

- in regards to an agreement not wholly reduced to writing, only the subsequent conduct known to the other party could be considered as revealing a common assumption as to the existence and terms of an agreement; and
- the ‘subjective views or reservations of one party undisclosed to the other, cannot provide a basis for inferring the terms of a pre-existing agreement.’

Accordingly, his Honour found that the appellants could not rely on communications with their solicitor as evidence that they did not personally believe they had an obligation to pay the \$170,000 (at [124]).

Mixed fact and law


President Beazley noted that ‘[t]here may be occasions where the question of what the terms of a contract are involves a question of mixed fact and law. In that case, the question of admissibility of post-contractual conduct is less clear’; unfortunately, her Honour went on to say that it was unnecessary to discuss that possibility in this case and did not elaborate on when such a question will be both factual and legal (at [84]). Similarly, Justice Basten stated that ‘to the extent that the evidence reveals an opinion as to the question of law rather than fact, the admission may be irrelevant’ (at [121]); although, in this case, his Honour found that the issue was clearly one of fact and not interpretation and therefore did not consider this issue further (at [122]).

Consequently, as much as this case sheds light on the relevance of post-contractual conduct, it still leaves two questions largely unanswered:

- when is the question of what the terms of a contract are one of both fact and law rather than just fact?; and
- where that question is both one of fact and law, will the relevant post-contractual conduct or communications be inadmissible in determining that question?

The court’s finding

Primarily considering various correspondence and phone calls between the solicitors of both parties subsequent to the variation of the deed of settlement, their Honours concluded that the deed of settlement had been varied by communications between the parties’ solicitors on 24 and 25 November 2011 and the variation was to defer rather than expunge the obligation to pay the sum of \$170,000 (at [77], [117], [130], [133]).



Chapter 2: Implication of terms

There are a number of grounds on which terms might be implied into a contract. These are usually described as implication of terms in fact, by law, by custom and by course of dealing.¹⁴

In deciding whether a term should be implied in fact, Australian courts usually apply the five tests established by the Privy Council in *BP Refinery*.¹⁵ In *Barnes v Forty Two International Pty Limited*¹⁶, the trial judge had found that there was an implied term in a share purchase agreement that the sellers would disclose all information known to them that was relevant to the financial results of the company. The Full Court overturned this decision, however, on the basis that the implication failed to satisfy three of the five criteria laid down in *BP Refinery*, being that it was not necessary to give business efficacy to the contract; it was not so obvious that it went without saying; and it was not capable of clear expression.

The circumstances in which a term will be implied in law are less clear. In *Commonwealth Bank of Australia v Barker*¹⁷, Mr Barker alleged that

his employment contract contained an implied term that neither party would, without reasonable cause, conduct itself in a manner likely to destroy or seriously damage the relationship of trust and confidence between them. Such an implied term had been recognised by the Full Court of the Federal Court, following a decision of the House of Lords.

The significance of implying a term 'in law' is that the implied term will apply to all contracts of a particular class. In deciding whether an implied term of mutual trust and confidence should be implied into all employment contracts, the High Court placed great emphasis on 'necessity'. In this context, it will be 'necessary' to imply a term if, absent implication, *'the enjoyment of the right conferred by the contract would or could be rendered nugatory, worthless or, perhaps, be seriously undermined' or the contract would be 'deprived of its substance, seriously undermined or drastically devalued.'*¹⁸

¹⁴ Implication by construction is sometimes put forward as a separate ground for implying terms. 'Construction' has also been put forward as the rationale for implication of terms in fact.

¹⁵ *BP Refinery (Western Port) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266. In *Byrne v Australian Airlines Limited* (1995) 195 CLR 410, the High Court limited the application of *BP Refinery* to those contracts that were complete on their face. For other contracts, the test is whether the implication of a particular term is necessary for the reasonable or effective operation of a contract of that nature in the circumstances of the case.

¹⁶ [2014] FCAFC 152.

¹⁷ [2014] HCA 32.

¹⁸ Chief Justice French, Justices Bell and Keane at [29], quoting Justices McHugh and Gummow in *Byrne v Australian Airlines Limited* (1995) 185 CLR 410 at 450 and 453.

Applying this test, the High Court unanimously held that it was not 'necessary' to imply a term of mutual trust and confidence into employment contracts.

The other case in this section considered whether an obligation to act in good faith should be implied into a contract and, if so, the content of such an obligation. In *Sigiriya Capital Pty Ltd v Scanlon*¹⁹, the NSW Court of Appeal refrained from deciding whether an obligation to act in good faith should be implied, as it held that there was in any case no breach of such an obligation. The court did, however, undertake a helpful discussion on what the content of such an obligation might be.

Barnes v Forty Two International Pty Limited [2014] FCAFC 152

- › Implied term to disclose information
- › Breach of implied term
- › Whether necessary to give business efficacy

In this judgment, the Full Court of the Federal Court of Australia considered, among other issues, the existence and breach of an implied term in a share purchase agreement that the sellers would disclose all information known to them which might become relevant to the calculation of the financial results of the company.

Their Honours held that no such implied term existed, on the basis that the implied term was not necessary to give business efficacy to the contract, it was not so obvious that it goes without saying, nor was it capable of clear expression.

This decision emphasises the high threshold for establishing the existence of an implied term in a detailed written contract and reinforces the well-established authority of *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266. Practitioners need to be aware that where detailed commercial contracts are the product of extensive negotiations involving legal advisers, it will be difficult to establish that an implied term exists unless certain conditions are met, including whether the term is necessary to give business efficacy to the contract.

Facts

Barnes and Hawksley were the founders, directors and majority shareholders of Forty Two, a company that developed and supported several software programs, the most significant of which was Campaign Master. On 24 October 2006, Barnes and Hawksley executed a share purchase agreement to sell all the issued capital in Forty Two to BlueFreeway. The sale price under the share purchase agreement was calculated by reference to three amounts:

- an initial payment of \$10 million to Barnes and Hawksley and their associates paid in December 2006 (the **initial payment**);
- a payment of shares in BlueFreeway as soon as reasonably

practicable after 31 October 2007, to be determined by reference to Forty Two's EBIT results for 2007 (the **additional payment**); and

- a cash or shares payment after 30 October 2008 and again after 30 October 2009, subject to certain conditions relating to the 2008 and 2009 EBIT targets for Forty Two (the **earn out price**).

The share purchase agreement also provided for a clawback amount in the event that the EBIT targets set out in the share purchase agreement for the 2008 and 2009 financial years were not achieved.

Following the sale, Barnes and Hawksley remained on the Board of Forty Two under a management deed, and were also employed by Forty Two under executive services agreements to undertake all duties and responsibilities consistent with the role of joint general manager.

In 2007, Barnes and Hawksley were involved in negotiations with a UK company, Campaign Master (UK) Limited (**CMUK**), to change CMUK's business model from a reseller arrangement to one in which CMUK would purchase a perpetual licence for the Campaign Master product. This licence was approved by the Board and signed on 22 May 2007, for a fee of £1.7 million, due to be paid on 30 June 2007. The receipt of the fee was anticipated to have a positive effect on the Forty Two EBIT for 2007. When CMUK failed to finalise the requisite funding to proceed with the payment for the licence on 30 June 2007, Barnes and Hawksley stepped in and procured the necessary finance by personally guaranteeing a loan to CMUK. In doing so, Barnes and Hawksley used part of the \$10 million they had received from BlueFreeway as the initial payment.

Barnes and Hawksley negotiated to leave the BlueFreeway group by way of an exit agreement executed in November 2007. This agreement brought about an early termination of the relevant contractual arrangements between BlueFreeway and Barnes and Hawksley, including the share purchase agreement, and quantified

the final consideration that they would receive from BlueFreeway for their shares in Forty Two as \$16,436,488, which was effectively treated as the additional payment. The provisions in the share purchase agreement relating to the earn out price and the clawback amounts were cancelled under the exit agreement.

BlueFreeway claimed that Barnes and Hawksley deliberately concealed their role in funding the licence fee with a view to increasing the additional payment by boosting Forty Two's 2007 EBIT results. BlueFreeway contended that, had it known of Barnes' and Hawksley's involvement in the financing, it would not have entered into the exit agreement, and would have instead relied on the share purchase agreement. Under the share purchase agreement, Barnes and Hawksley would not have received any further consideration for the sale of their share in Forty Two in light of Forty Two's financial performance over the 2008 and 2009 financial years. In the counterfactual, Barnes and Hawksley would have also been obliged to repay BlueFreeway part of the initial payment sum of \$10 million under the clawback provisions.

In the proceedings at first instance, Justice Griffiths held that Barnes' and Hawksley's conduct in failing to disclose their involvement in funding the licence fee amounted to a breach of an implied term of the share purchase agreement, which was to the effect that Barnes and Hawksley would disclose to BlueFreeway all information known to them that might become relevant to the calculation of the Forty Two EBIT results for 2007. Justice Griffiths ordered Barnes and Hawksley to pay \$2 million together with interest in compensation for BlueFreeway's lost opportunity to negotiate an exit arrangement with Barnes and Hawksley in the full knowledge of Barnes' and Hawksley's role in procuring finance for the licence fee.

Barnes and Hawksley appealed Justice Griffiths' decision on 14 grounds, three of which focused on the existence and breach of an implied term:

- that his Honour was in error in finding the implied term of the share purchase agreement contended for by BlueFreeway;
- that his Honour was in error for finding a breach of the implied term; and
- the loss claimed did not fall within either limb of *Hadley v Baxendale* (1854) 156 ER 145.

Judgment

Justice Beach delivered the leading judgment, with which Justice Siopis agreed. He emphasised that courts are generally slow to imply a term into an agreement, particularly where the contract is the product of extensive commercial negotiations involving legal advisers.

The court upheld Barnes' and Hawksley's grounds for appeal; stating that no implied term for the disclosure of all information that might become relevant to the calculation of Forty Two's 2007 EBIT results ought to have been found in the previous proceedings, and, in any event, there was no breach of such a term. The court also held that the finding of damages based upon a loss of opportunity did not fall within either limb of *Hadley v Baxendale* and was therefore not maintainable.

The court pointed to the five conditions identified by *BP Refinery* for a term to be implied in a written contract:

- it must be reasonable and equitable;
- it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it;
- it must be so obvious that 'it goes without saying';
- it must be capable of clear expression; and
- it must not contradict any express term of the contract.

Their Honours held that the second, third and fourth conditions were not satisfied.

In relation to the second condition, the court pointed to the various provisions in the share purchase agreement, management deed and executive services agreements that related to explicit reporting, accounting and operational obligations on both BlueFreeway and Barnes and Hawksley. The judgment held that, given the existence of such explicit terms dealing with the provision of information, it is difficult to see how there would be a need to imply the requisite term in order to give business efficacy to the share purchase agreement.

The court acknowledged that Barnes and Hawksley had greater access to information and enjoyed a large degree of independence in running the business, but held that this imbalance only goes to explain the existence of the detailed express terms for the provision

of information, and does not justify additional implied terms. Their Honours held that without the implied term, it cannot reasonably be said that BlueFreeway's rights were rendered nugatory, worthless or seriously undermined, nor was any transaction under the share purchase agreement rendered futile. While the implied term might have given greater protection to BlueFreeway, it does not demonstrate a sufficient reason for implying it.

With regards to the third and fourth condition in *BP Refinery*, the court held that in light of the express terms within the share purchase agreement, it cannot be said that the implied term is so obvious it goes without saying or is capable of clear expression, particularly as such an open-ended implied term is oppressively broad in breadth and scope.

Furthermore, their Honours stated that, even if the implied term did exist, there can be no breach considering that Barnes' and Hawksley's financing role was not relevant to the calculation of Forty Two's 2007 EBIT. The fact that the underlying financing for the licence fee came from Barnes and Hawksley does not change its genuineness, character or accounting treatment.

Finally, the court held that any damages flowing from a breach of the implied term is not maintainable, as any such loss would not fit within either limb of *Hadley v Baxendale*. The court held that any loss resulting from the loss of opportunity to negotiate a different form of exit agreement and payment flowing from a breach of the implied term was not a consequence 'arising naturally' from the breach (first limb), nor could it have been reasonably supposed to have been in contemplation of both parties at the time they made the contract (second limb).

Commonwealth Bank of Australia v Barker [2014] HCA 32

- › Implied terms
- › Mutual trust and confidence in employment contracts
- › Whether *Malik v Bank of Credit and Commerce International SA (In Compulsory Liquidation)* [1998] AC 20 is applicable in Australia

This decision of the High Court of Australia considered whether or not a term of mutual trust and confidence is implied by law into all employment contracts.

The High Court held that the implication of a term of mutual trust and confidence in all employment contracts is a step beyond the legitimate law-making function of the courts and should not be taken. It allowed the appeal against the decision of the Full Court of the Federal Court of Australia.

This decision confirms the orthodox approach to the implication of terms in Australian contract law, and the distinction between terms implied 'in fact' and 'in law'.

Facts

Mr Barker had been employed by the Commonwealth Bank of Australia (the **Bank**) since November 1981. At the time of his redundancy, Mr Barker was the Executive Manager of Corporate Banking, Institutional and Business Services, South Australia.

In February 2009, as part of a nationwide restructure of the Corporate Financial Services teams, the Bank decided to shut down Mr Barker's unit and make his position redundant.

On 2 March 2009, Mr Barker was notified in a meeting of the Bank's decision to make his position redundant and he was told that, if the Bank could not redeploy him, which was their preference, that his employment would be terminated in four weeks' time. He was given a letter to this effect, which stated that the redeployment process was to commence that day. The redeployment process that ensued was held to be less than ideal.

Ultimately on 9 April 2009, the Bank wrote to Mr Barker advising him that his employment would be 'terminated by reason of redundancy effective from the close of business today'. His retrenchment payments amounted to \$182,092.

Mr Barker commenced proceedings in the Federal Court in November 2010, alleging that certain terms were implied into his employment agreement by virtue of the terms of the Bank's Redundancy, Redeployment, Retrenchment and Outplacement Policy (the **redeployment policy**) and its Equal Employment Opportunity Policy having been incorporated into his employment agreement.

At first instance, Justice Besanko held that there was an implied term of mutual trust and confidence in Mr Barker's employment agreement, and the Bank's breach of the redeployment policy by failing to take meaningful steps towards Mr Barker's redeployment was so serious that it equated to a breach of the implied term.

On appeal to the Full Court of the Federal Court of Australia, the majority (Justices Jacobson and Landers, with Justice Jessup dissenting) held that the implied term of trust and confidence in employment contracts had obtained a sufficient degree of recognition in Australia and should be accepted. The majority adopted the language used in the House of Lords' decision in *Malik v Bank of Credit and Commerce International SA (In Compulsory Liquidation)* [1998] AC 20, stating that the term implies that 'the employer will not, without reasonable cause, conduct itself in a manner likely to destroy or seriously damage the relationship of confidence and trust between employer and employee'.

Judgment

The High Court of Australia held that the implication of a term of mutual trust and confidence in all employment contracts is a step beyond the legitimate law-making function of the courts and should not be taken.

Chief Justice French and Justices Bell and Keane considered the industrial landscape of the United Kingdom vis-à-vis Australia and discussed the recognition of the implied term of mutual trust and confidence in the House of Lords' decision in *Malik*. Their Honours

held that the conclusion reached by the House of Lords in *Malik* must be understood in the context of the existing body of decisions made by the courts and employment tribunals of the UK, reflecting a consensus as to the implication which predated the *Malik* decision and that the history of the development of the term in the UK is not applicable to Australia.

Their Honours discussed the bases upon which terms may be applied at common law and the distinction between terms implied by facts and terms implied by law and noted that the implication of a term regardless of whether it is by law or by facts requires the application of the necessity test set out in *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410, whereby to imply a term:

- in fact, the implied term must be necessary to give business efficacy to the contract; and
- by law, the test of necessity is broader and the court must determine the existence of the implied duty by reference to the principles governing implications of terms in law in a particular class of contract. The broad concept of 'necessity' may be defined by reference to what 'the nature of the contract itself implicitly requires' and it is not satisfied by demonstrating the reasonableness of the implied term.

As the term adopted from *Malik* was one implied by law, their Honours explained that such an implication required the court to determine whether the proposed implication is 'necessary' in the sense that would justify the exercise of the judicial power in a way

that may have a significant impact upon employment relationships and the law of the contract of employment in this country.

It was held that the implied term of mutual trust and confidence imposes mutual obligations wider than those that are 'necessary'.

Their Honours also emphasised that the common law can only evolve within the limits of judicial power and cannot trespass into the realm of legislative action, and the creation of a new standard of this kind is not a step to be taken lightly. This extension reflected a broader functional view, embracing not only the material conditions of employment such as pay and safety, but also the psychological conditions that are essential to the performance by an employee of his or her part of the bargain. The complex policy considerations encompassed by those views of the implication mark it, in the Australian context, as a matter more appropriate for the legislature than for the courts to determine.

The contention that the term could also be implied as a matter of fact into the employment agreement in question was rejected, as Mr Barker was unable to point to any particular feature of the employment agreement that would have supported its implication in fact.

Sigiriya Capital Pty Ltd v Scanlon [2013] NSWCA 401

- › Construction and interpretation
- › Loan to employee to take up parcel of shares
- › Whether implied term to act reasonably or in good faith
- › Whether consensual termination of employment contract amounted to 'early termination' for the purposes of loan agreement

In this decision, the NSW Court of Appeal dealt with the construction of a 'golden handcuff' contract in which an employer provided a loan to an employee to purchase certain shares. Specifically, the court looked at whether there had been an event of default under the contract in respect of which the employer could validly require the employee to repay the loan by transferring the shares to the employer (the value of which now far exceed the purchase price and value of the loan). In doing so, the court confirmed some basic principles of construction and also examined whether a duty of good faith was an implied term of the contract and whether any such duty would be breached by the employer enforcing the default provisions, given the increase in the value of the shares.

Justice Leeming held that there had been an event of default and that the relevant requirements had been complied with to entitle the employer to demand that the employee transfer the shares to them. His Honour also held that, assuming that a duty of good faith was implied into the contract, the employer would not be in breach of that duty merely by the fact that the shares had increased in value in circumstances where the employee had actively breached his obligations under the contract (which was on terms very favourable to him).

This decision confirms the basic principles that a contract will be construed as a whole and in a manner that makes it internally consistent. The decision also provides guidance on the content of a duty of good faith, and suggests that it is important to look at the conduct of both parties to consider whether or not such a duty has been breached by one of the parties.

Facts

The appellant, Sigiriya, and the respondent (its employee, Mr Scanlon), entered into a loan agreement in 2010, designed to operate as a 'golden handcuff'. Under the loan agreement, Sigiriya loaned \$47,500 to Mr Scanlon for the purchase of shares in York Potash Ltd, which he could be required to exchange for shares in Sirius Minerals Plc. The loan was to be repaid, along with all interest which was to be capitalised, in 2013 unless there was an 'Early Termination' of Mr Scanlon's employment with Sigiriya, or there was an 'Event of Default' under the agreement, in which case the loan was to be repaid by the transfer of the shares to Sigiriya. Other conditions of the loan agreement provided that Mr Scanlon was not to transfer, dispose of, encumber or deal with the shares in a similar way.

Of particular relevance to the court's findings, clause 10.2(c) provided:

Unless the Lender or an Authorised Officer of the Lender otherwise agrees in writing, the Borrower must not:

...

- (c) Disposal: sell, pledge, encumber, assign, transfer, or take any economically similar action, or make any such offer, in relation to the Shares, nor permit the sale, encumbrance, assignment, transfer or economically similar action of the Shares in any manner, including such actions as writing covered options or other economically similar undertaking.

Following a falling out, Mr Scanlon's employment was terminated by agreement. At first instance, Sigiriya submitted that Mr Scanlon was required to transfer the shares to it because the end to Mr Scanlon's employment constituted an 'Early Termination' under the contract, and also based on other events of default that it alleged. The primary judge held that there had not been an early termination and did not deal with Sigiriya's allegations of other events of default.

Relevant to the allegations of other events of default, Mr Scanlon had:

- opened a brokerage and margin account with JP Morgan and sought to use the shares as a form of formal or informal security for a margin loan by completing a form for the transfer of the shares in favour of JP Morgan titled an 'irrevocable stock or bond power for value received', and providing JP Morgan with the original share certificate; and
- completed a 'Crest transfer' form for the shares, making Chase Nominees Limited the registered owner of the shares, which were listed on the Alternative Investment Market Exchange of the London Stock Exchange.

Judgment

The court focused on whether Mr Scanlon's dealings with the shares constituted an event of default entitling Sigiriya to the shares, and to do so analysed the construction of the relevant conditions of the loan agreement. The court applied the following basic principles of construction:

- the contract must be read as a whole;
- where possible, the contract should be read so as not render a particular clause nugatory, particularly if it can be given a meaning that is consonant with the whole of the contract; and
- where possible, the contract should be construed so that it is internally consistent.

The court held that Mr Scanlon's transfer of legal title in the shares to Chase Nominees Limited (by the Crest transfer form) was a breach of clause 10.2(c). For this to constitute an event of default though, the court held that there also needed to be compliance with clause 11.1(c), which required that Sigiriya either form a view that the breach cannot be remedied or had not been promptly remedied. Sigiriya had written to Mr Scanlon complaining of the breach and, although it also purported to rely on clauses that the court held did not apply, it also stated that the breach engaged 11.1(c). Given that Mr Scanlon had been aware of the dealings in the shares for many months, the court was satisfied that this was sufficient to show that Sigiriya had formed the view that the breach had not been remedied within a reasonable

time, so that it did constitute an event of default.

Mr Scanlon submitted that the loan agreement included an implied term that Sigiriya exercise powers under the loan agreement 'fairly and in good faith'. This submission was only put on the basis of implication as opposed to construction, and, as a result, the court held that any argument based on the fact that the value of the shares now exceeded the amount outstanding under the loan agreement were not applicable. The court also noted that any implied term of 'good faith' could not be inconsistent with the express terms of the loan agreement.

Without deciding that there in fact was such a term, the court held that Sigiriya would not have been in breach of it, given the favourable terms to Mr Scanlon and Mr Scanlon's deliberate conduct in breaching the agreement.

The court's findings in relation to Mr Scanlon's argument based on a duty of good faith offers some guidance on the content of such a duty and the circumstances that should be taken into account in considering whether the duty has been breached. The court held that Sigiriya could not have been in breach of the contended term of 'good faith' simply by acting in accordance with the express conditions of the loan agreement, given the following circumstances:

- 'the Loan Agreement was not some onerous or valuable contract whose termination was to be regulated by reference to what was necessary for the protection of a party's legitimate interests' (see *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349 at 368 per Justice Sheller); and
- the loan agreement was of great benefit to Mr Scanlon and it did not impose on him any 'positive obligations' and 'had he done nothing, he would not be in breach'; and Mr Scanlon had 'set about actively breaching his obligations by transferring and pledging the shares as soon as it became possible for him to do so'.

➤ Chapter 3: Termination

There were two appellate decisions during 2014 that considered whether a party was obliged to make payments after a contract was terminated.

In *Austral Masonry (NSW) v Sementech Pty Ltd*²⁰, the court considered a clause under which a patent licensee was obliged to contribute to litigation costs incurred by the licensor. The Full Court of the Federal Court held that, even though the licence agreement had come to an end, and the licensee might therefore no longer receive any benefit from the litigation, the licensee was obliged to continue making payments after the licence agreement had terminated. The court reached this conclusion because the relevant clause, which survived the termination of the agreement, required such contribution where the litigation commenced before the contract was terminated. In *Neale v Ancher Mortlock and Woolley Pty Limited*²¹, the NSW Court of Appeal considered a slightly different situation: whether a party was obliged to make a payment notwithstanding that the time for making a payment did not occur until after the contract was terminated.

The contract dealt with in *Neale* included a clause that required a payment to be made on termination if the right to receive payment had 'accrued' at the date of termination. In considering this clause, the court distinguished clauses that deal with the earning of remuneration from clauses that deal with the timing of payment of the remuneration. The court held that, because all of the work to earn the remuneration had been completed, the right to payment had 'accrued', even though the time of payment had not yet passed.

Although this case turned on the particular contractual provisions, the court noted that the distinction it drew was consistent with general law principles concerning the rights of parties on termination.

²⁰ [2014] FCAFC 72.

²¹ [2014] NSWCA 72.

Austral Masonry (NSW) Pty Ltd v Cementech Pty Limited [2014] FCAFC 72

- › Survival of clause after termination
- › Contractual scheme for enforcement of intellectual property rights against third party infringers
- › Whether parties intended obligation to continue beyond termination of contract in circumstances where litigation commenced during term of contract

In this judgment, the Full Federal Court considered whether a licensee under an exclusive patent licence agreement was liable to contribute to the cost of litigation to protect the patent, even though the term of the licence agreement had expired.

In summary, their Honours held that, on the proper construction of the Intellectual Property Licence Agreement made between Cementech Pty Ltd and Austral Masonry (NSW) Pty Ltd, which permitted Austral to exploit a patent owned by Cementech (the **licence agreement**), Austral was liable to pay half of Cementech's costs of a proceeding against a third party, Adbri Masonry Pty Limited, even after the licence had expired.

The case highlights the need for contracts to specify clearly which obligations will continue beyond the end of the contract.

Facts

The appellant, Austral, and the first respondent, Cementech, were parties to a licence agreement that had a term of four years. Before the term expired, Cementech commenced proceedings against the second respondent, Adbri, for infringement of the patent and orders against Austral.

The licence agreement provided a 'code' for protection of the intellectual property rights, including the patent, licensed by Cementech to Austral. Cementech submitted that, under the code in the licence agreement, Austral was liable for half of the costs of Cementech's proceeding against Adbri (the **Adbri proceedings**).

The primary judge:

- declared that Austral was liable to pay half of Cementech's costs incurred in the Adbri proceedings;
- otherwise dismissed the proceeding against Austral; and
- ordered that the Adbri proceedings be transferred to the Full Federal Court.

Judgment

Cementech submitted that the code in the licence agreement applied to proceedings commenced during the term.

The Full Court found that the code recognised that the parties had an interest in protecting the intellectual property during the licence agreement's term. Their Honours also found that the parties must have known that litigation commenced during the term would not necessarily be completed during that term.

Although the code provided for sharing in the benefits of the proceeds of litigation commenced during the term, the relevant clause of the licence agreement expressly referred to 'commenced' rather than 'completed'.

Their Honours noted the unfairness of the code, stating its simplicity meant that it applied to all possible cases of litigation commenced during the term. Nonetheless, their Honours held that the relevant clause survived the licence agreement's expiry and therefore Austral would be liable to pay half of Cementech's costs incurred in the Adbri proceedings.

Neale v Ancher Mortlock & Woolley Pty Ltd [2014] NSWCA 72

- › Contract for the provision of professional services
- › Whether a deferred fee was payable on termination

This decision of the NSW Court of Appeal considered whether a deferred fee had become payable on termination of a professional services contract.

The court held that the respondent's right to the disputed part of the agreed fee had been established. The court found that, while the contract provided for payment of the relevant part of the fee to be deferred until the receipt of a specified governmental approval, this provision was superseded by a clause which provided for the immediate payment of 'all accrued fees' on termination of the contract. As the respondent had completed all of the work specified under the contract, their fees were 'accrued fees'.

In this case, the Court of Appeal affirmed that rights which have already arisen under a contract will not be affected by the termination of that contract. While rights which require further performance of the contract will not arise after termination, where all of the facts or elements of performance on which a right depends have occurred, that right will become an 'immediately enforceable obligation'.

The case also emphasises that the court will take an objective approach to the determination of rights and obligations under contracts and will seek to provide a 'business-like interpretation' of commercial contracts.

Facts

On or shortly after 30 July 2009, Ancher Mortlock & Woolley Pty Ltd (the **respondent**) entered into a contract with Neale (the **appellant**) to provide certain architectural services, including the preparation of a Part 3A plan and an Environmental Assessment (**EA**) for a residential development. The contract specified that the work was to be completed in three stages, and set out fees for each of these stages. Relevantly, the contract provided that 60 per cent of the invoice for each stage of work was to be paid within 14 days, and that the balance of each invoice was payable 'within 8 weeks of EA approval.'

The contract also contained provisions regarding termination, stating that each party had the right to terminate the contract by giving at least 10 days' written notice (**clause F2**). If this right to terminate was exercised, the contract provided that:

Clause F3

Within 10 working days of the date of the notice of termination the client must pay the architect all accrued fees (including all costs and disbursements) in full provided that the termination is not on the grounds of architect's incapacity or failure to perform.

The respondent completed the work that it was contracted to do in each of the stages, and, after a number of revisions, the prepared EA was eventually accepted by the NSW Department of Planning for public exhibition on 10 November 2010.

There was some dispute between the parties as to timing, but each accepted that in either March or April 2011, the contract between the parties was terminated under clause F2. After termination, the respondent requested the payment of the outstanding 40 per cent of its invoices. The appellant refused, claiming that the deferred fees were not due and payable, as 'EA Approval' had not occurred.

At first instance in the District Court, Judge Curtis found that the fees were payable in their entirety.

On appeal to the NSW Court of Appeal, the appellant claimed that the primary judge had erred in finding that the 40 per cent of the fees outstanding was due and payable on termination. The respondent opposed this claim, and, in the alternative, claimed that the outstanding fees were payable on the basis that EA approval had already occurred, as the plans had been put on public display.

Judgment

The court unanimously held that the respondent was entitled to be paid the outstanding fees. The court found for the respondent on two alternative bases:

- if, as the appellant claimed, EA approval had not occurred by the date the contract was terminated, the respondent was entitled to be paid the entirety of the fees due to the operation of clause F2, which provided for the payment of all accrued fees in full within 10 working days of termination of the contract; and
- EA approval had occurred by the time the contract was terminated, and the balance of the invoices was therefore payable within eight weeks of this approval.

Clause F3 – Termination

The court found that the respondent was entitled to be paid the entirety of the fees even if EA approval had not yet occurred, due to the operation of clause F3.

Justice Barrett distinguished between clauses that deal with the earning of remuneration, and those that deal with the timing of payment of the remuneration. The contractual provision which deferred payment of part of the fees until eight weeks after EA approval was an example of the latter; it did not deal with the creation of the debt. Once the respondent had completed the work described in each contractual stage, which occurred in March or April 2011, the entire debt was owed, even though 40 per cent of that debt was not payable until EA approval had occurred.

Under clause F3, on termination of the contract, all ‘accrued fees’ became payable within 10 working days. As ‘all accrued fees’ would include debts that were owing, but that had not yet been paid, the effect of termination was that the remaining 40 per cent of the fees that were owing to the respondent became payable within 10 working days.

Justice Barrett referred to the decision in *Westralian Farmers Ltd v Commonwealth Agricultural Service Engineers Ltd* [1936] HCA 6 which established, among other things, that:

- where a contract is terminated by a party, the rights and obligations which have already arisen as a result of performance under the contract will not be affected; and
- after termination, rights which would be dependent upon further performance under the contract will not arise. However, where all

of the facts which would entitle one of the parties to certain rights under the contract (such as a debt or a chose in action) have already occurred, then that right will become an ‘immediately enforceable obligation’ even if, under the contract, the right to payment was a future right or contingent upon the occurrence of an event or circumstance which did not require further execution of the contract.

His Honour noted that these principles supported the conclusion that the effect of the termination was to accelerate the applicant’s obligation to pay the outstanding 40 per cent of fees, an obligation that had already arisen due to the completion of the specified work. The time for payment set out in clause F3 replaced the term which provided that payment was to be made within eight weeks of EA approval.

Justices Gleeson and Leeming agreed with Justice Barrett’s findings on this issue.

EA approval

The court found that EA approval had actually already occurred by the time the contract was terminated in March or April 2011. The respondent was therefore entitled to the outstanding fees based on this approval and the general legal principle that contractual rights that have already vested will not be affected by the termination of the relevant contract: *McDonald v Dennys Lascelles Ltd* [1933] HCA 25.

It was noted that the contract did not contain a definition of ‘EA Approval.’ However, the court considered that ‘EA Approval’ in this case must be taken to have referred to the Director-General’s acceptance of the applicant’s environmental assessment as appropriate for putting on public exhibition. The court emphasised that it will take an objective approach when assessing contractual rights and obligations, and referred to the recent High Court case of *Electricity Generation Corporation v Woodside Energy Ltd* [2014] HCA 7, which emphasised the need to give a commercial contract a ‘businesslike interpretation.’

Justice Leeming agreed.

➤ Chapter 4: Penalties and illegality

In the *Bank Fees Class Action*²², the High Court held that the doctrine of penalties was not limited to cases where one party had breached a contract. This decision was applied by the Victorian Court of Appeal in *Cedar Meats (Aust) Pty Ltd v Five Star Lamb Pty Ltd*²³.

The agreement in that case provided that, if the volume of lambs delivered to an abattoir fell below a certain agreed level, the abattoir would be entitled to shortfall payments. The abattoir argued that, because there was no contractual obligation to deliver the agreed daily volumes to the abattoir, the shortfall payments were not payable on breach, but were an alternative means of performing the contract; and they therefore could not be categorised as penalties. The Victorian Court of Appeal, applying the High Court's decision in *Bank Fees Class Action*, rejected this argument.

If a contract contains provisions that contravene legislation, a court will often need to consider whether the whole contract is unenforceable or whether the offending provisions can be 'severed'. In *Mackinlay v Derry Dew Pty Ltd*²⁴, the Western Australia Court

of Appeal considered a deed that assigned the balance of a lease (approximately 14 years) and granted two further five-year options. The deed contravened Western Australian legislation because the period of the lease, including the options, exceeded 21 years.

In considering whether the options were severable, the court applied a test, approved by the High Court, whether the options were 'in substance so connected' with other obligations under the agreement that they formed an *'indivisible whole, which cannot be taken to pieces without altering its nature'*. In applying this test, the court held – perhaps somewhat surprisingly – that the options were not severable and that the entire agreement was unenforceable.

²² *Andrews v Australian and New Zealand Banking Ltd* [2012] HCA30.

²³ [2014] VSCA 32.

²⁴ [2014] WASCA 24.

Cedar Meats (Aust) Pty Ltd v Five Star Lamb Pty Ltd [2014] VSCA 32

- › Abandonment of accrued rights under an agreement
- › Penalty

In this decision, the Victorian Court of Appeal addressed a claim for payments due under an agreement that was allegedly abandoned.

Their Honours upheld the appeal, finding that Cedar Meats' conditional refrain from enforcing its accrued rights under the agreement did not have the effect of abandoning or waiving those rights. However, as the payments claimed by the appellant were found to be capable of being a penalty, that issue was remitted to the primary judge for determination.

This decision is a reminder that where a contract has been partly performed, it would be very difficult to infer that parties intend to abandon accrued rights even if those rights are not actively enforced or if the contract is later abandoned.

The case also followed the High Court's judgment in *Andrews v ANZ* [2012] HCA 30 (the **Bank Fees case**) in finding that a sum of money payable may be regarded as penal if it secures the satisfaction of a condition even though that condition does not import a contractual promise.

Facts

In 2009, the respondent (**Five Star**) entered into an agreement with the appellant (**Cedar Meats**) for the manufacturing, processing and packaging of lamb products at Cedar Meats' abattoir (the **agreement**). Relevantly under the agreement, if the actual daily volume of lamb delivered by Five Star to Cedar Meats fell below an agreed daily volume, Cedar Meats would be entitled to payment for a portion of the shortfall in price (the **shortfall payments**).

From the agreement's commencement, Five Star fell short in providing Cedar Meats with the agreed daily volume. However, it was common ground that Cedar Meats wanted to provide as much help to Five Star as possible and therefore never pressed for the shortfall payments. Five Star's financial situation deteriorated in 2010 and, by November 2010, production ceased at the abattoir because of

the very low volume of lamb being delivered. Around that time, Five Star and Cedar Meats met to discuss ending the agreement. Cedar Meats did not sign the termination agreement prepared by Five Star; instead Cedar Meats stated that it was prepared to waive the shortfall payments and accept non-deliveries as long as Five Star recommenced production with Cedar Meats whenever it was able to do so.

Throughout 2011, Cedar Meats agreed on occasions to process small quantities of lamb for Five Star when Cedar Meats had space left over from its processing of other products. Both parties saw this arrangement as ad hoc and, among other changes, Cedar Meats charged prices that were higher than those stipulated under the agreement.

When Five Star resumed production in late 2011, it retained another processor rather than returning to Cedar Meats. Cedar Meats then claimed for shortfall payments owing under the agreement.

Judgment

Abandonment of accrued rights

The primary judge held that Cedar Meats had abandoned its accrued entitlements to the shortfall payments, as it did not expressly reserve its rights or enforce them for two years, during which time it began to deal with Five Star on terms different to the agreement terms.

On appeal, their Honours rejected this finding and held that:

- even if the parties had abandoned the agreement at the end of 2010, absent a clear indication to the contrary, it is to be inferred that the abandonment of a contract operates prospectively without prejudice to accrued entitlements;
- Cedar Meats made patently clear to Five Star that its preparedness to refrain from enforcing its accrued rights to the shortfall payments was both limited and conditional;

- far from an abandonment of those accrued rights, Cedar Meats' representation to 'stay its hand' until Five Star could enter into a new agreement with Cedar Meats for proper production had the legal effect of either an accord executory or an accord and satisfaction [25];
- the ad hoc arrangement in 2011 was not inconsistent with Cedar Meats' preservation of accrued rights; and
- whether accrued rights have been abandoned is a question of law to be decided by an objective assessment of the effect of the parties' words and actions to one another. Their subjective intentions (eg Five Star's mistaken belief that Cedar Meats agreed to terminate the agreement in late 2010) or perceptions (eg Cedar Meats' failure to record its accrued entitlements as an asset in its books) are irrelevant.

Relying on similar grounds, their Honours proceeded to find that Cedar Meats had not waived its claim under the agreement, nor had it falsely represented to Five Star an intention to abandon or waive its claim.

Penalty

Although Cedar Meats' entitlement to the shortfall payments was not extinguished and it was not estopped from claiming them, their Honours upheld the primary judge's finding that the shortfall payments were penal in nature and therefore capable of being unenforceable if they were excessive and unconscionable.

Cedar Meats argued that the shortfall payments could not be characterised as penalties as the relevant provisions did not impose

any obligation on Five Star to deliver the agreed daily volumes for processing; they simply governed what would happen if Five Star did not do so. Five Star responded that those provisions, when taken as a whole with the agreement, implied an obligation on Five Star to deliver the agreed daily volumes; alternatively, they secured a promise by Five Star to make the shortfall payments to Cedar Meats in the event Five Star failed to deliver.

Their Honours accepted Cedar Meats' contention that the shortfall payments provisions did not impose a contractual obligation on Five Star to deliver the agreed daily volumes. However, they also accepted Five Star's fall-back response that the shortfall payments served as security for the delivery condition imposed by Cedar Meats in substitution of actual performance by Five Star. Their Honours then applied the High Court's decision in the *Bank Fees* case, remarking that 'Andrews re-established that such a provision may still be regarded as penal if it secures a primary stipulation even though the stipulation does not import a contractual promise'.

As the primary judge had deemed it unnecessary to consider this issue, their Honours could not determine the extent to which the shortfall payments were excessive and unconscionable in comparison to the greatest loss to Cedar Meats that conceivably could be proved. In remitting this issue to the primary judge, their Honours commented that courts should be prepared to allow a substantially larger degree of latitude in reviewing clauses agreed between commercial parties of apparently equal bargaining power than would be appropriate in case of a contract of adhesion (that is, a contract in which one party has no opportunity to negotiate the terms).

Mackinlay v Derry Dew Pty Ltd [2014] WASCA 24

- > Effect of illegality or invalidity
- > Severance

In this judgment, the Western Australian Court of Appeal considered whether a lease containing options to renew was invalid for contravening town planning legislation and, if so, whether the options provision could be severed so as to save the lease.

The lease was construed as contravening the applicable legislation. Severance was held to be unavailable with reference to the following principles:

- Justice Buss, with Justice Newnes agreeing, held that the options were at or near the ‘heart’ of the arrangements, that severing them would radically change the ‘kind’ of contract between the parties, and that accordingly the options were in substance so connected with the other terms as to form an ‘indivisible whole’; and
- Justice Pullin held that severance was impossible in any event because the statute rendered the grant of a lease, and not merely a provision in the lease, illegal and void.

The respondent’s loss was held to have been caused by the appellant, a solicitor, failing to advise the respondent regarding the unenforceability of the lease.

[The case serves as a reminder of the circumstances in which a court will apply the doctrine of severance where a contract is otherwise void and unenforceable due to statutory illegality. The case also considers issues of contractual construction and principles of causation.](#)

Facts

The respondent purchased a business known as the Forrestfield Tavern from Cancon Pty Ltd. The tavern was operated in a building that was subject to a lease from the owner of the land, Mr Vellios, to Cancon, with no options for renewal (the **lease**). The tavern building occupied about 20 per cent of a lot, the remainder of which was mainly covered with vegetation.

When the respondent purchased the business, Mr Vellios agreed to an assignment of the lease from Cancon to the respondent together with two five-year options to extend the existing term of the lease. The respondent engaged the appellant, its solicitor, to prepare a deed of assignment and variation (the **deed**) reflecting these terms.

After the deed was executed, disputes arose between Mr Vellios and the respondent over various matters, and, over the course of their discussions, they each received advice that the lease, as varied by the deed, failed to comply with s20(1) of the now repealed *Town Planning and Development Act 1928* (WA) (the **TPD Act**). Section 20(1) provided that, without approval, land could not be leased for more than 10 years (21 years if an exception applied, which it did in the present case), including any renewal options, unless the land was dealt with under the lease ‘as a lot or lots’. The balance of the lease, as assigned by the deed, was approximately 14 years. Counting the options, it was approximately 24 years. The manner in which the lease had been drafted gave rise to some controversy over whether it dealt with the entire lot, or only the portion of the lot where the tavern building was situated.

After unsuccessful negotiations, the respondent issued a notice of termination to Mr Vellios. The respondent subsequently commenced proceedings against its solicitor for negligence, claiming, among other things, that the lease, as varied by the deed, contravened s20(1) of the TPD Act and that the solicitor had failed to advise the respondent that the lease was therefore illegal, void and of no effect. The trial judge found in favour of the respondent at first instance.

The following issues were raised on appeal:

- Construction of the lease and the deed: whether the trial judge erred in law in construing the lease as leasing, and the deed as assigning, only a portion of the lot.

- Statutory illegality and severance: if the lease was only for a portion of the lot, whether the trial judge erred in law in holding that the renewal options could not be severed from the deed, and that the lease, as assigned by the deed, was therefore entirely void.
- Causation: whether the trial judge erred in fact and law in holding that the appellant's failure to advise the respondent regarding the efficacy of the deed caused the respondent to serve the notice of termination and consequently suffer loss and damage through losing business at the Forrestfield Tavern.
- the test of whether valid and invalid promises are severable is whether they are 'in substance so connected' with each other that they 'form an indivisible whole which cannot be taken to pieces without altering its nature';
- invalid promises can be severed from valid promises if their elimination changes 'the extent only but not the kind of the contract';
- if the substantial promises are all illegal or void, 'merely ancillary' promises are inseverable; and
- it is difficult to see how a valid promise associated with an invalid promise can be enforceable unless it is 'supported solely by a separate consideration so exclusively attributable to it that there are in substance two independent contracts and not one composite contract'.

Judgment

The appeal was dismissed.

Construction of the lease and the deed

Justices Buss and Newnes agreed with the reasons of Justice Pullin, who held that:

- the operative leasing clause in the lease, read with the definitions of 'Leased Premises' and 'Land', unambiguously demonstrated that the parties intended only to lease the portion of the lot where the tavern building was situated; and
- the deed unambiguously assigned the lease (being a lease of the portion of the lot where the tavern building was situated) and introduced options relating only to that portion of the lot.

Statutory illegality and severance

The majority (Justice Buss, with Justice Newnes agreeing) held that where a statute expressly or impliedly prohibits a transaction embodied in a contract, 'the doctrine of severance may be invoked if the transaction involves distinct promises or engagements, some of which are legal and some of which are illegal. Statutory illegality renders a contract void and unenforceable only to the extent that the contract cannot be severed.'

Whilst stating that the test of severability is flexible and depends on the circumstances, including the nature of the illegality, the majority adopted and applied the following test for severability as set out by Chief Justice Jordan in *McFarlane v Daniell* (1938) 38 SR (NSW) 337, noting that this test has been approved by the High Court and the Privy Council:

The majority found that the assignment by the deed of the balance of the lease was not in itself an illegal transaction; however, the assignment of the balance of the lease in combination with the granting of the options to renew was an illegal transaction. Severance would therefore require the excision of the options provision.

Although the nature of the illegality in these circumstances was not seen as a bar to severance, the majority refused to sever the options provision because the options were at or near the 'heart' of the arrangements between the parties, severing them would radically change the 'kind' of contract between the parties, and accordingly the options were in substance so connected with the other terms as to form an 'indivisible whole'.

In a separate judgment, Justice Pullin generally accepted the same test for severability as the majority. However, Justice Pullin held that the effect of 20(1) was to make the grant of a lease illegal where the requirements of that section were not met. On this view, severance was impossible in any event because it was the entire lease, and not just the options provision in the lease, that was illegal.

Causation

The appellant argued that the cause of the respondent's loss was the respondent's own action in issuing a notice of termination, and not the appellant's failure to advise on the deed's efficacy.

The majority (Justice Buss, with Justice Newnes agreeing) applied the ordinary principles that causation is established if the relevant act or omission contributed materially to the loss or damage suffered, which is essentially a question of fact to be resolved as a matter of common sense and experience, notwithstanding the presence of an intervening act.

On this basis, the majority found that the appellant's negligence had caused the respondent's loss, notwithstanding the respondent's service of the notice of termination. Although the respondent may have been able to mitigate its loss by negotiating a new lease, the appellant had not pleaded a failure to mitigate. Furthermore, the notice of termination only operated to terminate a periodic tenancy that arose at law between the parties, and not the void and unenforceable lease as assigned by the deed.

Justice Pullin also found that the appellant's negligence had caused the respondent's loss. His Honour reached this conclusion on the basis that 'because of' the appellant's failure to advise regarding the deed's efficacy, the respondent had proceeded to settlement and paid the purchase price for the Forrestfield Tavern while believing it had an assignment of a valid lease, when in fact it gained nothing more than a periodic tenancy.

➤ Chapter 5: Damages and setting aside contracts

In *Clark v Macourt*²⁵, a doctor purchased the assets of a fertility clinic for approximately \$400,000. Some of those assets were unusable and had to be replaced, from a US supplier, at a cost of more than \$1 million. The doctor fully recouped those additional costs, however, by passing on the additional costs to her patients. The NSW Court of Appeal held that the doctor was not entitled to any damages because she had fully mitigated her loss by passing on the additional costs to her patients. The High Court, however, disagreed and held that the doctor was entitled to recover the cost of purchasing replacement stock. The High Court reached this conclusion on the basis that damages should be assessed as at the date of the breach of contract. There is some tension, however, between this principle and rules concerning mitigation.

The courts have been stricter in preventing plaintiffs receiving windfalls in cases involving the setting aside of contracts. In *First Mortgage Managed Investments Pty Limited v Pittman*²⁶, the NSW Court of Appeal overturned a decision of a trial judge declaring a loan agreement to be wholly unenforceable, where part of the loan had been used to discharge an earlier loan. The court emphasised that the powers under the *Contracts Review Act 1980* (Cth) should only be exercised to the extent necessary to remedy the injustice.

²⁵ [2013] HCA 56.

²⁶ [2014] NSWCA 110.

The NSW Court of Appeal took a similar approach in *Bendigo and Adelaide Bank Ltd v Karamihos*²⁷, although, in that case, the court also overturned the finding that the loan contract was unjust.

*Taheri v Vitek*²⁸ was a third case in which the NSW Court of Appeal considered the setting aside of an agreement. This case was quite unusual, however, in that it involved a successful application to set aside a settlement agreement on the basis of a fraudulent misrepresentation made during the course of proceedings. The facts in this case were particularly stark, as the appellant made inconsistent statements in affidavits filed before and after the claim against her was settled. However, the court emphasised that a fraudulent misrepresentation need only play some part in the decision to settle the proceedings, and that the threshold for showing causation is low. The ability of a party to set aside a settlement agreement, on the basis of fraudulent statements made during proceedings, has the potential to undermine the finality of many settlements – although, of course, proving fraud is usually a difficult exercise.

²⁷ [2014] NSWCA 70.

²⁸ [2014] NSWCA 209.

Clark v Macourt [2013] HCA 56

- > Breach of contractual warranty
- > Assessment of damages

This decision of the High Court of Australia considered the proper calculation of damages for breach of a contractual warranty.

The majority held that damages for breach of contract must be assessed at the date of the breach, even though the plaintiff was able to avoid any loss by passing on additional costs to her customers.

This case confirms the key principles for the assessment of damages for breach of contract, and provides guidance on circumstances in which mitigation of loss by the promisee may be found.

Facts

The appellant, Dr Clark, was a medical practitioner who purchased the assets of St George Fertility Centre Pty Limited (the **vendor**), a company which provided reproductive technology services. The appellant, Dr Macourt, was guarantor for the vendor. The sale price for the assets totalled \$386,950. These assets included a stock of frozen donated straws of sperm. Under the sale contract, the vendor warranted that the identification of the sperm donors complied with specified guidelines. Following the sale, 1996 straws of sperm were found not to comply with the identification guidelines and therefore were unusable. When the usable stock of sperm straws was exhausted, the appellant purchased additional sperm straws to replace those that were unusable. Suitable replacements were only available from a US supplier at a cost of approximately \$1 million. The appellant recouped the costs of the replacement sperm straws by charging her patients a fee that corresponded with the amount she had outlaid for the replacement sperm.

In proceedings before the Supreme Court of NSW, the appellant claimed damages for the breach of warranty under the sale contract.

At first instance, the court held that there had been a breach of warranty with respect to the unusable sperm straws, and fixed the damages for breach as the amount the appellant would have had to pay for the replacement sperm at the time of the breach of contract.

The decision was reversed on appeal, with the NSW Court of Appeal holding that no damages were awardable for the breach of warranty as the appellant, by recouping the costs of the replacement sperm from her patients, had mitigated any loss she sustained from the breach.

Judgment

The majority of the High Court (Chief Justice Keane and Justices Hayne, Crennan and Bell) allowed the appeal and held that the appellant's damages for breach of warranty should be fixed by reference to the cost of the replacement sperm straws at the time of the breach of contract. The court determined that the appropriate approach was to assess the expense incurred by the appellant to acquire substitute stock at the date of breach, rather than assess the loss to the appellant of the value of the sperm stock at the date of purchase.

The majority affirmed the guiding principle that damages for breach of contract must be assessed by reference to the loss of the value of what the promisee would have received if the promise had been performed. The purpose of contractual damages is, therefore, to put the promisee in the same situation, so far as money can, as the promisee would have been in had the contract or broken promise been performed.

In discussing this guiding principle, the majority of the High Court held that:

- the principle applies irrespective of whether the contract is one for the sale of goods or the sale of a business;
- the damages to be paid are to be assessed at the date of breach of the contract. According to Justice Keane (with whom Justices Hayne, Crennan and Bell generally agreed), this is an integral aspect of the principle 'which is concerned to give the purchaser the economic value of the performance of the contract at the time that performance was promised' (at [109]); and

- the principle is concerned with compensating the promisee for the loss of the benefit of the bargain and does not require an apportionment of the components of the bargain. Therefore, the fact that the price paid by the appellant specifically for the sperm under the sale contract could not be calculated was irrelevant.

Applying these principles to the circumstances, the court held that the value of the loss was revealed by what the appellant would have paid for the replacement sperm straws at the time of the breach of warranty. This was considered an appropriate proxy for the loss suffered by the appellant as a result of the breach.

In reaching its decision, the Justices (except Justice Gageler) dismissed the NSW Court of Appeal's finding that no damages were awardable because the appellant had fully mitigated her loss by passing on the cost of the replacement sperm straws to her patients. The majority held that the appellant's purchase of the replacement sperm straws and the subsequent transactions with her patients did not 'avoid, or increase or diminish the loss of her bargain', and consequently there was no mitigation or aggravation of her loss. Furthermore, the fact that the cost of the replacement sperm straws significantly outweighed the price paid under the contract was irrelevant.

Justice Gageler dissented, agreeing with the approach adopted by the NSW Court of Appeal.

First Mortgage Managed Investments Pty Limited v Pittman [2014] NSWCA 110

- › Sections 7(1) and 9 of the *Contracts Review Act 1980* (NSW)
- › Unwarranted benefit
- › Unjust contract
- › Discharge existing mortgage

This decision of the NSW Court of Appeal addressed:

- whether a loan agreement between the applicant and respondents was unjust; and
- whether the primary judge should have taken into account the moneys used by the respondents to discharge pre-existing mortgages when declaring the loan agreement to be wholly unenforceable under s7(1) of the *Contracts Review Act 1980* (NSW) (the **Act**).

The Court of Appeal upheld the primary judge's finding that the mortgage provided by the respondents to First Mortgage Managed Investments Pty Ltd (**FMI**) was unjust under s7(1) of the Act. However, the Court of Appeal found that the primary judge had erred in finding the loan contract and accompanying mortgage wholly unenforceable, stating that the primary judge should have taken into account the money that the respondents obtained from the loan agreement to discharge pre-existing mortgages.

This decision emphasises that borrowers who enter into a mortgage agreement that is found to be an unfair contract will not automatically be relieved from all their obligations under that mortgage if they have used some of the funds obtained from that contract to repay pre-existing debts. In order to be relieved from the obligation of repaying moneys used to discharge pre-existing debts, the borrower must establish that the agreement which gave rise to the pre-existing debts would not be enforceable under s7(1) of the Act.

Facts

FMI was an unlisted public company that managed an investment scheme that obtained funds from the public and lent them on the security of first mortgages over land. The respondents, Mr Pittman and Mr Wilson, owned three pieces of property (the **lands**). Both respondents were not commercially sophisticated and had a combined income of only \$30,000 at the date of the hearing.

Ms Locke, a neighbour of the respondents, had, in the past, convinced them on a number of occasions to mortgage the lands in order to secure loans from third parties to herself. The respondents generally received no financial benefit from these transactions.

On 6 November 2006, FMI issued a letter of offer for a loan of \$2,030,000 to the respondents at a rate of 10.75 per cent per annum at the behest of Ms Locke. On 6 December 2006, the respondents attended a firm called Christopher M Edwards and met with a solicitor, Ms O'Callaghan, whom Ms Locke had used for a number of property matters in the past. Ms Locke was present at the meeting, and the respondents signed a document and statutory declaration acknowledging that they had received advice from a solicitor on a number of matters relating to their obligations under the loan from FMI, including the provision of security. However, the primary judge found that the advice Ms O'Callaghan had offered was not independent because of her relationship with Ms Locke.

Subsequently, FMI and the respondents entered into a loan agreement dated 15 December 2006 under which FMI was said to have loaned \$2,030,000 to the respondents (although the money was for the benefit of Ms Locke) (the **loan agreement**). The primary judge actually found that the loan was in fact \$1.9 million. The loan was secured by a mortgage over the lands (the **FMI mortgage**). In 2008, the 2006 loan agreement was varied to increase the amount of the

loan to \$2,025,000 (the **2008 variation**). Most of the funds advanced under the loan agreement were used to discharge two pre-existing mortgages that the respondents had provided to third parties who had loaned Ms Locke money: these two mortgages were referred to as the 'Moranon mortgage' (\$512,000) and the 'Flamanda mortgage' (\$654,089).

The primary judge, Justice Garling, found that both the loan agreement and the 2008 variation were unjust when made for a number of reasons, including errors in the loan documents that greatly exaggerated the respondents' income and the lack of independent advice received by the respondents. Under s7 of the Act, his Honour declared those agreements were unenforceable: *First Mortgage Investments Ltd v Pittman* [2012] NSWSC 1332.

FMI appealed against that decision, contending that the findings that the loan agreement, the 2008 variation and the FMI mortgage were unjust should be set aside. FMI also argued that Justice Garling erred in making no allowance for the financial benefits FMI said that the respondents received from the loan agreement, being the amount of \$1,172,713, which was used to discharge the Moranon and Flamanda mortgages.

Judgment

Contracts Review Act

Where a court finds a contract to have been unjust, s7(1) of the Act authorises the court to impose a number of remedies, including declaring the contract void or varying the contract in whole or in part. Section 9 of the Act sets out a non-exclusive list of criteria the court should consider in exercising its discretion under s7(1), which are in addition to the 'public interest' and 'all the circumstances of the case':

Suitable remedy

The Court of Appeal upheld the primary judge's finding that the FMI mortgage was unjust under s7(1) of the Act and, in doing so, adopted most of the primary judge's reasoning (at [17]).

However, the Court of Appeal did not uphold the remedy imposed by the primary judge under s7(1), being that the respondents should be relieved of the entirety of their obligations under the FMI mortgage, notwithstanding that part of the funds obtained under that mortgage were used to discharge pre-existing debts of the respondents under the Moranon and Flamanda mortgages. Instead, the Court of Appeal found that the respondents should still be accountable under the FMI mortgage to repay those amounts that were used to discharge the two earlier mortgages (at [217]).

Nature of s7(1) and an unwarranted benefit

The Court of Appeal observed that its powers to grant relief under s7(1) of the Act are not unlimited: rather, once a contract is found to be 'unjust', the court's remedies are limited to avoiding an 'unjust consequence or result of the unjust contract' (at [167]). In addition, the Court of Appeal approved the characterisation of the court's power under s7(1) offered by Justice Handley in *Esanda Finance Corporation Ltd v Tong* (1997) 41 NSWLR 482 (at 489), being that the power is:

... neither penal nor disciplinary, and should not be exercised for such purposes. Once injustice to the weaker party has been remedied, the Court should not further interfere with the rights of the parties. Interference beyond that point will cause injustice to the other party, and is not authorised by the section.

In developing this characterisation of s7(1) of the Act, Justice Handley relied on the approach taken in equity to impugned transactions (such as for unconscionable conduct) of preventing one party from obtaining an 'unwarranted benefit' at the other's expense (at [171]). In the present case, the Court of Appeal endorsed that approach, explaining that the award of an 'unwarranted benefit' under s7(1) of the Act would exceed the court's 'statutory mandate' under that section (at [173]).

Nonetheless, the Court of Appeal stated that the need to avoid awarding an 'unwarranted benefit' does not necessarily mean that if a borrower uses money lent to him or her under an unjust contract to discharge a pre-existing liability, the relief granted to the borrower will automatically have to account for the amount used to discharge the borrower's pre-existing debt (at [174]).

Unjust not sufficient

The Court of Appeal agreed with the appellant's submission that *St George Bank Ltd v Trimarchi* [2004] NSWCA 120 (a case factually similar to the present one) stood for the proposition that (at [182]):

... an unjust loan or mortgage can be declared wholly unenforceable under the Act even if the borrower uses the funds advanced to discharge a pre-existing liability, *but only if the borrower establishes that the pre-existing liability arose under a transaction that could have been avoided at the suit of the borrower* [emphasis added].

This proposition rests on the observation that, where the first loan might have been avoided under s7(1) of the Act, the discharge of that loan would not amount to any benefit to the borrower. The Court of Appeal later explained that finding the Flamanda and Moranon mortgages were unjust would not automatically mean that the FMI mortgage had not provided any financial benefit to the respondents, since the primary judge had not found that the former two mortgages were liable to be set aside or avoided at the suit of the respondents (at [183]). Consequently, the respondents would still be liable to repay the amounts borrowed under the Flamanda and Moranon mortgages and therefore using the funds supplied under the FMI mortgage to discharge those pre-existing debts amounted to an 'unwarranted benefit' (at [183]-[186]). As a result, the Court of Appeal found that the primary judge had erred in concluding that the respondents should be relieved of the entirety of their obligations under the FMI mortgage (at [183]).

Other paths

Nonetheless, the Court of Appeal observed that the court's finding in *St George v Trimarchi* did not preclude there being 'other circumstances' (in addition to the one discussed above) in which a loan agreement could be declared wholly unenforceable regardless of the fact that part of the unjust agreement was used to discharge a pre-existing liability of the borrower (at [184]). The Court of Appeal stated that such circumstances might include where 'the lender's actions may have deprived a vulnerable borrower of the opportunity to take an available course, other than refinancing through the lender, that would have permitted the borrower to pay out the earlier loan.' Unfortunately, the Court of Appeal did not elaborate on this point.

However, the Court of Appeal noted that the primary judge had not articulated what these 'other circumstances were' in the present case. Instead his Honour had been satisfied that he could make an order under s7(1) declaring that the FMI mortgage was wholly unenforceable merely because the Flamanda mortgage and other preceding loans were 'unjust' (at [185]). Accordingly, the Court of Appeal found that the primary judge's exercise of his discretion under s7(1) had been miscarried.

Re-exercise of discretion under s7(1)

As the Court of Appeal concluded that the discretion of the primary judge under s7(1) of the Act had been miscarried, the Court of Appeal ordered that the respondents should not be relieved of their obligation under the FMI mortgage to repay the portion of that loan which they used to discharge the Moranon and Flamanda mortgages. The Court of Appeal listed several ways in which the orders of the primary judge could be altered to give effect to the above conclusion and gave the parties 14 days to agree on their preferred alteration.

Bendigo and Adelaide Bank Ltd v Karamihos [2014] NSWCA 17

- > Unjust transactions
- > *Contracts Review Act 1980* (NSW)

This judgment of the NSW Court of Appeal dealt with the *Contracts Review Act 1980* (NSW) (the **Act**) and a mortgage involving elderly borrowers.

At first instance, the court (Justice Pembroke) held that a loan from Bendigo and Adelaide Bank Ltd (the **Bank**) to the respondents was unjust (within the meaning in the Act), and relieved the respondents from their obligations in relation to it. The respondents were an elderly couple who had borrowed \$1.2 million from the Bank to invest in a family business which later encountered financial difficulties.

On appeal, Justice Macfarlan delivered the primary judgment and found that there was no evidentiary basis to support a finding that the relevant loan contract and mortgage were unjust. The first instance decision was set aside and the respondents were liable to the Bank in relation to the loan.

This decision is a reminder that courts will only make a finding that a transaction is unjust (within the meaning of the Act) on the basis of clear evidence. Importantly, it demonstrated that a court, in applying the Act:

- must have clear evidence before it can set aside a transaction on the basis it is unjust;
- cannot infer that certain circumstances result in unjustness; and
- must consider all of the facts and circumstances in a case and not grant relief to the parties under the Act in such a way that would confer a windfall.

Facts

In 2007, the respondents, an elderly couple, refinanced an existing loan from the Bank of Queensland. As a result of this refinancing, the respondents borrowed \$1.2 million from the Bank. The appellants had operated a take-away business and used the borrowed funds to:

- discharge their existing mortgage to the Bank of Queensland;
- make a gift of \$100,000 to their daughter; and
- invest in their business.

At the time of applying for the loan from the Bank, the respondents indicated that they had three principal assets:

- their residential home (which was offered as security for the loan from the Bank);
- their business premises (but this was already advanced as a security for a separate loan); and
- the take-away business itself.

Critically, the respondents had self-assessed the value of their business premises at \$2 million. The value of this property was one of the factors relied on by the Bank in determining the ability of the respondents to repay the loan. The Bank did not conduct its own enquiries to ascertain the value of the business premises. It emerged that the business premises were significantly overvalued. At first instance, Justice Pembroke held that this valuation was 'piteously optimistic and unsupportable' [43].

The respondents sought to have their loan with the Bank set aside on the basis it was unjust within the meaning of the Act. At first instance, his Honour found for the respondents, on the basis that:

- the respondents had limited financial acumen;
- the Bank failed to conduct reasonable enquiries in relation to the value of the respondents' business premises; and
- the respondents had a limited understanding of English and did not fully comprehend the loan documents.

The bank appealed.

Judgment

The Court of Appeal upheld the Bank's appeal and set aside the first instance judgment. The Court of Appeal held that:

- there was no material difference between the Act and the National Credit Code, so the proceeding could be determined by reference to the Act [32];
- even if the Bank had conducted its own enquiries in relation to the value of the business premises, it would not have been able to uncover anything (at the time) that would have affected its decision to grant the loan to the respondents [53];
- there was insufficient evidence before the trial judge to allow the court to reach the conclusion that the respondents had limited financial acumen, or that they could not protect their own interests [65];
- there was a general lack of evidence to establish that the loan to the respondents was unjust and that, to the contrary, the evidence tended to suggest that the respondents' financial problems arose because of a failure to follow their own investment strategy [65]; and
- in formulating the orders at first instance (effectively setting aside the loan from the Bank), the court had failed to consider whether the respondents had gained a windfall as a result of those orders.

Taheri v Vitek [2014] NSWCA 209

- › Rescission for fraudulent representation
- › Compromise of litigation induced by fraudulent representation in affidavit

In this decision, the New South Wales Court of Appeal dealt with a compromise of litigation induced by fraudulent representations in an affidavit.

Chief Justice Bathurst and Justices Emmett and Leeming agreed with the first instance decisions of Chief Justice Bergin and Justice Rein in finding that the vendors relied on and were induced by fraudulent representations made by a guarantor in deciding to settle litigation.

This case provides guidance on the factors a court may take into consideration when determining whether a compromise of litigation induced by fraudulent representation should be set aside.

Facts

Peter Vitek and Shoshana Vitek (the **vendors**) entered into a contract with Estate Homes Pty Ltd (the **purchaser**) on 15 September 2003 for the sale of land at Redfern (the **contract**). Veeda Taheri (**Ms Taheri**) and her husband Siamac Taheri (**Mr Taheri**) were named in the contract as guarantors of the obligations of the purchaser (the **guarantors**). Under a power of attorney, Mr Taheri signed his wife's name on the contract. A dispute arose between the parties and the contract did not complete.

The vendors commenced proceedings in March 2005 against the purchaser and the guarantors. The purchaser and the guarantors brought a cross-claim against the vendors and against their adviser, Bernard O'Donnell (**Mr O'Donnell**). During the course of the proceedings, Ms Taheri served an affidavit to the effect that she was unaware of the fact that her husband had purported to bind her to the contract (the **first affidavit**).

The matter was heard before Justice Barrett and, on the fourth day of the hearing, Ms Taheri reached a settlement with the vendors (the **first settlement**) and Mr O'Donnell (the **second settlement**). On 30 April 2009, Justice Barrett made consent orders relating to both settlements (the **orders**). After the first settlement, Ms Taheri served

evidence to the effect that she was aware of the contract and that she had been bound as a guarantor. The vendors' claims against Mr Taheri and the purchaser subsequently proceeded and the vendors obtained judgments which were not satisfied.

The vendors commenced further proceedings against the guarantors and Mr O'Donnell. The vendors alleged that they had agreed to the first settlement in reliance on false representations made by Ms Taheri. There were two hearings at first instance. At the first, Chief Justice Bergin found that the vendors were induced to settle by Ms Taheri's fraudulent misrepresentations and ordered the first settlement to be set aside. At the second, Justice Rein held that Ms Taheri was liable on the guarantee.

Ms Taheri appealed the findings made at first instance. Separate appeals from the judgments delivered by Chief Justice Bergin and Justice Rein were heard concurrently. The key issue raised in the appeal was whether Chief Justice Bergin had erred in concluding that:

- the vendors relied on and were induced by the fraudulent misrepresentations made in the first affidavit (the **no reasonable reliance/inducement argument**); and
- the appropriate relief for fraudulent misrepresentation was the setting aside of the first settlement in circumstances where the second settlement remained on foot (the **no substantial restitution in integrum argument**).

Judgment

The court held that both appeals should be dismissed. In particular, the court found:

- that the vendors relied on and were induced by the fraudulent misrepresentations made in the first affidavit; and
- the fact that the second settlement had not been set aside did not prevent rescission of the first settlement.

In relation to the no reasonable reliance/inducement argument, the court noted the following:

- the availability of ‘judicial rescission’ turned on whether the vendors could obtain rescission of the first settlement on which the orders were based (*Toubia v Schwenke* [2002] NSWCA 34);
- it is sufficient if the fraudulent misrepresentation played some part in contributing to the formation of the contract. If there is no causal connection between the representation and the contract entered into, then judicial rescission will not be available (*Henville v Walker* [2001] HCA 52);
- the threshold for the test is low, it would be no defence to show that the vendors might well have entered into the first settlement absent any fraudulent misrepresentation (*Barton v Armstrong* [1976] AC 104; *Macquarie Generation v Peabody Resources* [2000] NSWCA 361);
- an absence of belief in the truth of a representation is not fatal to a claim based on it (*Gipps v Gipps* [1978] 1 NSWLR 454);
- the reliance by the vendors, through their counsel, was not upon the truth of the representations, but upon the fact that they were made and might be accepted by the court, thereby giving rise to the litigation risk which could jeopardise the prospects of the vendors [90]; and

- it is self-evident that the assessment of litigation risk was informed by the representations made in the first affidavit. It follows that there was a causal connection between the fraudulent misrepresentations and the decision to bargain away the litigation risk by the first settlement [92].

In relation to the no substantial restitutio in integrum argument, the court confirmed the following:

- rescission of a contract induced by fraudulent misrepresentation will be available in equity in circumstances where precise restitution in integrum is not possible, if equity ‘can do what is practically just between the parties, and by doing so restore them substantially to the status quo’ (*Alati v Kruger* (1955) 94 CLR 216); and
- the availability of rescission in equity in this case depends on whether there was a single tripartite contract, or two bipartite contracts entered into at the same time and reflected in the orders simultaneously. The agreements reflected in the orders contemplated the possibility that one might be performed and the other breached. As neither agreement is dependent on the other, no prejudice exists by the rescission of one and not the other [99]-[101].



Chapter 6: Repudiation and waiver

If a party repudiates a contract, the other party may either accept the repudiation, which brings the contract to an end, or insist on continued performance of the contract. An issue recently considered by the NSW Court of Appeal was whether a party, having initially insisted on performance of a contract, could later accept the repudiation and bring the contract to an end.

In *Galafassi v Kelly*²⁹, the purchasers failed to complete the purchase of a residential property because they were unable to obtain finance. The vendor commenced proceedings seeking specific performance of the contract. Subsequently, the vendor found another buyer and purported to accept the purchasers' repudiation. The purchasers argued that, by commencing proceedings for specific performance, the vendor had elected to affirm the contract and waived any right to accept the repudiation.

The NSW Court of Appeal rejected the purchasers' argument. The court held that there was a continuing repudiation of a contract and that the vendor was therefore entitled to accept the repudiation, notwithstanding the earlier election to seek specific performance.

²⁹ [2014] NSWCA 190.

³⁰ *Peter Turnbull & Co. Pty Ltd v Mundus Trading Co. (Australasia) Pty Ltd* (1954) 90 CLR 235.

If a repudiation is not accepted, then both parties are obliged to continue complying with their obligations under the contract. One exception to this principle, recognised by the High Court in *Peter Turnbull*³⁰, is that the party not in breach may be dispensed from performing a term of the contract if the party in breach has expressly or impliedly intimated that it would be useless for the innocent party to perform that obligation, and the innocent party relies upon that intimation. It is sometimes said in this situation that the party in breach has 'waived' the obligation to perform the condition – although this waiver is probably best understood as being a consequence of an estoppel.³¹

In *Allianz Australia Insurance v BlueScope Steel Ltd*³², the NSW Court of Appeal applied the *Peter Turnbull* principle to a situation where the party 'waiving' compliance has not repudiated the contract. In that case, an insurer indicated that it would not indemnify the insured because the insured had settled proceedings without the written consent of the insurer. It was not alleged that the conduct of the insurer was repudiatory. The court nevertheless held that the insured might be excused from its failure to obtain consent if the insurer had

³¹ *Foran v White* (1989) 168 CLR 385.

³² [2014] NSW CA 276.

indicated that it was useless for the insured to seek its consent to a settlement because, come what may, the insurer would not indemnify its insured. As the tribunal had not made any such finding, nor any finding on reliance, the proceedings were remitted to the tribunal.³³

Parties to a contract are often concerned that, by negotiating new arrangements with a party in breach, they might be held to have waived their rights in relation to the breach. Such an argument was raised in *Cedar Meats*³⁴ (also considered in this update in the 'Penalties and illegality' section). It was, however, rejected by the Victorian Court of Appeal, which confirmed that clear, objective evidence is required to show that a right has been waived.

³³ Note that this policy was not governed by the *Insurance Contracts Act*, so there was no consideration of the effect of s54. There was, however, some consideration of s18 of the *Insurance Act 1902* (NSW), which may also sometimes excuse non-compliance with a condition of an insurance contract. This issue was also remitted to the tribunal.

³⁴ *Cedar Meats (Aust) Pty Ltd v Five Star Lamb Pty Ltd* [2014] VSCA 32.

Galafassi v Kelly [2014] NSWCA 190

- > Repudiation and non-performance
- > Election
- > Specific performance and damages
- > Scope of without prejudice privilege

In this decision, the NSW Court of Appeal considered whether repudiation of a contract of sale by the purchaser entitled the vendor to accept the repudiation and sue for damages, despite the vendor previously electing to sue for specific performance.

The court held that where there is ongoing repudiatory conduct, an election to sue for specific performance does not preclude that party from subsequently accepting the repudiation. The court also considered the scope of without prejudice privilege in relation to the admissibility of two emails from the purchasers to the vendor, which formed the basis of the court's finding that the purchasers were unable and unwilling to complete under the contract.

The case highlights the risks associated with parties communicating directly with each other when litigation is already on foot, or clearly in contemplation. It also demonstrates the risk of a court finding that a state of affairs described in a particular communication may be held to constitute ongoing repudiatory conduct, unless and until the party makes clear that the circumstances described in the communication have changed.

Facts

In September 2011, Mr and Mrs Galafassi (the *purchasers*) signed a contract for the purchase of a residential property in Paddington from Mrs Kelly (the *vendor*). The purchase price was \$6,350,000 and the sale was due to complete on 30 December 2011. On that date, the purchasers' solicitor wrote to the vendor informing them that the purchasers did not have the funds necessary to complete and would not be proceeding with the purchase.

The vendor responded that they did not accept the purchasers' repudiation of the contract and would commence proceedings for specific performance. On 4 January 2012, the purchasers' solicitor wrote to the vendor informing them that the purchasers were not

financially capable of completing the contract and that any order for specific performance would be futile.

On 20 January 2012, the vendor commenced proceedings in the NSW Supreme Court seeking specific performance of the contract. On 24 January, and again on 24 February 2012, Mrs Galafassi sent an email directly to the vendor apologising for the purchasers' inability to complete and confirming that they did not have sufficient funds to pay for the property (the *emails*). The emails also stated that the purchasers had agreed to a property swap arrangement, losing their savings in the process, and making them financially incapable of completing the purchase of the vendors' property. Relevantly, the January email concluded by saying:

ps...our lawyer was not entirely comfortable with us writing this letter and does not want it used against us. His advice is to state that this 'appeal' is without prejudice and should not be used in a legal case against us, or in the press, and is very much confidential.

On 24 April 2012, a notice of termination of the contract was issued by the vendor, purporting to accept the purchasers' ongoing repudiation. By this time, the vendor had found an alternative purchaser for the property (for a purchase price of \$5,500,000). By way of an amended statement of claim filed in June 2012, the vendor sued for damages.

The vendor was successful at first instance. Justice Windeyer held:

- the emails were admissible because, properly characterised, they were not an attempt to negotiate a settlement and so s131 of the *Evidence Act 1995* (NSW) (the **Act**) did not apply;
- there was a clear continuing act of repudiation by the purchasers, evidenced by the emails, and the purchasers had clearly indicated that it was beyond their power to complete and that they had no intention of completing;

- even if the vendor had elected to affirm the contract by taking the step of suing for specific performance and filing pleadings, this did not preclude them from subsequently claiming damages for breach of contract where there was an ongoing repudiation of the contract by the purchasers;
- service of a notice to complete was not necessary in the circumstances of the case; and
- the vendor had made reasonable efforts to minimise their loss and were entitled to damages under the contract with respect to special interest and land tax.

Judgment

The principal issues in the purchasers' appeal were:

- the lawfulness of the vendor's purported termination of the contract on 24 April 2012;
- the admissibility of the emails;
- whether the vendor failed to mitigate their loss on the resale of the property; and
- whether the vendor was entitled to damages under the contract with respect to special interest and a reimbursement for land tax liability for the 2012 year.

The Court of Appeal dismissed the purchasers' appeal, save with respect to the claim for special interest. Relevantly, the court held:

- the two emails from Mrs Galafassi to the vendor had been properly admitted into evidence by the primary judge. Justice Gleeson, with whom Chief Justice Bathurst and Justice Ward agreed, concluded that the 24 January email was 'merely a communication which indicates that if the proceedings can be dealt with in some way which avoids publicity for the Purchasers, they would be most grateful for the Vendor's assistance'. In relation to the 24 February email, his Honour held that it contained 'no invitation to negotiate; there was merely the expression of "hope" for a resolution which would avoid adverse publicity for the Purchasers'; and

- accordingly, neither email was found to be sufficiently close to 'an attempt to negotiate a settlement of a dispute' so as to fall within the scope of s131 of the Act. In any event, even if the emails did fall within s131 of the Act, Justice Gleeson held that the exceptions in s131(2)(g) and s131(2)(i) would have applied so that the documents could be admitted into evidence – the former section applying where the court would likely be misled as to the existence or contents of an excluded communication, and the latter section applying where the communication affects the rights of a person (in this case, the vendor).

The court went on to hold that the emails, considered in their entirety and the context in which they were sent, constituted clear evidence of the purchasers' inability and unwillingness to perform the contract according to its terms. The court held that, despite being sent before the vendor's decision to terminate the contract, they constituted a continuing repudiation by the purchasers unless and until they were withdrawn. Since that did not occur, the court was satisfied that there was an ongoing repudiation of the contract that the vendor was entitled to accept. Justice Gleeson stated:

... the inescapable conclusion is that there was a continuing repudiation by the Purchasers day by day from 4 January 2012, which the Vendor was entitled to accept and terminate the contract.

In relation to the issue of election, his Honour stated:

In summary, the legal significance of commencing proceedings for specific performance is as follows – a vendor who elects to sue for specific performance is not thereby precluded from later terminating the contract and claiming damages for the continued refusal by the purchaser to complete if the purchaser, after the institution of the proceedings, either committed a breach of an essential term of the contract or otherwise evinced an intention to no longer be bound by the contract.

Accordingly, the termination of the contract by the vendor on 24 April 2012 was held to be lawful. In relation to the other appeal points, the court held:

- the primary judge was right to conclude that the failure of the vendor to issue a notice to complete did not prevent them from lawfully terminating the contract in circumstances where the purchasers' conduct constituted an ongoing repudiation of the contract;

- there was no error on the part of the primary judge in determining the issue of whether the respondents had failed to exercise the power of resale in a reasonable manner, or mitigate their loss; and
- since the vendor sued for liquidated damages under clause 9.3.1 of the contract, as opposed to damages under the general law, whether they were entitled to special damages was a question of construing the relevant provisions of the contract.

The court held that, properly interpreted, special interest was only payable when completion occurred, which, on the facts of this case, never happened.

Allianz Australia Insurance Ltd v Bluescope Steel Ltd [2014] NSWCA 276

- › Repudiation of contract
- › Waiver of compliance with the conditions of a contract

In this decision, the NSW Court of Appeal considered the circumstances in which a party will no longer be required to comply with a contract due to the conduct of the other party.

The court held that the matter should be remitted to the Dust Diseases Tribunal to consider whether the insured was excused from compliance with the insurance contract because of the insurer's conduct in refusing to indemnify the insured and communicating that refusal. That issue was not pleaded at first instance or on appeal.

This case suggests that there may be circumstances in which a party to a contract can, by their conduct, expressly or implicitly communicate to the other party that there will be no need for them to continue to comply with the contract. A waiver of compliance is different from repudiating the contract.

Facts

Allianz Australia Insurance Ltd was the insurer of BlueScope Steel Ltd. Mr Jackson was a former employee of BlueScope who contracted mesothelioma. Before his death, he claimed compensation from BlueScope.

BlueScope notified Allianz of Mr Jackson's potential insurance claim after a bedside hearing of the Dust Diseases Tribunal (*DDT*) prior to Mr Jackson's death. BlueScope requested Allianz defend the claim on its behalf and confirm it would indemnify BlueScope.

Allianz later refused to do so because BlueScope had failed to notify Allianz of the claim as soon as possible. Allianz also refused to communicate with BlueScope in respect of any settlement negotiations.

BlueScope settled the claim with Mr Jackson's widow. BlueScope then filed a cross-claim against Allianz for the settlement amount. In its defence, Allianz argued BlueScope failed to comply with relevant terms of the insurance policy, being:

- their obligation to notify Allianz; and
- that Allianz was to provide written consent prior to incurring any litigation expenses or making any settlement.

BlueScope argued that, if that were the case, its breaches were excused by section 18(1) of the *Insurance Act 1902* (NSW), and, at first instance, the DDT held that Allianz was liable to BlueScope by reason of s18(1). Allianz appealed to the New South Wales Court of Appeal.

Judgment

Justices Basten, Meagher and Ward agreed that Allianz did not repudiate the insurance contract by refusing to defend the claim against BlueScope. Allianz was under no obligation to indemnify BlueScope until Bluescope provided sufficient proof of liability. Their Honours cited the comments of Justice Stephen in *Distillers Co Bio-Chemicals (Australia) Pty Ltd v Ajax Insurance Co Ltd* [1974] HCA 3; 130 CLR 1 in support.

Their Honours also noted that a wrongful refusal to indemnify, falling short of a wrongful repudiation of the insurance contract, may, in certain circumstances, waive the obligation of the insured to continue to comply with the terms of the insurance contract.

Their Honours applied the decision in *Peter Turnbull & Co Ltd v Mundus Trading Co (Australasia) Pty Ltd* [1954] HCA 25; (1954) 90 CLR 235, in which the High Court held that compliance with the contract can be waived where one party, by their conduct, indicates the other party 'may be dispensed from performing a condition by the defendant expressly or impliedly intimating that it is useless for him to perform it and requesting him not to do so'. Their Honours agreed that, as this issue had not been pleaded, further facts were necessary to determine whether such conduct had occurred and so the question of waiver should be remitted to the DDT.

Justice Meagher noted:


- a party may 'waive' compliance with a contract where, for example, an insurer has 'repudiated all liability under the policy' and indicated that it was 'not prepared to deal with the matter in any way whatever'; and
- if Allianz had indicated prior to the time for performance that performance was not necessary, Allianz may be estopped from relying on any non-compliance by the insured. (*Foran v Wight* (1989) 168 CLR 385, *Austral Standard Cables Pty Ltd v Walker Nominees Pty Ltd* (1992) 26 NSWLR 524 and *Peter Turnbull & Co*).

Justice Ward considered in detail the issue of repudiation of the contract and the type of conduct that may excuse another party from compliance with the contract in detail. Her Honour noted:

- in respect of Allianz's alleged repudiation, Allianz had not communicated that it would never indemnify BlueScope but rather it was not willing to indemnify BlueScope at that particular time. Consequently, Allianz was entitled to assert that position in accordance with the contract. A repudiation of the contract would have occurred if Allianz had issued a blanket refusal to indemnify BlueScope without any basis in the contract (*Distillers*). Allianz was 'objectively acting in accordance with what it understood to be its legal rights under the contract, not repudiating the contract';

- a 'mistaken interpretation' of a contractual obligation will not evidence an intention to walk away from the contract in its entirety and consequently will not amount to a repudiation (*DTR Nominees Pty Ltd v Mona Homes Pty Ltd* [1978] HCA 12; (1978) 138 CLR 423; *Woodar Investment Development Ltd v Wimpey Construction UK Ltd* [1980] 1 WLR 277; *Australian Stratacore Holdings Ltd (in liq) v Sanwa Australia Securities Ltd* [1994] NSWCA 11); and
- in respect of *Peter Turnbull & Co*, Allianz's refusal to confirm BlueScope's indemnity until it was proven was of itself insufficient to amount to a waiver of performance. Further facts were necessary to prove that Allianz's conduct waived BlueScope's obligations under the contract.

The New South Wales Court of Appeal decided that the question of whether Allianz had, by its conduct, 'waived' any obligation of BlueScope to continue to comply with the conditions of the contract of insurance should be remitted to the DDT to reconsider, as it had not been pleaded at first instance or on appeal.



➤ Chapter 7: Reasonable endeavours

Our *Contract Law Update 2013* included a summary of the decision of the Western Australia Court of Appeal in *Verve Energy*. In that case, the court held that an obligation to take reasonable endeavours would ordinarily require a party to do all that can be reasonably done in the circumstances to achieve the contractual object.

On appeal, the High Court took a different approach.³⁵ The majority gave particular weight to a clause in the agreement that permitted the seller of gas, in deciding whether it was 'able' to supply supplementary gas at an agreed price, to take into account all relevant commercial, economic and operational considerations – including (on the facts of this case) that the market price was significantly higher than the contractually agreed price.

The WA Court of Appeal (and Justice Gageler in dissent in the High Court) had construed 'able' as referring to the capacity or ability to supply supplementary gas. The majority of the High Court, however, held that 'able' permitted the sellers to have regard to their own business interests.

The decision of the majority in this case turned, to an extent, on the particular wording of the reasonable endeavours clause. However, the majority also referred to earlier cases which had held that obligations to use 'reasonable endeavours' or 'best efforts' did not prevent a party acting in its own business interests.

The High Court did not expressly address the issue whether 'reasonable endeavours' had a different meaning from 'best endeavours' or 'best efforts', but it did note that argument before the court had '*proceeded on the basis that substantially similar obligations are imposed by either expression*'.³⁶ Until the High Court provides definitive guidance on this issue, parties will no doubt continue to debate which expression should be used in their contracts.

Parties seeking to minimise the uncertainty about what reasonable endeavours requires may set out, in the contract itself, an internal standard of what is 'reasonable'. However, it will not be possible for such a clause to cover every contingency and there will always be some uncertainty about the precise scope of the obligation.

³⁵ *Electricity Generation Corporation v Woodside Energy Ltd* [2014] HCA 7.

³⁶ Per Chief Justice French and Justices Hayne, Crennan and Kiefel at [40].

Electricity Generation Corporation v Woodside Energy Ltd [2014] HCA 7

- › Construction
- › Whether sellers of gas breached obligation to use 'reasonable endeavours' to supply supplemental gas

In this judgment, the High Court of Australia considered the construction of a long-term gas supply agreement, and specifically whether the seller had breached an obligation to use 'reasonable endeavours' to supply supplemental gas.

The court held by majority that the seller had not breached its obligation to use 'reasonable endeavours' to supply gas. In determining whether it was able to supply the gas, the seller was entitled to take into account all relevant 'commercial, economic and operational matters', and the court found that this included the business interests of the seller and the fact that, at that particular time, they were able to obtain significantly higher prices for the gas (than provided for in the contract) by selling to other buyers.

This case clarifies that obligations to use 'reasonable endeavours' to achieve a contractual outcome will not necessarily require a party to ignore their own business interests. The obligation is not absolute and will be qualified by what is reasonable in the particular circumstances and by any express considerations in the contract.

Facts

The appellants, Electricity Generation Corporation trading as Verve Energy (**Verve**) and various gas suppliers in Western Australia including Woodside Energy Ltd (the **sellers**), are party to a long-term gas supply agreement (the **GSA**). Each seller under the GSA is obliged to make available for delivery to Verve a share of a maximum daily quantity of gas, and to use 'reasonable endeavours' to make available to Verve a supplemental maximum daily quantity of gas (**SMDQ**) at the price set out in the contract. The relevant clause in the GSA is clause 3.3:

3.3 Supplemental Maximum Daily Quantity

(a) If in accordance with Clause 9 ('Nominations') the Buyer's nomination for a Day exceeds the MDQ, the Sellers must use reasonable endeavours to make available for delivery up to an additional 30TJ/Day of Gas in excess of

MDQ ('Supplemental Maximum Daily Quantity' or 'SMDQ').

(b) In determining whether they are able to supply SMDQ on a Day, the Sellers may take into account all relevant commercial, economic and operational matters and, without limiting those matters, it is acknowledged and agreed by the Buyer that nothing in paragraph (a) requires the Sellers to make available for delivery any quantity by which a nomination for a Day exceeds MDQ where any of the following circumstances exist in relation to that quantity:

(i) the Sellers form the reasonable view that there is insufficient capacity available throughout the Sellers' Facilities (having regard to all existing and likely commitments of each Seller and each Seller's obligations regarding maintenance, replacement, safety and integrity of the Sellers' Facilities) to make that quantity available for delivery;

(ii) the Sellers form the reasonable view that there has been insufficient notice of the requirement for that quantity to undertake all necessary procedures to ensure that capacity is available throughout the Sellers' Facilities to make that quantity available for delivery; or

(iii) where the Sellers have any obligation to make available for delivery quantities of Natural Gas to other customers, which obligations may conflict with the scheduling of delivery of that quantity to the Buyer.

In June 2008, an explosion occurred at the gas plant of Apache, the other major supplier of natural gas in Western Australia, causing a reduction in the availability of gas in the market. Shortly after this incident, the sellers informed Verve that they would not supply SMDQ under the GSA. The sellers instead offered to supply Verve with that quantity of gas for the month of June at a price significantly higher than that provided for in the GSA, and from July – September invited them to tender for the gas under short-term supply contracts.

Verve commenced proceedings against the sellers, claiming that the sellers had failed to comply with clause 3.3(a) of the GSA. It was accepted by both parties that the sellers had capacity to supply SMDQ during the relevant period. At first instance in the Supreme Court of Western Australia, Justice Le Miere held that clause 3.3(b) conditioned

the sellers' obligation to supply SMDQ, and that the sellers had not breached clause 3.3 of the GSA. On appeal, the Western Australian Court of Appeal found that the sellers' construction was inconsistent with the ordinary meaning of the clause, and that there had been a breach.

Judgment

The High Court by majority allowed the appeal by the sellers.

The court held that, while clause 3.3 imposed an obligation to use reasonable endeavours to supply SMDQ, this was qualified by their right to take into account their own commercial, economic and operational interests in relation to the supply. The expression 'commercial, economic and operational matters' was held to include reference to matters affecting the sellers' business interests, which included the prevailing market conditions after the Apache explosion. The court noted that the word 'able' in clause 3.3(b) should not be interpreted narrowly to refer only to the sellers' capacity to supply, as this would not accurately reflect the whole of clause 3.3(b), which included a list of potential considerations not limited to issues of capacity.

The court made some general observations regarding obligations to use reasonable endeavours. It was noted that:

- an obligation to use 'reasonable endeavours' is not an absolute or unconditional obligation;
- the nature and extent of such an obligation is qualified by what is reasonable in the circumstances, which can include a party's business interests; and
- some contracts will prescribe their own standard of what is reasonable, by express reference.

Justice Gageler dissented, finding that the sellers' appeal should be dismissed. His Honour argued that it was difficult to understand how reasonable commercial parties, having agreed on a fixed price for the supply of supplemental gas, and having agreed that one party would use 'reasonable endeavours' to supply that gas, could be found to have agreed to allow the sellers to refuse to provide the supplemental gas merely because they could obtain a higher price by selling to other parties. Accepting this construction of clause 3.3 would mean that the fixed price agreed for SMDQ would only be relevant in circumstances where it was to the sellers' advantage to accept that price. His Honour found that clause 3.3 referred to the sellers' lack of capacity or inability to supply SMDQ, rather than to circumstances in which they were unwilling to supply SMDQ.

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