

➤ Allens Contract Law Update 2015

➤ Introduction

Welcome to our annual summary of important contract law judgments delivered by Australian appellate courts.

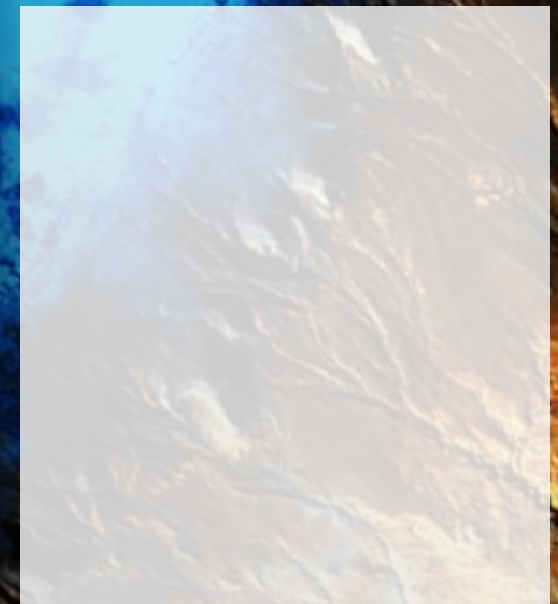
A surprising number of appellate judgments in 2015 considered one of the most fundamental questions in contract law: is there a legally binding contract between the parties? In the absence of a signed agreement, this can turn on whether there was (objectively) an intention to create legal relations. As can be seen in chapter 1 of this *Update*, this is an issue on which different judges can reach different conclusions on the same or similar facts.

Chapter 2 looks at some further, incremental developments in the law of implied terms. In contrast to some fairly dramatic changes in English law over the past six years, appellate courts in Australia continue to apply and develop orthodox tests for the implication of terms. The most controversial issue in this area in Australian law is whether a duty of good faith should be implied into contracts and, if so, the content of that duty. Although this issue was touched on by appellate courts last year, courts are usually able to determine disputes without needing to decide whether or not such an implied term exists.

One of the most important developments in Australian contract law in recent years was the High Court's restatement of the penalties doctrine in the bank fees class action in 2012. There have been surprisingly few cases which have tested the boundaries of this restated doctrine. Those cases that were decided in 2015 largely turned on orthodox principles and tended to narrow, rather than expand, the number of clauses likely to be affected by the doctrine. We will see whether the High Court endorses or reverses this trend when the bank fees class action comes back before it in early 2016 (on appeal from a Full Court judgment summarised in this *Update*). The other cases discussed in Chapter 3 raise some important issues which should be considered by parties when negotiating and drafting settlement agreements.

The High Court's decision in 2014, in *Clark v Macourt*, showed how difficult it can sometimes be to apply the law on damage to particular factual situations. The appellate judgments during 2015 provide useful guidance on how damages should be calculated in a variety of different situations – the decision in *Chand* will, in particular, provide some comfort to defendants.

The last chapter of this *Update* covers a NSW Court of Appeal decision on whether an expert determination, which was found to have applied a different formula from that specified in the contract, was nevertheless binding on the parties. The court found that the determination was not binding because it was not made in accordance with the contract. It is always open to the parties, however, to state expressly the extent to which errors in expert determinations are nevertheless binding on the parties.



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➤ Chapter 1: Contract formation

One of the essential requirements for a legally binding contract is that there be, objectively, an intention to create legal relations. Conventionally, this intention is manifested by the parties signing a written agreement. Where the parties have not signed a written agreement, disputes will frequently arise as to whether there was an intention to create legal relations. Four such cases were considered by appellate courts last year.

In *Ashton v Pratt*¹, the NSW Court of Appeal unanimously held that, despite the court being satisfied that Mr Pratt has promised to make substantial payments to Ms Ashton (his escort), there was no intention to create a legally binding agreement. The challenge to Mr Pratt's will therefore failed. A claim in promissory estoppel similarly failed, and the leading judgment of Chief Justice Bathurst discussed the unresolved debate as to whether promissory estoppel can be a source of an obligation, or only a restraint on the enforcement of legal rights.

Similar issues arise surprisingly often in a commercial context. In *Pavlovic v Universal Music Australia Pty Limited*², the court considered correspondence and draft agreements to terminate a joint venture between Universal Music Australia and Mr Pavlovic (an Australian music promoter). On Christmas Eve, Mr Pavlovic's lawyer stated that his client would sign the documents 'tomorrow' and that they would be sent back to Universal Music's lawyers on Boxing Day. Universal Music's lawyers, in reply, agreed to allow Mr Pavlovic a further 48 hours to forward signed copies to them. The documents were never in fact executed and the Court of Appeal, overruling the trial judge, found that the correspondence between the parties did not lead to a binding contract. The court also found that, in any case, the solicitors did not have authority to bind their clients (such ostensible authority in solicitors usually only exists for contracts to settle disputes).

1 [2015] NSWCA 12.

2 [2015] NSWCA 313.

The Western Australian Court of Appeal, however, reached a different conclusion on apparently similar facts in *Vantage Systems Pty Limited v Priolo Operation Pty Ltd*³. In that case, the parties exchanged proposals as to the terms on which a lease and licence would be renewed. An agreement was reached on the commercial terms, and lawyers were instructed to prepare lease and licence agreements. Although these agreements were never signed, the court held that the agreement on the commercial terms manifested an intention to create legal relations.

The absence of a signature was also relied upon by the unsuccessful respondent in *Caltex Australia Petroleum Pty Ltd v Troost*⁴. A director in that case signed under the 'guarantee' section of an agreement but not under the 'indemnity' section. The trial judge held that the director was therefore not bound by the indemnity. The court of appeal overruled her, on the basis that the guarantee and indemnity were treated as one obligation under the contract.

In addition to the intention to create legal relations, the two other main requirements for a binding contract under Australian law are the movement of consideration from the promisee and agreement on the essential terms. This latter requirement was considered in *Mushroom Composters Pty Ltd v IS&DE Robertson Pty Ltd*⁵. In that case, the parties purported to enter into a four-year agreement, but the court held that the parties had only agreed on a price for the first year of the contract. As there was no agreement on price for the subsequent years, there was no binding contract beyond the first year of the agreement. This case can therefore also be understood as an example of the principle that an agreement to agree is not a legally binding agreement.

Even where the formalities for creating a contract are satisfied, a binding contract will not be formed if one of the parties did not have the power to enter into a contract. This is a particularly important consideration when entering into agreements with government entities. In *Peregrine Mineral Sands Pty Ltd v Wentworth Shire Council*⁶, the NSW Court of Appeal held that an agreement, between a local council and the operator of a mine, to fix land rates for 20 years, was invalid because it impermissibly fettered the statutory obligation of the council to fix rates each year.

3 [2015] WASCA 21.

4 [2015] NSWCA 64.

5 [2015] NSWCA 1.

6 [2014] NSWCA 429.

Ashton v Pratt [2015] NSWCA 12

- > No requisite intention to create legal relations
- > Domestic, social and other agreements
- > Uncertainty
- > Equitable estoppel

This decision of the NSW Court of Appeal dealt with an escort challenging the will of the late Richard Pratt (once chairman of Visy Industries) who passed away in 2009. The case deals with the legal effect of conversations between the escort (Ms Ashton) and Mr Pratt, and subsequent dealings with Mr Pratt's associates.

The court upheld the primary judge's findings that Mr Pratt's promises to Ms Ashton in November 2003 were not enforceable, and Mr Pratt's estate was not estopped from denying that Mr Pratt and Ms Ashton had entered into a contractual arrangement.

Clients should be aware:

- the law on promissory estoppel is uncertain. The predominant view is that promissory estoppel only acts as a restraint on the enforcement of legal rights;
- however, in commercial contexts, promissory estoppel is unlikely to extend to impose an obligation arising from a contract that has been void for uncertainty or incompleteness.

Facts

Ms Ashton provided escort services to Mr Pratt at various times. The period relevant to the case was from October 2003 to the end of 2004.

In November 2003, in conversations accepted as fact by the primary judge, Mr Pratt promised Ms Ashton \$500,000 per annum, \$36,000 for her accommodation and \$30,000 to grow her accessories business, and to set up two separate trusts, each \$2.5 million for Ms Ashton's two children.

The primary judge found that the November 2003 conversations did not create a legally binding agreement as there was no requisite intention. The primary judge also held that Mr Pratt's estate was not estopped from denying that Mr Pratt and Ms Ashton had entered into a legally binding agreement.

Judgment

Was there a binding contract between Ms Ashton and Mr Pratt?

The court was unanimous in finding that there was no intention to create a legally binding agreement between Mr Pratt and Ms Ashton. This was because the conversation (with the exception of a small part) was 'not cast in the language of obligation' (Chief Justice Bathurst at [80]), and that it was unclear what the obligations of Ms Ashton as mistress would be. Further, Ms Ashton's responses to Mr Pratt's promises 'did not suggest that she was undertaking legally enforceable obligations' (Justice Meagher at [230]). Chief Justice Bathurst noted that the conversations took place after Mr Pratt and Ms Ashton had resumed sexual relations and did not contain the requisite consideration. The promise of creating the individual trusts for Ms Ashton's children was also not binding as there was uncertainty of the terms of the trusts. Any subsequent argument that Ms Ashton had breached a fiduciary obligation of the trusts could not stand.

Is Mr Pratt estopped from denying that Ms Ashton and Mr Pratt had entered into a contractual arrangement?

The leading judgment by Chief Justice Bathurst surveyed case law on promissory and proprietary estoppel. His Honour said that there is significant authority that promissory estoppel 'only acts as a restraint on the enforcement of legal rights' (at [138]) and cannot be a source of obligation. His Honour acknowledged that there was uncertainty as to this limitation on promissory estoppel, but expressed a view that it was unlikely that the doctrine extended to impose an obligation on the promisor to adhere to the representation where the same 'obligation [was] said to arise under an assumed contract, which itself was void for uncertainty or incompleteness' (at [139]).

These observations are dicta given the unanimous finding that Ms Ashton had not suffered detriment and that the object of estoppel was to 'avoid the detriment which would be suffered by the party who has been induced to act or to abstain from acting thereon' (Chief Justice Bathurst at [110], citing Justice Brennan in *Waltons Stores (Interstate) Limited v Maher* (1988) 164 CLR 387, 423). See also Justice Meagher's comments at [235]-[236].

Pavlovic v Universal Music Australia Pty Limited [2015] NSWCA 313

- > Whether parties' intention was to be bound prior to signature and execution of agreement
- > Relevance of subsequent conduct of parties
- > Ostensible authority of solicitor to bind client to a contract

In this decision, the NSW Court of Appeal considered the extent to which parties can be bound to a contract which has been agreed, but not executed.

The Court of Appeal allowed the appeal, finding that the primary judge had erred in respect of his conclusions, and held that the agreement was not binding and that the solicitor did not have actual or ostensible authority to bind his client in the circumstances.

This judgment illustrates that an agreement in principle, absent execution, will be insufficient to bind parties to an agreement unless the words and conduct of the parties, judged objectively, demonstrate a departure from the initial intention to formally document and execute an agreement.

Absent clear and cogent evidence, a solicitor does not have authority to bind his or her client to a contract, except in the context of litigation conducted on the client's behalf.

Facts

The case related to an agreement to terminate a joint venture between Universal Music Australia and the founder of Modular Recordings, Stephen Pavlovic (a well-known Australian music promoter, who had signed acts including Wolfmother, Tame Impala and Cut Copy).

A deed of release and settlement was drafted and negotiated by the parties in late 2014. On Christmas Eve, the parties' solicitors exchanged emails, confirming that the deed was in agreed form. However, the deed was never signed. The relevant correspondence between the parties' solicitors was as follows:

- on 23 December 2014, Universal Music's lawyers, Gilbert + Tobin, sent the draft deed of release to Mr Pavlovic's lawyer, Mr Gorry;
- on Christmas Eve, Mr Gorry responded, stating: 'Assuming I get all the documents today, I will forward them to [Mr Pavlovic], he will sign tomorrow, and then he will scan and forward the documents back to me and then on to you on 26 December...';
- Gilbert + Tobin replied, stating: 'in the circumstances our client is prepared to allow Mr Pavlovic a further 48 hours to sign the documents and forward copies to us'; and
- neither party sent an executed copy of the deed to the other. When Gilbert + Tobin followed up in the new year, it became apparent that the deed had not been executed.

At first instance, Justice Sackar held that the parties had entered into a binding agreement on Christmas Eve on the terms of the proposed deed. His Honour held that Mr Gorry had the actual authority to bind Mr Pavlovic, and that viewed objectively, the parties were content and clearly intended to be bound to the terms of the proposed deed. Justice Sackar considered Gilbert + Tobin's email of 23 December to constitute an offer, which was subsequently accepted by way of the response from Mr Pavlovic's solicitor.

Judgment

Two issues were raised on appeal:

- a contractual issue, as to whether Justice Sackar had erred in finding that the parties, through their solicitors, had entered into a binding agreement; and
- an issue of agency, as to whether Justice Sackar had erred in concluding that each party's solicitors had actual or ostensible authority to enter into an agreement on behalf of their clients.

The Court of Appeal allowed the appeal, finding that his Honour had erred in respect of both conclusions.

Contract

The court noted that it was well established that where parties intend to enter into a formal agreement to give effect to agreed terms, the question of whether those parties intend to be immediately bound must be determined objectively, with regard to the outward manifestations of the parties' intentions: *Masters v Cameron* (1954) 91 CLR 353 at 362.

The court held that the relevant question to ask is 'what each party by words and conduct would have led a reasonable person in the position of the other party to believe', with regard to the commercial context and surrounding circumstances of the parties' dealings, including subsequent conduct. In considering this question, the court emphasised that the three levels of negotiation in *Masters v Cameron* should not be applied as strict categories.

The solicitors' emails were considered in light of the formal relationship between the parties, the complexity of the dispute, the length of the negotiations and the sophistication of the parties. Particular emphasis was placed on the fact that it was intended from the start of negotiations that any agreement reached between the parties would be embodied in a deed.

Although the authorities do not require a precise offer or acceptance in order for a contract to be binding, the court found that the language used in the emails was not the language of an immediately binding contract. The words 'he will sign' did not constitute acceptance of an offer – they were merely a statement that the client would enter into a contract. Gilbert + Tobin's response, offering a further 48 hours to sign a document, also suggested that the parties did not consider the agreement to already be in place.

Although it was clear that the parties had finalised their negotiations, neither party had indicated an intention to depart from the formal arrangements envisaged throughout the negotiations. The agreement was therefore not binding.

Agency

In relation to the issue of agency, the court noted that solicitors do have actual authority to conduct negotiations as to the terms of a contract. However, that authority falls short of binding a client to a contract, except where:

- there is clear and cogent evidence of such authority: *Pianta v National Finance & Trustees* (1964) 180 CLR 146 at 154; or
- the contract is agreed in the context of litigation conducted on the client's behalf, in which case a solicitor has ostensible authority to bind his or her client if the contract relates to, and in particular compromises, that litigation: *Lucke v Cleary* (2011) 111 SASR 134.

The court dismissed the first exception on the basis that the words 'will sign' did not bear the 'clear and cogent' meaning that the client had given instructions to the solicitor to immediately bind him to the contract. The court noted that even the statement 'I will sign' would be considered to be equivocal. The dispute was also considered to be insufficient to engage the second exception, given that the parties had only contemplated the potential for litigation at the time.

The court concluded that Mr Gorry did not have either actual or ostensible authority to bind Mr Pavlovic to the agreement.

Vantage Systems Pty Ltd v Priolo Corporation Pty Ltd [2015] WASCA 21

- > Agreement contemplating execution of formal documents
- > Rectification

In this decision the Western Australian Court of Appeal dealt with, among other issues, whether the parties intended to enter into a binding agreement following acceptance of a revised proposal notwithstanding that a formal lease and licence agreement had not been executed.

Their Honours held that, on an objective assessment, the parties intended that there should be a concluded and binding agreement for a new lease and a new licence, and that the parties would be bound immediately and exclusively by the express and any implied terms of the revised proposal. The concluded and binding agreement would be superseded by the parties executing formal agreements later. The court reached this conclusion despite a material error in the licence fee in the revised proposal, and rectification of the error was upheld.

This case provides a useful reminder for both lessors and lessees that where they do not intend to be bound until such time as both parties have prepared and signed formal documentation, this should be clearly stated before and during negotiations as well as at the time that execution copies are sent for signing. In the absence of that clear intention, where parties have negotiated and agreed on all the essential terms of an agreement, that agreement could be binding upon the parties even if formal documentation has not been signed by one or any of the parties.

Facts

The appellant, Vantage Systems Pty Ltd as lessee and the respondent, Priolo Corporation Pty Ltd as lessor were parties to a lease of office premises on Colin Street, West Perth. Vantage sublet a portion of the premises to Deugro Projects (Australia) Pty Ltd.

Priolo became the registered owner of the property on 21 December 2007. The premises were previously leased to Vantage by Gamol Pty Ltd from 1 July 2003, expiring on 30 June 2006. Gamol had also granted Vantage a licence to use six car bays on the property for the same period. Before the expiry date, Vantage exercised the options to renew the original lease and licence for an additional three years which was due to expire on 30 June 2009.

In May 2009, Priolo's leasing agent, Graham Postma of Savills had discussions with David Walker of Vantage about the possibility of a new lease of the premises upon the expiry of the original lease as renewed. The key events leading up to the dispute were as follows:

- On 11 May 2009, Mr Postma emailed Mr Walker a proposal for a new lease. The email referred to an earlier telephone conversation on 8 May 2009 and stated that following discussions with Priolo, he was 'pleased to provide the following proposal for your consideration'.
- The proposal was not acceptable to Mr Walker, who emailed Mr Postma on 29 May 2009 objecting to the amount of rent and the period for which a bank guarantee was required.
- Following further correspondence between the parties, Mr Postma emailed Mr Walker on 4 June 2009 with a revised proposal. The email asked Mr Walker to 'please confirm in writing that this proposal is acceptable to Vantage and we will arrange for [Priolo's] solicitors to prepare the draft documentation'.
- The revised proposal provided that Priolo's standard lease and licence agreements would be used to document the agreement between the parties, and would be prepared by Priolo's solicitors incorporating the relevant terms contained in that proposal. There was a material error in the revised proposal with respect to the licence fee for the six car bays being \$375 per bay per annum as opposed to \$375 per month.

- On 10 June 2009, Mr Walker sent two emails to Mr Postma, the first stating that 'Vantage Systems is happy with the terms of the proposal', and the second stating that '[w]e have received [Deugro's] approval of the terms as well. Please proceed with wrapping this up'.
- On 11 June 2009, Mr Postma instructed Priolo's solicitors to prepare draft lease and licence agreements using a copy of the revised proposal. The error with respect to the licence fee was picked up by Mr Postma at this point, and he instructed Priolo's solicitors to amend the error in the draft lease and licence agreements which he sent to Mr Walker on 2 July 2009. Mr Walker responded, saying that he would review the documents over the weekend. That did not occur.
- Following a number of follow up emails from Mr Postma, Mr Walker emailed Mr Postma on 4 September 2009, raising his concerns about the 'make-good' provision.
- On 11 September 2009, Mr Postma informed Mr Walker by email that Priolo was not willing to accept Vantage's alternative 'make-good' clause. Subsequently, Deugro purported to terminate its alleged 'tenancy at will' by one month's notice because it took the view that there was no binding agreement between Vantage and Deugro in relation to the sub-lease.
- On 6 October 2009, Vantage's solicitors informed Priolo that there was no concluded agreement to lease and Vantage was occupying the premises pursuant to the holding over provision in the original lease as renewed, and that Vantage would vacate the premises on 30 November 2009.

Priolo brought a claim against Vantage alleging breach of an agreement to lease. The trial judge found on the balance of probabilities that Priolo and Vantage intended to enter into a binding agreement for lease by Vantage's acceptance of the revised proposal on 10 June 2009. His Honour ordered Vantage to pay Priolo damages in the amount of \$271,177 together with interest and costs.

Judgment

The critical issue in the appeal was whether Priolo and Vantage made a concluded and binding agreement to lease by the exchange of the emails between Mr Postma and Mr Walker leading up to 10 June 2009. The court also considered whether Priolo should have been allowed to amend its statement of claim to plead rectification of the revised proposal in respect of the licence fee after each party had closed its case, and alternatively, whether there could be a claim for rectification of the revised proposal.

Principles on intention to contract

The court stated that the relevant intention is intention to contract, and not what the parties intended by the terms of the alleged concluded and binding agreement. The court set out the legal principles in relation to intention to contract:

- Whether a completed and binding agreement has been made is assessed objectively, and the search for an intention to create contractual relations is not a search for the uncommunicated subjective motives or intentions of the parties.
- The subject matter of the agreement, the status of the parties to it, their relationship to one another, and other surrounding circumstances may be taken into account in determining whether a completed and binding agreement has been made. These surrounding circumstances include the dealings and communications between the parties over a period of time and the commercial circumstances known to the parties surrounding those dealings and communications.
- There are some Australian cases, especially in New South Wales, which say that evidence of the actual or subjective intention of each party is, at least in some circumstances, relevant and admissible in determining whether the parties made a concluded and binding agreement. However, such evidence needs to be examined carefully following the High Court decisions on the primacy of the objective theory of contracting.
- It is well established that the court may take into account the dealings and communications between the parties after, as well as before, the formation of an alleged concluded and binding agreement, for the purpose of objectively determining whether they intended to form such an agreement.

Whether there was a concluded and binding agreement

Applying these principles to the facts, the court held that it should be inferred from the evidence, on an objective assessment and having regard to all relevant factors and circumstances in the commercial context, that both Priolo and Vantage were willing to bind themselves to a new lease of the premises and a new licence in respect of the six car bays on the terms of the revised proposal. The parties agreed that formal agreements would be in the form of Priolo's standard lease and licence agreements, which would be amended to incorporate the express terms of the revised proposal and any other provisions which may, by negotiation, be agreed between the parties. The factors leading to the court's decision were, among others:

- When Vantage accepted the revised proposal, it had occupied the premises since July 2003. It was therefore very familiar with the premises including the standard of the fixtures, fittings and services and the suitability of the premises for its business activities. Similarly, Priolo had been the lessor of the premises since December 2007, and Vantage was therefore very familiar with the representatives of Priolo.
- As at 10 June 2009, Vantage had not identified any other office premises which it might lease and it was not endeavouring to locate alternative premises. Likewise, Priolo had not endeavoured to locate an alternative lessee for the premises.
- Deugro had informed Vantage that it approved the terms of the revised proposal when Vantage accepted the revised proposal.
- The revised proposal embodied all terms that were legally necessary to form a contract. The duration of the new lease was three years which was identical to the duration of both the original lease and the renewed term.
- The failure of the parties to agree on the 'make-good' provision in the draft lease prepared by Priolo's solicitors or Vantage's alternative provision was not inconsistent with an objective assessment that the parties intended that, upon Vantage accepting the revised proposal, there should be a concluded and binding agreement. The consequence meant that the parties were bound by the express term in the revised proposal with respect to Vantage's obligation to reinstate.

The court concluded that the above factors in combination outweighed any relevant countervailing factors, and the parties intended that there should be a concluded and binding agreement to lease and take a licence. The subsequent negotiations, dealings and communications between the parties did not destroy the earlier concluded and binding agreement between them.

Rectification

The court commented that the licence fee error of \$375 per bay per annum was binding on the parties unless Priolo could establish that the revised proposal should be rectified to read \$375 per bay per month.

Vantage challenged the trial judge's decision to allow Priolo to amend its statement of claim to seek an order for rectification of the revised proposal. While the court recognised that it was unusual for an amendment to a statement of claim to be allowed after each party has closed its case at trial, the application for leave to amend involved the exercise of a judicial discretion and the court was satisfied that the trial judge's exercise of the discretion was not vitiated by a material error of law or fact.

In the alternative, Vantage argued that the revised proposal was not able to be rectified because the revised proposal was not an instrument that could be rectified and further, it did not fit within the requirements of a rectification as contemplated by the trial judge.

The court rejected these submissions, and found that in all the circumstances, Vantage's conduct in seeking to take advantage of Priolo's obvious and significant mistake in the revised proposal was unconscionable. Consequently, it would be inequitable for Vantage to object to the rectification of the revised proposal. The court said that it was irrelevant that the revised proposal was not executed or signed because a concluded and binding agreement was formed when Vantage accepted the revised proposal in Mr Walker's two emails on 10 June 2009.

Caltex Australia Petroleum Pty Ltd v Troost [2015] NSWCA 64

- > Guarantee and indemnity
- > Construction of indemnity clause
- > Signature and execution
- > Whether director bound by indemnity
- > Whether material variations to principal obligations discharged obligation to indemnify
- > Duration of indemnity

This NSW Court of Appeal decision dealt with whether a sole director, who did not provide his signature to all of the relevant guarantee and indemnity sections of a credit facility application, was still bound by an obligation to indemnify under the contract.

The court allowed the appeal and held that, in the present circumstances, the director was still bound by the relevant indemnity clause. The obligation to indemnify was not discharged by subsequent variations to the terms and conditions applicable to the facility.

The main points to note from this case are that:

- there is a need to exercise caution in the drafting and structuring of guarantee and indemnity clauses, especially in respect of signature blocks, in circumstances where a party is seeking the benefit of both forms of liability;
- it's important to obtain consent from an indemnifier where a material variation is sought to the terms and conditions applicable to the obligations of the principal debtor to the principal creditor;
- where the principal arrangement, however, provides for variation of its terms, an obligation to indemnify will also be subject to variation, meaning that an indemnifier's liability will generally not be discharged; and
- a resigning director, as a signatory of a continuing indemnity, is entitled to, and should give, notice to the indemnified party that they will not be responsible for liability incurred after the giving of that notice.

Facts

In 2002, Mr Troost in his capacity as a sole director of the company, Road Sea Rail Logistics Pty Ltd, applied for a credit facility from Caltex Australia Petroleum Pty Ltd. This required Troost to execute a credit facility application form. That application form contained, relevantly, the following sections:

- a 'Guarantee and Indemnity by Directors' section, which had four signature blocks; and
- a 'Statutory Declaration by Guarantor/Indemnifier' section, which had two signature blocks.

The 'Guarantee and Indemnity by Directors' section was divided into two columns, with each column containing two signature blocks. The left-hand column contained a guarantee clause, while the right-hand column had, in effect, an indemnity clause. The signature blocks in each column were accompanied by the notation 'signature of guarantor (director)'. Troost signed in the left-hand, but not the right-hand, column. Caltex subsequently approved the application and supplied the company with petroleum products.

In 2008, Caltex notified the company on several occasions that there would be changes to the terms and conditions which applied to the credit facility. Caltex also stated that, unless notified otherwise, the company would be deemed to have agreed to comply with the amended terms and conditions.

Troost ceased being a director of the company in October 2009. In November 2009, after his resignation, Caltex issued written demands to Troost for debts amounting to \$132,513 allegedly owed by the company. The company then entered into voluntary administration in 2010, with Caltex ultimately receiving a small final dividend. Caltex then commenced proceedings against Troost in November 2012.

At first instance, the trial judge held, relevantly, that Troost was not bound by an obligation to indemnify as he did not execute the indemnity clause. On appeal, Caltex contested this finding. Troost, in response, supported the trial judge's conclusion and further contended that:

- the variation of the terms and conditions between Caltex and the company in 2008, absent his consent in his capacity as indemnifier, discharged the obligation to indemnify;
- Caltex's failure to preserve security under the facility discharged him from the obligation to indemnify; and
- the obligation to indemnify was limited to any liability incurred while he was a director of the company.

Judgment

Whether Troost was bound by the indemnity clause

Justice Emmett held that, in the present circumstances, the parties had intended the separate guarantee and indemnity sections to have created one obligation for any director signing the provision, given in consideration for the granting of the credit facility. In reaching this conclusion, his Honour referred to, among other factors, the use of the conjunctive 'and', such as in:

- the title of the 'Guarantee and Indemnity by Directors' section; and
- the expression 'Guarantor(s) and Indemnifier(s)' in the statutory declaration.

This meant that Troost, subject to any defences raised, was bound by the indemnity clause, despite only executing the guarantee clause.

Variation of terms and conditions

Justice Emmett noted that an indemnity, in contrast to a guarantee, creates a primary liability and is not dependent on the non-performance of an obligation owed by a principal debtor to a principal creditor. However, the legal principles governing guarantees and indemnities, at least in respect of variations, are similar. Justice Emmett outlined the following principles:

- a material variation of the terms governing the principal arrangement between a creditor and debtor may, absent the consent of the indemnifier, discharge the obligation to indemnify; and
- where the principal arrangement, however, provides for variation of its terms, an obligation to indemnify will in turn be subject to variation, meaning that an indemnifier's liability will not, in general, be discharged.

The indemnity clause provided that the signatory would indemnify Caltex against loss or damage incurred, relevantly, by reason of any default by the company 'under the facility'. The word 'facility' was not, however, defined in the documentation. The court held that 'facility' could only refer to the credit facility which was the subject of Troost's application. That facility, as stipulated in the application form, was subject to terms and conditions 'as may be amended from time to time'. Accordingly, this meant that Troost's obligation to indemnify, in effect, was also varied when the variations to the terms and conditions were made in 2008. In these circumstances, the obligation was not discharged despite Troost not providing consent in his capacity as an indemnifier to the variation.

This conclusion meant that it was not strictly necessary for the court to decide whether the 2008 variations were material. Justice Emmett did note, however, that the alterations made in 2008 would have been material to an indemnifier.

Failure to preserve security

The court also rejected Troost's contention that his indemnity obligation was discharged by Caltex's failure to preserve security that it was entitled to under the facility. Under the relevant clauses of the application form, and by virtue of s263 of the *Corporations Act 2001* (Cth), it was the company, not Caltex, that was obliged to register any charge. The failure to do so by the company constituted a default giving rise to loss and damage covered by the indemnity clause.

Whether liability limited by reference to time as director

The 'Guarantee and Indemnity by Directors' section in the facility application form made reference to a 'continuing guarantee'. While that did not expressly extend to an indemnity, Justice Emmett held that the provision could be construed as operating on the basis that a signatory of a continuing guarantee and indemnity could terminate liability accrued in the future. This applied in circumstances where the consideration for a guarantee (and, by parity, an indemnity) is divisible, such as when a creditor supplies goods from time to time to a debtor. Accordingly, it was open to Troost to notify Caltex that he would no longer be responsible for any liability incurred by the company after his resignation, as distinct from liability arising from any extant obligations of the company.

Mushroom Composters Pty Ltd v IS & DE Robertson Pty Ltd [2015] NSWCA 1

- > Whether parties had agreed the essential term of price for the duration of the arrangement
- > Admissions of law and fact
- > Whether an admission by a party to an alleged contract on a matter of law should be given any weight

This is a judgment of the New South Wales Court of Appeal in which the court dealt with the enforceability of an agreement to supply wheaten straw.

Their Honours held that the price of the straw had only been agreed for the first year, not the four years contended by the respondent.

The case does not introduce any new contractual concepts, but it reinforces those already established. Namely:

- in determining whether a binding contract exists, the law is concerned with what the outward manifestation of the parties' intentions would cause a reasonable person to conclude, which can include conduct of the parties following a concluded contract;
- it is not necessary to identify a precise offer or acceptance, nor a time when these occurred;
- if parties fail to agree on essential terms, an enforceable contract does not exist; and
- an agreement for the supply and sale of goods requires agreement as to price in order to constitute an enforceable contract.

It was also held that an admission that involves a conclusion as to a legal standard carries little weight as evidence that the standard has been reached.

Facts

The appellant, Composters, uses wheaten straw to produce mushroom compost, and the respondent, Robertson, had supplied Composters with wheaten straw for all but two years since 1996.

At a time when straw was hard to procure and prices were high, the General Manager of Composters and the two directors of Robertson commenced discussing the possibility of entering into a four year contract in January 2008. The documents and discussions said to evidence their arrangement were as follows:

- a telephone conversation on 25 January 2008 regarding the general terms of the agreement, including that it would be for 10,000 tonnes for each of the next four years and that Composters would pay a price of \$140 per tonne of straw, split into an upfront payment (royalty price) of \$60 and a payment to be made on delivery (baling price) of \$80, indexed to inflation;
- a letter dated 25 January 2008 agreeing in principle to the terms discussed by telephone with the additional caveat that the royalty price would be subject to reduction if there was an overabundance of straw in any season;
- a fax dated 8 October 2008 setting out the CPI rate (4.5 per cent);
- a discussion at the Robertsons' house in September/October 2008 during which the CPI adjustment for the 2008-09 season, the first year of the four year agreement, was confirmed as \$3.60 per tonne and the payment schedule for the royalty payment was also confirmed;

- an email dated 22 October 2008 attaching a heads of agreement for the 2008-09 season setting out, among other things, a royalty price of \$60 per tonne, baling price of \$83.60 and a total price of \$143.60 per tonne; and
- a telephone conversation on 24 October 2008 where Robertson requested amendments to the heads of agreement (which were not made but which did not relate to price) to which Composters agreed.

The parties operated under the agreed arrangements for approximately 20 months, before Composters indicated to Robertson that they would only be requiring half the amount of wheaten straw bales that they had in previous years, and the relationship deteriorated.

Judgment

The court summarised the fundamental contract principles outlined above in their decision, most relevantly that for an agreement for the supply and sale of goods to constitute an enforceable contract, the parties must agree as to price, although they may leave the price to be determined by a third person or agreed mechanism. The court found that:

- the trial judge was in error in concluding that the parties had reached agreement on the price for the four year duration of the contract; and

- the price had been agreed only for the first year of the contract, with the price for years 2, 3 and 4 to be resolved by further negotiation. The 25 January 2008 letter did not specify the overall price for the straw, instead dividing the price into two components, the royalty price and the baling price. The letter stated that the royalty price would be subject to reduction if there was an overabundance of straw in any season. The conversation following the letter proceeded to fix the royalty price for the first year of the contract only, and the heads of agreement, which set out the fixed prices, specified that it related to the 2008-09 season only.

Further, they found that a statement by Composters in the 24 October 2008 conversation that the parties were in agreement carried little weight as evidence that the contract between the parties was concluded, as it was an opinion only and related to the application of a legal standard to the negotiations between the parties.

Peregrine Mineral Sands Pty Ltd v Wentworth Shire Council [2014] NSWCA 429

- > Contractual clause predetermining land rates
- > Impermissible fetter on council's statutory discretion
- > Whether primary judge erred in finding that the agreement as to rates was not authorised by, or was inconsistent with, the *Local Government Act 1993* (NSW)

In this judgment, the New South Wales Court of Appeal dealt with the validity of a contractual clause that purported to predetermine the land rates for a local mine.

The court unanimously held that the clause impermissibly fettered the Council's statutory duty to assess the rates for each property within its precinct on an annual basis, and was therefore invalid.

The case highlights that contractual clauses that purport to predetermine the land rates chargeable on certain properties within a council's area are not enforceable. A council has a statutory duty to set these rates on an annual basis, and a contractual clause that attempts to fix these rates will amount to an impermissible fetter on a council's statutory discretion.

Facts

Four mining companies were involved in a joint venture concerning the mining of mineral sands. Three of the companies held a lease for the Ginkgo Mine, which was located in the Wentworth Shire.

The remaining company, Pooncarie Operations Pty Ltd, acting as agent for the other companies, entered into the road acquisition and construction agreement (the **Road Agreement**) with the Wentworth Shire Council. The Road Agreement permitted Pooncarie and the other companies to operate the Ginkgo Mine.

Clause 3.1(a) of the Road Agreement

The dispute between Pooncarie and the Council arose in relation to a provision of the Road Agreement which purported to predetermine the annual land rates chargeable on the Ginkgo Mine. Clause 3.1(a) stated:

3.1 In addition to the Company's Undertakings, the Company [Pooncarie] will;

(a) Pay to Council in respect of the Ginkgo Mine, land rates of \$100,000.00 per annum commencing 1st January, 2006 and adjusted annually in accordance with the Local Government Act.

Despite the apparent contractual cap on the rates that could be charged for the Ginkgo Mine (at \$100,000 per annum), in September 2006, the Council issued a rate notice to Pooncarie for \$360,190. The sum was arrived at in accordance with the valuer-general's valuation of the Ginkgo Mine, which took into account the mine's land value and mineral content.

Pooncarie refused to pay the sum, arguing that, apart from any minor annual adjustments, cl3.1(a) of the Road Agreement prevented an amount greater than \$100,000 being charged. The mining companies commenced proceedings in the Equity Division of the Supreme Court of New South Wales seeking a declaration to this effect.

Judgment at first instance

Justice Rein found in favour of the Council. His Honour held that even if cl3.1(a) of the Road Agreement capped the rates chargeable on the Ginkgo Mine at \$100,000 per annum, the clause was not enforceable. This was because it impermissibly fettered the Council when undertaking its statutory duty of assessing rates each year in accordance with the *Local Government Act 1993* (NSW) (the **Act**). His Honour concluded that cl3.1(a) was not compatible with the Act, and was therefore a provision beyond the power of the Council to make. Pooncarie and the other mining companies appealed against Justice Rein's decision.

Judgment

The critical issue on appeal was whether the Council's entry into the Road Agreement, and specifically cl 3.1(a), was compatible with its statutory duties arising under the Act. These duties included: levying an ordinary rate for each year on rateable land in the Council's area (s494); that each rateable charge be made for a specified year (s534); allocating each property within the Council's area a category (ie farmland, residential, mining or business), which would then be used to assess annual land rates (s525); and preparing a draft management plan detailing the Council's revenue intake for the next three years (s402).

Pooncarie's argument

While acknowledging the above duties arising under the Act, Pooncarie submitted that the Council, as a body corporate under s220 of the Act, had the powers conferred on all bodies corporate under s50 of the *Interpretation Act 1987* (NSW). It also referred to s23 of the Act which enables the Council to 'do all such things as are supplemental or incidental to, or consequential on, the exercise of its functions', and s24, which empowers councils to provide goods, services and facilities appropriate to the needs of the local community.

In essence, Pooncarie was portraying the Council as a body with a broad range of powers, and a legal entity with a general power to enter into contracts. It submitted that this contractual power was validly exercised when entering into cl3.1(a) under the Road Agreement, as there was nothing in the Act which prohibited a provision of this nature. In other words, Pooncarie was submitting that the Council had the power to set rates for a particular property under an antecedent agreement, and this agreement could permissibly inform how the Council exercised its statutory discretion under the above provisions in the future.

The Council's argument

Central to the Council's submissions was the general principle that a public authority cannot preclude itself from exercising important discretionary powers by entering into incompatible contractual undertakings. This principle was enunciated by the High Court of Australia in *Ansett Transport Industries (Operations) Pty Ltd v Commonwealth* (1977) 139 CLR 54 per Justice Mason at 74, and has since been followed in *City of Subiaco v Heytesbury Properties Pty Ltd* (2001) 24 WAR 146 at [44]–[46], and *Penola and District Ratepayers' and Residents' Association v Wattle Range Council* (2011) 110 SASR 110 at [89]–[92] and [108]–[109].

Applying this principle to cl3.1(a) of the Road Agreement, the Council argued that the provision curtailed the discretion conferred under the above provisions, and as such, was incompatible with the Act. In essence, the Council submitted that it would essentially be abdicating the power conferred on it by the Act to levy land rates if it were bound by antecedent agreements which had already predetermined these rates.

The court's ruling

The court accepted the Council's argument. Appeal Justice Ward, who gave the lead judgment, favoured the view that the Act created a system whereby councils were obliged to consider the chargeable rate for each property in their area on an annual basis, and antecedent agreements which predetermined these rates were incompatible with this system.

Her Honour rejected Pooncarie's attempt to portray the Council as a body with broad contractual powers such that it could essentially 'retrofit' the chargeable rate for certain properties. Even though it was arithmetically or administratively possible for the Council to predetermine such rates, the Act created a regime under which the Council needed to justify to its local residents the rates it was charging and the rationale behind these figures. Appeal Justice Ward ascribed considerable weight to Justice Mason's 'non-fetter' principle from *Ansett*, ultimately holding that 'to the extent that the contract commits the Council in the future to exercise its statutory power in a particular way, it infringes the principle articulated in *Ansett*'. Her Honour therefore concluded that Justice Rein did not err in his decision and dismissed the appeal accordingly.



➤ Chapter 2: Implied terms and good faith

In 2009, the Privy Council stated that the process of implying terms into a contract was really just an exercise in construing a contract.⁷ This judgment had the potential to change quite radically the law on the implication of terms. Courts in Australia have neither followed nor explicitly rejected the approach taken by the Privy Council in that case, although earlier this year the UK Supreme Court effectively overruled the judgment and confirmed the traditional legal tests for the implication of terms.⁸ It therefore seems unlikely that Australian courts will now follow the earlier Privy Council decision. They have, however, long recognised the close relationship between the traditional legal tests for implying terms and the process of construing a contract.

In *Regreen Asset Holdings Pty Ltd v Castricum Brothers Australia Pty Ltd*⁹, the Victorian Court of Appeal considered what evidence would be admissible in deciding whether to imply a term into a contract. The court confirmed that evidence of pre-contractual conduct could be admissible for this purpose, although (as with the interpretation of contracts) such evidence would not be admissible for the purpose of showing the parties' subjective intentions. The court did not need to decide whether post-contractual conduct was admissible in deciding whether to imply a term (it is generally not admissible for the purpose of construing a contract), but the judgment contains a useful discussion of the law on this point. The court confirmed the decision of a trial judge to imply a term (the completion of one agreement was conditional on the completion of a related agreement), whether or not one had regard to post-contractual conduct.

⁷ *The Attorney General of Belize v Belize Telecom Ltd* [2009] UKPC 10.

⁸ *Marks & Spencer PLC v BNP Paribas SSTC* [2015] UKSC 72.

⁹ [2015] VSCA 28.

As stated in the 2014 [Contract Law Update](#)¹⁰, the implication of terms in law can raise more difficult legal issues than the implication of terms in fact. In particular, there is a long-standing controversy as to whether, and to what extent, an obligation to act in good faith should be implied in law. A recent case to consider these issues was the decision of the Full Court of the Federal Court in *Marmax Investments Pty Ltd v RPR Maintenance Pty Ltd*¹¹. The court did not find it necessary to decide whether an obligation to act in good faith should be implied into the contract, as such an implied term would not have led to a different outcome from the implied obligation on the parties to do all things necessary to enable the other party to have the benefit of a contract (being an implied term in law already recognised by Australian courts). The case does, however, contain a useful review of the relevant authorities and considered the effect of such implied terms on the obligations of a franchisor to a franchisee.

¹⁰ At [Chapter 2](#).

¹¹ [2015] FCAFC 127.

Regreen Asset Holdings Pty Ltd v Castricum Brothers Australia Pty Ltd [2015] VSCA 28

- > Construction of a contract
- > Terms implied in fact
- > Admissibility of pre-contractual conduct
- > Admissibility of post-contractual conduct

This Victorian Court of Appeal decision dealt with the implication of terms in fact and when pre-contractual or post-contractual conduct will be admissible for such a purpose.

The court held that pre-contractual conduct is admissible when implying a term in fact. In obiter, the court noted that there are risks associated with relying upon post-contractual conduct to imply a term in fact.

[This case outlines the appropriate application of the BP Refinery test for the implication of terms in fact. It summarises the leading cases with respect to the admissibility of pre-contractual conduct and post-contractual conduct when implying a term and notes that the law with respect to the admissibility of post-contractual conduct for this purpose remains unclear.](#)

Facts

Castricum Brothers Australia Pty Ltd was the owner of land on which several buildings and an abattoir were located. Rendering equipment was attached to one of the buildings.

In March 2011, Castricum engaged Grays (Aust) Holdings Pty Ltd to sell the infrastructure and equipment located on the land except for the rendering equipment, which was to be sold separately.

On 3 November 2012, Castricum asked GraysOnline to advertise the rendering equipment on its website. The advertisement showed that the rendering building was being sold separately to the rendering equipment and the rendering equipment could be removed from the land.

Betjulla Tahiri, the sole shareholder of Regreen Asset Holdings Pty Ltd, agreed to purchase the land from Castricum. The contract for sale of the land was dated 2 May 2013 (the *land agreement*).

On 15 May 2013, Mr Tahiri visited the land and discussed with a representative from Castricum whether the rendering equipment would be purchased or removed prior to the sale of land. The parties had several further discussions about purchasing the rendering equipment, including a discussion on 21 May 2013, in which Castricum offered Regreen the use of other equipment rent-free if it purchased the rendering equipment.

Castricum and Regreen then entered into a separate agreement for the purchase of the rendering equipment dated 30 May 2013, comprising several documents: an inventory, an invoice and a paid invoice together with several covering emails (the *RE agreement*).

The land agreement did not reach settlement, owing to Mr Tahiri's failure to successfully obtain finance. On that basis, Castricum refused to proceed with the RE agreement.

Regreen sought damages for conversion of rendering equipment. Castricum separately sought repayment of the deposit for the land agreement but later withdrew that claim.

The Victorian Supreme Court held that there was an implied term in the RE agreement that the contract was subject to the land agreement and therefore the claim for damages should be dismissed. Regreen appealed that decision.

There were two main questions before the Victorian Court of Appeal:

- Was there an implied term in the RE agreement that completion was subject to settlement of the land agreement?
- For the purposes of implying the term, could the court have reference to pre-contractual conduct or post-contractual conduct and if so, in what circumstances?

Judgment

The court noted that:

- while there is no binding authority in Australia as to whether the process of implying a term in fact is a process of contractual construction, there is authority to suggest that the principles of contractual construction are analogous when determining whether pre-contractual conduct is admissible (*Commonwealth Bank of Australia v Barker* (2014) 253 CLR 169; *Codelfa Construction Pty Ltd v State Railway Authority* (1982) 149 CLR 337); and
- the High Court had referred to the issue of whether the implication of a term is to be regarded as an exercise in the construction of a contract, without making any definitive pronouncement.

Pre-contractual conduct

The court first considered whether pre-contractual conduct was admissible when implying a term in fact. The court noted that:

- pre-contractual conduct can be admissible when construing a written contract when:
 - objective facts known to the parties are used to discern the subject matter of the contract; and
 - the language used, the surrounding circumstances and the commercial purpose are used to establish the reasonable meaning of terms in a contract;
- the parties' subjective intentions will not be admissible when implying a term in fact (but may be relevant in respect of a claim for rectification);
- a court can look to matters which do not form a term of the contract but were a 'matter of common assumption' between the parties when implying a term in fact; and
- a court can therefore consider pre-contractual conduct when applying the test in *BP Refinery* as to whether a term should be implied in fact.

It held that the *BP Refinery* test was made out and a term should be implied in fact in light of the pre-contractual discussion on 21 May 2013 which indicated that the RE agreement and the land agreement were always intended to be linked and this was a matter of 'common contemplation' between the parties.

Post-contractual conduct

In obiter, the court considered whether post-contractual conduct was admissible when implying terms in fact. The court:

- noted that post-contractual conduct will never be admissible to identify the terms of a formal written contract;
- reiterated that, when a formal written contract does not exist, post-contractual conduct can be used to ascertain:
 - if a contract was formed;
 - the parties to the contract;
 - whether a particular term should be inferred; and
 - the subject matter of the contract;
- acknowledged that the law with respect to the admissibility of post-contractual conduct for implying a term into an unwritten contract remains unsettled and summarised a line of case law in support of using post-contractual conduct to imply a term (*Arthurson v Victoria* (2001) 149 IR 188; *Sydney City Council v Goldspar Australia Pty Ltd* (2006) 230 ALR 437; *ACN 074 971 109 Pty Ltd v The National Mutual Life Association of Australasia Pty Ltd* (2009) 21 VR 351; *Fenridge Pty Ltd v Retirement Care Australia (Preston) Pty Ltd* [2013] VSC 464; *Barker*; *Codelfa*);
- held it was not necessary to consider whether evidence of post-contractual conduct was admissible but, if it was, the cases relied upon in support were insufficient as they related to the process of the construction of a contract and not to implying terms in fact; and
- noted that, even if post-contractual conduct was admissible, the *BP Refinery* test would still have been made out with respect to the implied term.

Marmax Investments Pty Ltd v RPR Maintenance Pty Ltd [2015] FCAFC 127

- > Franchising agreements
- > Construction of commercial contracts
- > Implied terms
- > Duty of good faith
- > Duty to co-operate
- > Duty to do all things necessary to enable other contracting party to have the benefit of the contract
- > Whether franchisor obliged to take positive steps to prevent one franchisee from servicing customers in another franchisee's territory

In this judgment, the Full Court of the Federal Court of Australia dealt with the scope of a franchisee's exclusive right to operate the franchise business in its territory and the content of the implied duty, on the part of the franchisor, to do all things necessary to enable the franchisee to have the benefit of that exclusive right.

Their Honours held that, in granting an exclusive franchise for a particular territory, the franchisor made a correlative promise not to engage in, or to authorise others to engage in, the franchise business in that same territory. However, their Honours held that the implied duties of good faith and co-operation did not require the franchisor in this case to take any positive steps to protect the franchisee's exclusive right from infringements by another franchisee.

The case highlights that a franchisor will not necessarily be obliged to take any positive steps to protect an exclusive right granted to a franchisee. The extent of the franchisor's obligations to protect that exclusive right will depend on the content of the implied duties of good faith and co-operation, which in turn depend on the terms of the franchise agreement and the nature of the exclusive right conferred by it.

To protect their exclusive rights under a franchise or other licence agreement, licensees should ensure that the agreement includes obligations on the licensor to take positive action against any third parties that infringe on those exclusive rights. Licensees should also consider including an express obligation on the licensor to properly investigate any potential infringements by other licensees.

Facts

Spanline Weatherstrong Building Systems Pty Ltd, a franchisor of a business of selling and installing home additions, entered into separate franchise agreements with RPR Maintenance Pty Ltd and Marmax Investments Pty Ltd, under which it granted each of them an exclusive right to conduct the franchise business in adjacent territories.

Without RPR's knowledge or consent, Spanline gave permission to Marmax to service customers who had contacted Marmax but who resided in RPR's territory.

RPR made a number of complaints to Spanline about the work Marmax was doing in RPR's territory. Spanline acknowledged that Marmax had serviced customers in RPR's territory after looking into its jobs database but concluded that nothing looked suspicious. In response to further complaints by RPR, Spanline gave a warning to Marmax.

Marmax continued to service customers in RPR's territory in accordance with the permission granted to it by Spanline. Spanline contended that it was not required to do anything further as the issue was essentially a dispute between two franchisees.

RPR brought claims for breach of contract against Marmax and Spanline and was successful against both.

Both Marmax and Spanline appealed that decision.

Judgment

The scope of RPR's exclusive right

The court held that the granting of the exclusive right by Spanline to RPR to operate the franchise business in the franchise territory included a prohibition on Spanline establishing or operating its own Spanline business in the territory. The court found that, in granting that right, there was also an implied term or 'correlative promise', which prohibited Spanline from authorising another franchisee (including Marmax) to establish or operate a Spanline business in RPR's territory. Spanline breached that 'correlative promise' when it gave permission to Marmax to service customers who resided in RPR's territory.

The effect of the breach was to deprive RPR of the benefit of the exclusive franchise, and as a result, RPR was awarded damages in the amount of 80 per cent of the value of the jobs undertaken by Marmax in RPR's territory pursuant to the permission granted by Spanline. A 20 per cent discount was applied to take account of the lack of certainty that RPR would have actually obtained all of the jobs undertaken by Marmax in its territory.

The content of the implied duties of good faith and co-operation

The primary judge found that there were implied terms requiring the parties to act in good faith and to do all things necessary on their part to enable the other party to have the benefit of the contract. In this case, those implied duties required Spanline not only to refrain from positive conduct that would infringe on RPR's exclusive rights, but also to take 'reasonable and available' steps to ensure that RPR's territory remained exclusive.

The Full Court considered a number of authorities concerning implied terms. Attention was drawn to the requirement of 'necessity', which says a term will only be implied if the contract would be unworkable without it, or the absence of such a term would render the contract nugatory, worthless or seriously undermined. The court found that, in this case, all that the implied duty to co-operate required Spanline to do was to refrain from taking positive steps that would infringe upon or cause a third party to infringe upon the exclusive rights of RPR. It would exceed the requirement of necessity to require Spanline to do more, such as to take positive steps to investigate possible incursions by Marmax into RPR's territory. The absence of a requirement to investigate such conduct would not render the franchise agreement nugatory, worthless or seriously undermined. For the same reasons, the court did not accept RPR's contention that Spanline was under an obligation to take steps to enforce its contractual rights against Marmax for the benefit of RPR.

The court accepted that the authorities relied upon by the primary judge supported the implication of a duty of good faith in the circumstances of the case. That duty requires a party to act reasonably and not in a manner which substantially defeats the legitimate expectations of the other party to the contract, but does not require a party to prefer the interests of the other party or to subordinate its own interest. The full court held that the implied duty of good faith in the circumstances of this case did not require anything more of Spanline than the duty to co-operate.

Liability of Marmax for incursions into RPR's territory

At trial, RPR was successful in a claim against Marmax for breach of two separate agreements entered into between those parties. The full court overturned that part of the decision. The court found, in respect of one agreement, that the contractual relationship had ended before the incursions by Marmax into RPR's territory and, in respect of the second agreement, that the terms of the contract did not prohibit Marmax from doing work in RPR's territory. As a result, Marmax was not liable to pay any damages to RPR.

➤ Chapter 3: Settlements and penalties

Most commercial disputes are resolved by settlement rather than by judicial or arbitral determination. Many settlements, however, give rise to further disputes. Some common settlement issues which are subsequently litigated include:

- whether a binding settlement agreement has been reached;
- whether causes of action are discharged immediately upon settlement or whether the discharge is conditional on further steps being taken (such as the payment of the settlement sum); and
- whether consequences of non-payment of the settlement sum can constitute a penalty.

The decision of the NSW Court of Appeal in *Jingalong v Todd*¹² considered the first two issues. In that case the court held that the agreement was legally binding and operated to discharge immediately the parties' causes of action. In reaching this conclusion, the court cautioned against overreliance on pre-determined categories of settlement such as 'accord executory' and 'accord and satisfaction'.

It is common for settlement agreements to oblige a party to pay a higher amount (such as the entire amount claimed) if the settlement amount is not paid by the required date. In a few cases last year, appellate courts considered whether, in these circumstances, the obligation to pay a higher amount was an unenforceable penalty. In *Lachlan v HP Mercantile Pty Ltd*¹³, the NSW Court of Appeal held that, because the appellant had acknowledged that the higher amount was a 'present debt', the obligation to pay that higher amount was not a penalty. The court was therefore able to distinguish an earlier Queensland Court of Appeal case¹⁴ in which the court held that an obligation to pay a higher amount, following default on an instalment payment, was a penalty.

The NSW Court of Appeal reached the same conclusion (and followed its own decision in *Lachlan*) in *Auzcare Pty Ltd v Idameneo (No 123) Pty Ltd*¹⁵, in which an express acknowledgement of debt prevented the impugned obligation from being penal.

¹² [2015] NSWCA 7.

¹³ [2015] NSWCA 130.

¹⁴ *Zenith Engineering Pty Ltd v Queensland Crane and Machinery Pty Ltd* [2000] QCA 221.

¹⁵ [2015] NSWCA 412.

Outside the context of settlements, there were further developments in the doctrine of penalties as restated by the High Court in *Andrews*. In *Paciocco v Australia and New Zealand Banking Group Limited*¹⁶, the Full Court of the Federal Court heard the appeal against the second decision of Justice Gaudron in the Bank Fees class action. This case was particularly important for widening the categories of losses (which might be suffered by the 'innocent' party) that should be considered in deciding whether an obligation is penal.

The High Court subsequently granted the plaintiff leave to appeal against this decision. The appeal was heard in February this year. It will provide an opportunity for the High Court not only to consider the categories of losses which can be relied on by an innocent party, but also to comment on the decision of the House of Lords in *Cavendish Square Holding BV v Talal El Makdessi; ParkingEye Limited v Beavis*¹⁷, handed down late in 2015, which discussed the doctrine of penalties in some detail.

¹⁶ [2015] FCAFC 50.

¹⁷ [2015] UKSC 67.

Jingalong v Todd [2015] NSWCA 7

- > 'Settlement agreement' executed by parties after mediation - whether binding and enforceable
- > Whether intended to discharge causes of action

In this case, the court considered whether a handwritten 'settlement agreement' executed by parties at the conclusion of a mediation constituted an immediately binding and enforceable contract, and what effect it had on the proceedings.

This case shows that, in determining the effect of a 'settlement agreement', it is necessary to consider separately:

- whether it was intended to bind parties immediately; and
- if so, what effect it had on the proceedings.

Care should be taken not to approach the construction of such an agreement by reference to pre-determined categories, such as accord executory and accord and satisfaction. Each agreement must be construed in accordance with accepted principles of construction, which require the court to assess the intention of the parties objectively, having regard to the language they have used, the surrounding circumstances known to the parties and the objects the agreement is intended to secure.

Even if the relevant agreement does not expressly dispose of a cause of action, it will be sufficient to do so if the continuation of the cause of action is inconsistent with the agreement – although it is prudent to include an express clause to that effect.

The High Court dismissed an application for special leave to appeal the Court of Appeal's decision.

Facts

Mr Todd was the registered proprietor of a property, which he planned to subdivide. In 2002 or 2003, Mr Todd entered into an oral agreement with Mr Pernice, who agreed to purchase Lot 1 for \$300,000 which he was to pay in instalments. In 2005, Mr Todd became concerned he may not be able to complete the subdivision and entered into a written contract of sale with the Poultons. The contract included a special condition that once the subdivision was completed the Poultons would transfer Lot 1 back to Mr Todd (or his nominee) for \$1.

In 2010, Mr Todd discovered that the Poultons were intending to sell the property, and he lodged a caveat claiming an equitable interest in Lot 1. Mr Todd introduced the Poultons to a director of Jingalong Pty Ltd, as he understood Jingalong could provide additional funds to complete the subdivision. Jingalong entered into a Joint Venture with the Poultons, the terms of which acknowledged Mr Todd's equitable interest. To effect the sale of a certain portion of land to Jingalong, Mr Todd agreed to withdraw his caveat.

In 2011, the Poultons sold part of the property, including Lot 1, to Jingalong, without recognising Mr Todd's equitable interest.

In 2012, Mr Todd lodged another caveat regarding his equitable interest, then commenced proceedings against Jingalong and Mr Pernice. During the pleading stage of the proceedings, the parties attended a mediation. At the conclusion of the mediation, the parties executed a handwritten 'Heads of Agreement' (the **Agreement**) which purported to settle the proceedings. It provided (among other things) for the various parties to pay certain amounts to each other and that the Agreement 'ha[d] effect unless any later deed is entered into by the parties'.

Mr Todd subsequently decided not to comply with the Agreement. Jingalong sought to enforce it. The primary judge held that the Agreement was a mere 'accord executory', which did not bar the proceedings unless and until there has been performance. Here, there had not been performance by any of the other parties, so it was not enforceable against Mr Todd. Jingalong challenged this decision on appeal.

Court of Appeal judgment

The Court of Appeal (Acting Justice Sackville, with Justices Meagher and Leeming agreeing) held that the Agreement was binding and enforceable and disposed of the causes of action that Mr Todd and Mr Pernice had against Jingalong, and against each other.

The principles

First, the court canvassed the traditional approach at common law, which was that a cause of action could be discharged by an agreement for valuable consideration if it amounted to an 'accord and satisfaction'. The essence of 'accord and satisfaction' is the acceptance by the plaintiff of something in place of his cause of action, which may be a promise or contract or act or thing. Whatever it is, until it is provided and accepted, the cause of action remains alive and the accord 'executory'. There is also another possibility: a 'conditional satisfaction', which merely suspends the original cause of action so the plaintiff can resume prosecution of the proceedings if the defendant does not perform the agreement according to its tenor.

The court said that the availability of these alternatives suggests that care should be taken not to approach the construction of an agreement by reference to pre-determined categories of accords. Each agreement must be construed in accordance with accepted principles of construction, which require the court to assess the intention of the parties objectively, having regard to the language they have used, the surrounding circumstances known to the parties and the objects the agreement is intended to secure. The court doubted that there was a general preference for construing a compromise agreement as extinguishing the original cause of action only upon performance of the agreement, rather than immediately on entry into the agreement.

The court then turned to consider the Agreement. It noted that it was necessary to separately consider whether the agreement was intended to bind the parties immediately and, if so, what effect it had on the proceedings. In relation to the latter, it was also necessary to separately consider what effect it had on the particular causes of action against each party.

An immediate and binding agreement?

The context of the Agreement – the fact that it came into existence as the result of a mediation between the parties, all of whom were legally represented – suggested that the parties intended to enter an immediately binding agreement.

There were also textual indications to that effect. The Agreement contained a clause stating 'These Heads of Agreement have effect unless any later deed is entered into by the parties'. This demonstrated that the parties intended to be bound even if a more formal deed was entered into at a later date. The phrase 'it is hereby agreed' was further evidence of this intention. The fact that the Agreement did not make provision for what was to happen in the event that performance was not completed did not detract from the fact that it was intended to be binding.

Discharge of the causes of action?

The Agreement reflected a compromise between the parties' competing claims. It would be strange if one party (here, Mr Todd) could prevent such an agreement having any legal effect by simply refusing to perform acts they have agreed to perform. This would be the result of holding, as the trial judge did, that the Agreement was an 'accord executory'.

Furthermore, the fact that the Agreement did not contain a specific clause in which Mr Todd and Mr Pernice agreed to abandon their claims against Jingalong, or acknowledge that those claims had been satisfied, was not fatal. If an agreement is inconsistent with the continuation of a cause of action, it is not difficult to construe the agreement as incorporating a release or discharge of that cause of action.

Here, the Agreement provided that Jingalong was to sell Lot 1 for \$350,000 to Mr Pernice and that Mr Pernice and Mr Todd were to contribute defined shares of the purchase price. This was inconsistent with Mr Todd or Mr Pernice retaining the right to receive a transfer of Lot 1 from Jingalong for the nominal price of \$1, as was asserted in the proceedings. Viewed objectively, the purpose of the Agreement was to resolve the competing claims to a beneficial interest in Lot 1.

There was a clause which required consent minutes to be executed disposing of the proceedings once the amounts stipulated under the Agreement were paid. Alone, that might suggest that the agreement was executory until those amounts were paid, but an agreement must be read as a whole and in light of its context. When that is done, it is clear that the Agreement was intended to be immediately binding.

Finally, the court noted that Jingalong did not invoke the equitable principles applying to an agreement for value to release an obligation. It was therefore not appropriate to consider whether those principles may apply. However, the court observed that it should not be assumed that those equitable principles are circumscribed by the limitations imposed on the common law doctrine of accord and satisfaction.

Accordingly, the court dismissed Mr Todd and Mr Pernice's claims against Jingalong. As Jingalong had not properly formulated a claim for relief, the court remitted its cross-claim to the court below for further hearing on this issue in light of its reasons.

High Court special leave disposition

The High Court dismissed an application for special leave to appeal. It said that the case turned on the application of 'very well-settled principles of construction'. It was not satisfied that an issue of principle would arise or that there was sufficient doubt about the Court of Appeal's decision to warrant special leave.

Lachlan v HP Mercantile Pty Ltd [2015] NSWCA 130

- > Settlement
- > Whether clause in deed a penalty or present debt
- > No express acknowledgment of present debt in deed
- > Express acknowledgement not necessary
- > Recitals may be used as an aid to construction
- > Clause is not a penalty

The New South Wales Court of Appeal considered whether a clause of a settlement deed that provided for payment of a 'judgment debt' constituted a penalty and was therefore unenforceable.

In dismissing the appeal, the Court of Appeal held that the relevant clause did not constitute a penalty because the appellant had implicitly acknowledged that the 'judgment debt' was a present debt.

This case considers the principles on which a court may vary consent orders in circumstances where the consent orders are based on an underlying contract between the parties.

This case is particularly relevant to practitioners acting for banks or other creditors. It demonstrates the factors a court will take into account in determining whether, in settlement of a debt, a clause providing for recovery of the full debt upon default of specified conditions is unenforceable under the doctrine of penalties. It serves as a reminder that, when drafting a settlement deed, the deed should contain an express acknowledgement that the total amount of the debt is due and owing. However, even where there is no express acknowledgment, a court may construe the agreement in a manner that finds an implicit acknowledgment, including by reference to the recitals in the deed.

Facts

The appellant entered into four loan agreements with Tumut River Orchard Managements Ltd in relation to an orchard management scheme. The rights of Tumut River Orchard Managements Ltd under the loan agreements were assigned to the respondent. The respondent sought to recover the amounts outstanding under the loans, resulting in a dispute between the parties that led to legal proceedings.

The legal proceedings were settled by the parties' entry into a Deed of Release and Assignment. The deed provided that the appellant was to pay the respondent \$300,000 in instalments and that, should there be an unrectified default in the making of these payments, the respondent was entitled to enter judgment for \$1,570,292, an amount defined in the deed as the 'Judgment Debt'. Consent orders were made, which gave effect to this agreement.

The appellant defaulted on the final instalment payment and failed to rectify the default following notice. The respondent sought judgment for the amount of the judgment debt.

The appellant sought an extension of time to pay the final instalment (therefore requiring variation of the consent orders) under r1.12 of the *Uniform Civil Procedure Rules 2005* (NSW). The appellant also claimed that clause 10 of the deed, which provided for the judgment debt, was unenforceable as it amounted to a penalty.

In the New South Wales Supreme Court, Justice Darke refused to grant an extension of time and held that clause 10 was not a penalty. The appellant appealed the decision.

Judgment

Extension of time

The appellant submitted that the decision in *Paino v Hoffbauer* (1988) 13 NSWLR 193, which provided that a case must be ‘exceptional’ for a court to exercise discretion to vary a consent order which was based on a contract that itself could not be varied, was plainly wrong and should not be followed. The appellant submitted that in applying this decision, the trial judge had erred in his discretion by taking into account an irrelevant consideration.

Their Honours rejected these arguments, finding that *Paino* was still good law, and that the application of *Paino* did not impermissibly fetter the trial judge’s general discretion under the procedural rules that permitted extensions of time. Their Honours held that in a case where parties have bound themselves to a contract that underpins a court’s orders, the court’s general discretion should be exercised in the context of the respect the law gives to parties being held to their bargain. To relieve a party from a bargain they had freely entered would require an ‘exceptional’ case. This approach does not fetter judicial discretion; rather, it is an appropriate exercise of discretion in particular types of cases.

Their Honours also rejected the appellant’s argument that, regardless of the correctness of *Paino*, the trial judge’s decision was ‘manifestly unreasonable’ in the circumstances. However, they noted that their position might have been different if clause 10 of the deed was found to be a penalty.

Penalty

On appeal, the question of whether clause 10 was a penalty was limited to the question whether, in the deed, the appellant had acknowledged that the judgment debt was a present debt. It was accepted that if there was such an acknowledgment, the clause was not a penalty. As there was no express acknowledgment, their Honours considered whether, upon proper construction of the deed, there was an implicit acknowledgment.

The appellant submitted that the only present debt was the obligation to pay \$300,000, and the judgment debt did not arise unless and until there was an unrectified default. In support of this construction, the appellant noted that the definition of judgment debt in the deed did not refer to the loans underlying the alleged indebtedness.

Their Honours considered case law involving circumstances where a creditor agrees to accept payment of part of a debt in full discharge if certain conditions are met, and stipulates that if the conditions are not met, then the full amount of the debt (implicitly acknowledged by the debtor to be the judgment debt) will be payable. Their Honours concluded that there is no penalty in such circumstances.

The appellant submitted that this case was similar to *Zenith Engineering Pty Ltd v Queensland Cane and Machinery Pty Ltd* [2000] QCA 221, in which a money claim was settled on terms that a lesser sum be paid by instalments, with the creditor entitled to enter judgment for the full amount if any instalment was not paid on time. In that case, it was found that as the claim had been settled, there was no present debt, merely an amount claimed, and accordingly there was a penalty.

Their Honours distinguished the present case from *Zenith* on the basis that the recitals in the deed contained an affirmation of the indebtedness under the loans, and noted that the sum claimed by the creditor in *Zenith* was disproportionate to its loss.

The conclusion that clause 10 was a present debt and did not constitute a penalty arose from a construction of the deed that took into account its recitals. The recitals referred to the loans that formed the subject of the respondent’s claim, while the operative provisions of the deed did not contain any cross-reference between the judgment debt and the loans. Their Honours accepted the trial judge’s observation that the recitals to an agreement can provide a means of proving background facts that are themselves legitimate aids to the construction of the agreement.

Auzcare Pty Ltd v Idameneo (No 123) Pty Ltd [2015] NSWCA 412

- > Doctrine of penalties
- > Compromise of claim resulted in acknowledgement of debt, to be released if ongoing obligations performed, failing which debt was immediately recoverable
- > Whether provisions penal
- > Whether penalties doctrine applied in circumstances where there were no obligations to repay acknowledged debt
- > Whether nature of claim which was compromised relevant to penalties doctrine

This decision of NSW Court of Appeal dealt with the doctrine of penalties and when it will apply.

The court confirmed that:

- there is a 'fundamental difference between an acknowledgement of an existing debt which is the subject of an indulgence, and provisions whose purpose is to compel performance of a new obligation';
- the penalties doctrine does not apply simply because there is no obligation to repay an acknowledged debt. The debt may be discharged by ways other than payment, such as by the provision of medical services; and
- the nature of the claim that was compromised (and which subsequently formed the basis for an acknowledgement of a debt) is not relevant to whether the penalties doctrine applies. As was the example in this case, the penalty doctrine does not apply merely because the comprised claims were based in quasi-contract and equity, rather than in debt.

This decision does not alter the doctrine of penalties. Practitioners and clients should be aware that a contractual provision may be void and unenforceable where it contains a new obligation that requires a party to pay or forfeit a sum of money to the other party in the event of a breach. Where, however, a party agrees that an indebted party can discharge an existing debt if certain conditions are met, and stipulates that if these conditions are not met the full amount is payable, the doctrine of penalties does not apply. This is the law regardless of how the parties agree to discharge the debt, and regardless of the nature of compromised claim which gave rise to the acknowledgment of debt.

Facts

Auzcare Pty Ltd is a company which owned and conducted a medical practice. Its sole director was Dr Muhammad Azam.

By a Deed of Sale of Practice dated 22 August 2012, Auzcare was sold to Idameneo (No 123) Pty Ltd for a purchase price of \$800,000. This amount was paid to an account held by Dr Azam's wife, and the amount was subsequently transferred from her account to a third party.

On the same date, Auzcare and Idameneo entered into a separate deed entitled 'Provision of Services to Incorporated Medical Practitioner' by which Auzcare promised to: conduct the medical practice; procure the attendance of, and provision of medical services by, Dr Azam at the Queensland premises for a period of ten years; and, pay Idameneo 50 per cent of all money received that was directly referable to medical services provided by Dr Azam.

Idameneo commenced proceedings in 2012, on the basis that Dr Azam had breached the sale and services deeds by not rendering the services promised. Following negotiations, the parties agreed to settle the 2012 proceedings by way of a 'Deed of Settlement and Release' (the *Deed*) entered into in April 2013. Amongst other things, the Deed provided that:

- Auzcare, Dr Azam and Mrs Azam each agreed and acknowledged that, as at the date of this Deed, they were jointly and severally indebted to Idameneo in the amount of \$800,000 (the *Debt*) by reason of the liability arising from the claims pleaded in the 2012 proceedings;

- Idameneo agreed not to enforce its rights immediately, on the basis that Auzcare and Dr Azam made new promises that were similar to the original promises to conduct the medical practice and to render medical services at Idameneo's premises. Auzcare, Dr Azam and Mrs Azam were also required to give mortgages over all real property owned by them, including two parcels of land in Queensland, to secure 'the monies owed and contingently owed' under the Deed; and
- Idameneo gave Auzcare, Dr Azam and Mrs Azam a release, dependent on their complying with the above obligations.

In 2014, Idameneo commenced proceedings claiming that the Deed had been breached. Idameneo sought judgment in the amount of \$800,000 plus interest and fees, and possession of the two Queensland properties.

The primary judge, Justice Hidden, held that the deed contained an express acknowledgement by Auzcare and the Azams that they were indebted to Idameneo by reason of their liability pleaded in the 2012 proceedings. The primary judge explained that the effect of the deed was that Idameneo agreed to postpone enforcement of the acknowledged debt, and ultimately to forgive it, upon certain conditions. If those conditions were not met, Auzcare and the Azams would lose the benefit of that forbearance and Idameneo was at liberty to recover the acknowledged debt.

Judgment

The defendants appealed, maintaining that certain provisions in the Deed were unenforceable penalties on the basis of three distinct submissions. The Court of Appeal disagreed with each of those submissions in turn.

First, the defendants submitted that, notwithstanding the written acknowledgement of the debt, there was in substance no present debt because a present debt does not exist unless there is an enforceable obligation to pay money that is not contingent on future events. Their Honours disagreed and held that there was a present debt that the defendants were bound to by way of their acknowledgement in the Deed. Their Honours explained that the law of penalties draws an important distinction between an existing debt, which is the subject of an indulgence given by the creditor provided that certain conditions are met, and provisions that compel performance of a new obligation. Accordingly, where there is a breach of a term that is an indulgence which compromises an existing obligation, there is no penalty.

Secondly, the defendants argued that the penalties doctrine is only inapplicable where a deed provides for the payment of an existing debt over time. In this case, there was no delayed payment and instead the purpose of the Deed was to coerce the provision of 10 years of medical services. Their Honours disagreed and held that the parties were free to negotiate how the acknowledged debt might be discharged. The fact that the parties negotiated to discharge the debt on terms involving the provision of medical services, rather than by a delayed payment plan, is of no significance to whether the term is a penalty.

Thirdly, the defendants submitted that, for the provisions to be enforceable, the nature of the compromised claim which gave rise to the acknowledged debt must be based in debt rather than contract or equity. In disagreement, their Honours held that the nature of the compromised claim was not relevant to the question of whether the provision was a penalty, and did not undermine the effect of an acknowledged debt.

Accordingly, the court dismissed the defendants' appeal.

Paciocco v Australia and New Zealand Banking Group Limited [2015] FCAFC 50

- > Bank fees
- > Doctrine of penalty
- > Whether various stipulations for fees are penalties at law or equity, or genuine pre-estimate of damage or compensation
- > Whether the relevant stipulations were for breach of term of contract, collateral or accessory in the nature of security
- > Whether the fees were extravagant or unconscionable
- > Whether the charging of the fees constituted unconscionable conduct, unjust transactions or unfair contract terms

In this decision, the Full Court of the Federal Court of Australia considered whether certain bank fees were penalties and whether they contravened statutory prohibitions on unconscionable [conduct](#).¹⁸

The Full Court overturned the first instance finding that ANZ's late payment fee was a penalty.

The court clarified the law of penalties as it applies to fees. The key development is that, in considering whether the amount of a fee is 'extravagant and exorbitant' compared to the potential costs incurred in dealing with a failure to perform an obligation, the court held that indirect costs could be taken into account.

Facts

At first instance, Justice Gordon held that none of the fees in question contravened the statutory prohibitions on unconscionable conduct. She also held that ANZ's late payment fees were penal because:

- the fees were charged when a customer failed to comply with the a term of their account that required them to make a minimum payment each month; and
- the amount of the fee was 'extravagant and unconscionable' compared to the costs the bank incurred in dealing with the customer's failure to make their payment on time.

Justice Gordon found that ANZ's other exception fees (honour, dishonour and overlimit fees) were not penal because they were charged in respect of an additional service and not as a penalty for not operating the account in a certain way.

Judgment

The Full Court confirmed that the key questions in considering whether a fee is penal are whether:

- it is imposed to secure the performance of another contractual requirement; and
- if so, whether the amount of the fee is extravagant or exorbitant having regard to the charging party's 'legitimate interest' in the performance of the contract, assessed by reference to the greatest conceivable loss that might follow from a failure to comply assessed at the time of entry into the contract.

It also confirmed that a genuine 'fee for service' will not be a penalty and, on that basis, upheld Justice Gordon's finding that ANZ's honour, dishonour and over limit fees were not penal.

The court also noted that the fact that behavioural modification may be one of the reasons for imposing a fee does not, of itself, make it penal.

¹⁸ This summary is taken from our [Client Update](#) of April 2015.

In considering the class of costs that could be taken into account in determining whether the amount of the late fee was 'extravagant and exorbitant', Justice Gordon focused only on the direct costs actually incurred by ANZ when Mr Paciocco (the representative applicant) was late in making his payment.

The Full Court determined that it is not the appropriate test and that the exercise:

- is to be conducted on a forward looking basis at the time of the contract (and not by reference to actual costs incurred after the event); and
- requires a broader (prospective) assessment of the losses that could flow to the charging party in the event that the relevant obligation is not complied with (and therefore a legitimate interest to be protected).

The court emphasised that this is a separate and distinct analysis to the question of the damage that has actually been incurred because of non-compliance. The separate question of actual loss suffered is only required if a fee is found to be penal and for the purpose of the assessing the degree to which the fee can be enforced.

Applying that approach, the Full Court found that, contrary to the first instance decision:

- ANZ's costs of having a collections department, together with the additional loss provisioning costs and the costs of holding additional regulatory capital incurred as a result of a customer not making payments on time, could be taken into account in determining whether the late payment fee was penal; and
- including those costs would likely increase the possible loss to a level at, or about, the amount of the fee in question.

On that basis, and having regard to the expert evidence given on behalf of both parties at trial, the Full Court overturned Justice Gordon's finding that ANZ's late payment fee was a penalty.

The Full Court confirmed Justice Gordon's decision that none of the fees in question contravene the statutory prohibitions on unconscionable conduct. In doing so, it confirmed that it is not interested in being a price regulator and will not intervene on the basis that a price may be said to be too high, in the absence of other indicators of unconscionability. The fact that standard terms may be imposed, with no opportunity to negotiate, does not alone give rise to unconscionability – there is still choice.

Although it was not necessary to decide the issue, the court indicated that it agreed with Justice Gordon's finding that the limitation period for the penalties claims did not start to run until the claimant could reasonably have discovered their cause of action. There was no appeal from her Honour's finding that the relevant time was when the first bank fees class action was filed in September 2010 (and that, prior to that time, they had been operating under a mistake of law as to ANZ's ability to charge the fees).

The most important aspect of the Full Court's decision is the finding that a broader category of costs may be taken into account in considering whether a fee is penal. Not only has this resulted in the initial finding in respect of ANZ's late payment fee being overturned, it is also likely to cause significant difficulties for the promoters of other current and proposed class actions in respect of the fees charged by other banks, finance companies and telecommunication companies.



➤ Chapter 4: Termination and damages

If one party repudiates a contract,¹⁹ the other party may bring the contract to an end by accepting the repudiation. It can, however, be risky to accept an alleged repudiation. If a court subsequently decides that the other party's conduct was not repudiatory, then the acceptance of the repudiation may itself be repudiatory conduct.

It will often be difficult to decide whether or not conduct is 'repudiatory'. In *Protector Glass Industries Pty Ltd v Southern Cross Autoglass Pty Ltd*²⁰, the NSW Court of Appeal, disagreeing with the trial judge, held that the conduct of one party was not repudiatory. Somewhat unusually, however, the court held that the contract had subsequently come to an end by 'abandonment', rather than the acceptance of a repudiation.

Where a repudiation is accepted, the innocent party will be entitled to seek loss of bargain damages. In *Naaman v Steiman*²¹ the innocent party sought to recover instalment payments that were due after termination. The NSW Court of Appeal considered two grounds on which the innocent party might be entitled to such payments: one possibility was that the right to receive these payments accrued before the date of termination, the other being a right to recover them as loss of bargain damages. The Court of Appeal agreed with the trial judge that the right to these instalment payments had not accrued as at the date of termination. The court further held, however, that the trial judge failed to consider whether the innocent party was entitled to receive these amounts as 'loss of bargain' damages, and on that basis remitted the matter to the trial judge.

¹⁹ That is, their conduct evinces an unwillingness or inability to tender substantial performance of the contract or an intention not to be bound by the contract, or only to fulfil it in a manner substantially inconsistent with their obligations: *Koompahtoo Local Aboriginal Land Council v Sanpine Pty Limited* [2007] HCA 61.

²⁰ [2015] NSWCA 16.

²¹ [2015] NSWCA 259.

A contract may also be terminated if it is superseded by a subsequent agreement between the same parties. The parties will usually specify whether the later agreement terminates the earlier agreement. In the absence of such express language, there may be uncertainty as to whether the later agreement replaces, or merely supplements, the earlier agreement. These issues were considered by the NSW Court of Appeal in *Hillam v Iacullo*²², in which the court held that a subsequent agreement did discharge the parties' obligations under an earlier agreement, including a commercially significant obligation on a borrower to pay an 'uplift'.

One of the more controversial cases summarised in our 2014 [Contract Law Update](#) was the decision of the High Court in *Clark v Macourt*. In that case, the plaintiff successfully recovered substantial damages despite the fact that, on one view, she had suffered no loss. This judgment was relied on by the plaintiff in *Chand v Commonwealth Bank of Australia*²³. In that case the defendant breached a contract by failing to comply with instructions to sell an investment portfolio. Subsequently, when he became aware of this failure, the plaintiff decided not to reissue the instructions (including at times when the portfolio could have been sold for a higher price). The portfolio was sold much later for a loss. The NSW Court of Appeal held that the sole, effective cause of the plaintiff's loss was his decision not to reissue the instructions to the defendant. On that basis, the plaintiff suffered no loss, and the NSW Court of Appeal held that the High Court's decision in *Clark v Macourt* did not require the court to ignore this subsequent conduct. In the later case of *Ng v Filmlock Pty Ltd*²⁴, the NSW Court of Appeal did however confirm the orthodox rule that damages should be calculated as at the date of breach, while acknowledge that evidence of later events may be relevant in that calculation.

If a plaintiff can prove that they have suffered some loss as a result of a breach of contract, the plaintiff is not obliged then to prove that it received no countervailing benefits (although it is open to the defendant to put on such evidence). The Western Australian Court of Appeal therefore held in *Culleton v Daken Farms Pty Ltd*²⁵ that the plaintiff was entitled to recover damages for loss of rent notwithstanding that the plaintiff had not proved the absence of any benefit flowing from the breach of other, related obligations.

²² [2015] NSWCA 196.

²³ [2015] NSWCA 181.

²⁴ [2014] NSWCA 389.

²⁵ [2015] WASCA 183.

Protector Glass Industries Pty Ltd v Southern Cross Autoglass Pty Ltd [2015] NSWCA 16

- > Repudiation
- > Anticipatory breach
- > Discharge by agreement or abandonment

In this decision of the New South Wales Court of Appeal, the court considered whether a purchaser had repudiated a contract when it threatened to terminate if the vendor could not satisfy it that it would be able to transfer title to property free of impairment.

The court held that the contract was not repudiated. The purchaser was entitled to emphasise that it required certain terms of the contract to be met, and was right to suggest it would not be required to complete the contract if those terms were not met. By doing so, it did not demonstrate an intention not to perform the contract substantially on the agreed terms.

The High Court dismissed an application for special leave to appeal.

The court's reasoning underlines its commercial approach to enforcing agreements and assessing pre-completion dealings. It will not compel a party to complete a contract where it appears clear that it will not receive what it bargained for. This is so even in the absence of a relevant condition precedent, and despite the party's ability to rely on warranties after completion.

Facts

Southern Cross Autoglass Pty Ltd (*SCA*) had agreed to sell, and Protector Glass Industries Pty Ltd (*PGI*) had agreed to buy, the assets and goodwill of an automotive glass business. The sale contract included standard obligations and warranties from SCA as to clear title to the assets. The arrangement also involved SCA's principals entering into employment contracts with PGI.

Before completion, PGI was put on notice that liquidators of a third party claimed that SCA held some of its assets on trust for the third party, and the liquidators would pursue PGI for the assets if title passed to it.

PGI wrote to SCA purportedly requiring SCA to settle the uncertainty about its title to the assets to PGI's satisfaction within 30 days, or else PGI would terminate the sale agreement. PGI and SCA had subsequent discussions that contemplated a differently-structured transaction that would avoid the clear title issue. PGI also sent SCA a draft 'Deed of Termination', though it was never signed.

The parties entered into alternative arrangements with each other. After the relationship fell apart, SCA alleged that PGI had repudiated the original sale contract either by its letter threatening to terminate or by the draft deed of termination. At first instance, Justice Kunc found in favour of SCA on both grounds.

Court of Appeal judgment

On appeal, the court found in favour of PGI, holding that it had not repudiated the contract, and that the parties had abandoned the contract.

The court overturned the primary judge's finding that PGI's threat to terminate evinced its intention to act inconsistently with the contract, given that the contract did not entitle it to make such demands of SCA and it had the benefit of warranties as to title.

The court found that PGI's letter merely emphasised its right under the contract to receive clear title and that it would not perform its obligations under the contract if that right were not 'recognised and accommodated'. This did not mean that it did not consider itself bound by the contract. The court emphasised that PGI could not be compelled to 'buy a lawsuit' by completing the contract in circumstances where it was clear that liquidators would pursue them for the assets. It was not relevant that PGI could not point to a condition precedent that required SCA to provide certain comfort in relation to its clear title.

The court's reasoning highlights that practitioners and parties must adopt a commercially realistic approach in pre-completion situations. It is common for parties to agree to contractual conditions precedent designed to assure them that they will receive what they bargained for, and contractual warranties to mitigate against the risk that they do not. The court will not, though, force a party to complete when it is clear that it will not receive what it bargained for, regardless of the agreed regime of conditions precedent and warranties.

However, it is not clear from the court's reasoning (and it was not necessary for it to decide) whether, or at what point, before the stated completion date, PGI would have been entitled to terminate the contract if SCA did not provide comfort as to clear title. It was not a matter of fact that SCA lacked clear title (SCA disputed the liquidator's contentions). It would be unrealistic for a court to expect that any third party claim to title, no matter how spurious, should undermine a sale contract.

The court also held that PGI did not repudiate the contract by sending a draft deed of termination. In fact, that it proposed a formal instrument to bring the contract to an end showed that PGI still considered itself bound by the original agreement.

The court held that the original sales contract had been abandoned, based on the parties' shared view that the original agreement was at an end. The court was satisfied that, based on this view, both parties had pursued an alternative approach that was inconsistent with the original contract. SCA had closed down its business and its principals had entered into employment contracts with PGI on different terms than agreed under the original arrangement. PGI, for its part, had actively explored, and proposed to SCA, options to structure the transaction differently.

The court's approach makes it clear that practitioners and parties must act cautiously and with a view to all the circumstances if they intend to terminate a contract based on anticipatory breaches. The court will not adopt a legalistic interpretation of individual events in isolation, but will consider dealings in their broader context.

High Court special leave disposition

The High Court dismissed SCA's application for special leave to appeal, saying that the Court of Appeal applied 'established principles' to the facts and circumstances.

Naaman v Sleiman [2015] NSWCA 259

- > Whether promisee had an accrued right to payment in the future following termination for promisor's repudiation
- > Promisee's right to payment in the future contingent upon his further performance of executory obligations
- > Whether payment obligations survived termination
- > Loss of bargain damages

This NSW Court of Appeal decision considered accrued rights, the survival of obligations following termination, and damages for loss of bargain in relation to a deed that had been terminated by the Appellant on the basis of repudiation.

Their Honours held that the appellant did not have an accrued right to receive the balance of future instalment payments upon termination of the deed, and that the clause that provided for the instalment payments did not survive termination of the deed. After considering the principles relevant to a claim for damages for loss of bargain, their Honours determined that this claim was 'certainly not hopeless', and had not been addressed by the primary judge. On that basis, the appeal was allowed.

This case considers the rights of the parties following the termination of a deed on the basis of repudiation. It explores the circumstances in which rights may accrue on termination, obligations may survive termination, and damages may be available for loss of bargain. On a practical level, the decision provides guidance to practitioners when drafting and negotiating an agreement involving payment by instalments in consideration for the provision of instructions and assistance to a business, in the context of a share sale.

Facts

The appellant, Mr Naaman, was a director and 90 per cent shareholder of a company known as Adult Education Academy Pty Ltd, and was the CEO of a group of companies known as the Phantom Group.

Under a share sale agreement, the issued shares in Adult Education and the Phantom Group were sold to Jaken Property Group Pty Ltd, which was the trustee of a trust associated with Mr Sleiman. In connection with the share sale agreement, Mr Naaman and Jaken entered into a deed of guarantee and restraint (the *Deed*) whereby, in consideration for the payment by Jaken of \$2.9 million, Mr Naaman agreed to:

- guarantee certain warranties and representations made by the vendor of the shares in the Phantom Group under the share sale agreement;
- refrain from competing with the relevant businesses for two years; and
- provide instructions and assistance to the relevant businesses in securing new clients.

The deed provided for payment of the sum of \$2.9 million by instalments over 24 months, subject to Jaken's right of set-off. Following payment of the first two instalments totalling \$900,000, Jaken informed Mr Naaman that it would not be making the next instalment payment, and that it would set off amounts payable to Mr Naaman as a result of an alleged failure of representations made by Mr Naaman. Mr Naaman informed Jaken that it was in material breach of the deed, that the deed was thereby terminated, and that he would seek damages for breach of contract. Subsequently, Jaken Properties Australia Pty Ltd (*Jaken Properties*) was appointed as trustee of the trust, and Jaken entered into voluntary liquidation.

Mr Naaman commenced proceedings in which he claimed the proceeds of sale of a certain property from Mr Sleiman (the first respondent), and separately claimed a liquidated sum of \$2 million under the deed, or alternatively damages in that amount for breach of the deed, from Jaken Properties (the second respondent) and Jaken (the third respondent). The primary judge dismissed all of Mr Naaman's claims.

Mr Naaman appealed against the orders dismissing his claim against Jaken Properties and Jaken. The issues relating to Mr Sleiman were not pursued on appeal. The primary judge's finding that Jaken had repudiated the deed, and that Mr Naaman had elected, as he was entitled, to accept the repudiation, terminate the deed and sue for damages was also not challenged on appeal.

Judgment

The Court of Appeal considered:

- whether Mr Naaman had an accrued right to receive \$2 million from Jaken as at the date of termination of the deed;
- whether Jaken's ongoing payment obligations under the deed survived termination; and
- whether Mr Naaman had a claim for loss of bargain damages following termination of the deed.

The judgment was handed down by Justice Gleeson, with Justices Ward and Meagher agreeing.

Their Honours allowed the appeal against Jaken Properties and Jaken, set aside the order dismissing the proceedings against these parties, and ordered a new trial on the quantification of damages.

Accrued rights as at the date of termination

Their Honours considered whether the obligation to pay the balance of the instalments under the deed, totalling \$2 million, had arisen before the termination of the deed. If Mr Naaman had an accrued right to payment of these instalments before termination, such right would not be divested by his election to accept the repudiation by Jaken and bring the deed to an end. Their Honours upheld the primary judge's finding that Mr Naaman did not have an accrued right, as at the date of termination, to receive payment of the future instalments.

In forming this conclusion, their Honours recognised a 'clear distinction' between a right to payment in the future which is contingent upon an event which does not involve the further performance of a contract, and one which does. They considered that in the present case, Mr Naaman's right to payment in the future of the instalments under the deed was contingent upon his further performance of his obligations contained in the deed, specifically his executory obligations not to compete with the businesses, and to provide introductions and assistance to the businesses in securing new clients. The terms of the deed made plain the interdependence between Jaken's obligation to pay the amount of \$2.9 million by the specified instalments, and its entitlement to receive performance by Mr Naaman of these executory obligations.

Survival of obligations following termination

Their Honours considered whether the clause of the deed that provided for the instalment payments survived termination of the deed, and held that the primary judge had been correct in rejecting Mr Naaman's claim for a liquidated sum of \$2 million.

Their Honours viewed this as a matter of construction of the terms of the deed. With reference to relevant clauses, they determined that on proper construction the obligations of Jaken to pay the future instalments were not intended to operate or apply after the termination of the deed.

Damages for loss of bargain following termination

Mr Naaman's essential complaint on appeal was that his claim for damages for loss of bargain had not been addressed by the primary judge. Their Honours recognised that this had arisen in part from Mr Naaman's expression of his damages claim 'in terms apt to confuse' and from Jaken Properties' erroneous conflation of certain issues. Their Honours accepted that there had been an error of law because this claim, which was 'certainly not hopeless', had not been addressed.

In considering this issue, their Honours set out the following principles:

- the ruling principle according to which damages for breach of contract are awarded is that, as far as money can do so, the damages should put the promisee in the same situation as it would have been in had the broken promise been performed;
- once termination due to the defendant's wrongful conduct is established, the plaintiff is entitled to damages for loss of bargain; and
- loss of bargain damages represent the difference, at the date of assessment, between the value to the promisee of the unperformed obligations of the promisor relative to the contract price which the promisee had agreed to pay or provide.

In the present case, no attention had been given at trial to the question of expectation damages (ie expenses justifiably incurred in the performance of Mr Naaman's obligations to provide services under the deed, and the amount by which gross receipts would have exceeded those expenses), nor had any defence of failure to mitigate loss been pleaded.

The primary judge had viewed Mr Naaman's relationship with Jaken under the deed as a relationship of employment, and on that basis had found that Mr Naaman had no claim to remuneration for work not yet done or for remuneration not yet earned. The primary judge had formed this view with reference to *Automatic Fire Sprinklers Pty Ltd v Watson* (1946) 72 CLR 435, a case concerning the effect of a wrongful dismissal upon a contract of employment.

Their Honours considered that it was unnecessary to determine whether the relationship between Mr Naaman and Jaken was a relationship of employment. In their view, assuming in favour of Jaken and Jaken Properties that this characterisation was correct, the principles in *Automatic Fire Sprinklers* did not preclude an employee in the position of Mr Naaman, who was not dismissed, from making a claim for damages for loss of bargain, described as 'damages for breach of contract by repudiation', in contrast to a claim for wrongful dismissal.

Hillam v Iacullo [2015] NSWCA 196

- > Rescission
- > Successive written loan agreements between same parties
- > Breach
- > Dependent and independent obligations

This judgment of the NSW Court of Appeal dealt with whether successive loan agreements between the same parties regarding the same subject matter discharged the parties' obligations under the earlier agreements, and whether the obligations of the parties in the latter agreement were dependent or independent obligations.

The court allowed the appeal, holding that the latter agreement discharged the parties' obligations under the earlier agreement and was not abandoned by the parties; that the respondents were in breach of the latter agreement; and that the appellant's obligation to pay the respondents an 'uplift' under the latter agreement was dependent on the respondents' obligations under that agreement.

When parties enter into a subsequent agreement which deals with the whole of the subject matter of the former agreement, in a manner wholly inconsistent with the former agreement, the parties are taken to have rescinded the former agreement, and will be bound by the latter agreement. Further, the modern day approach to contractual interpretation favours construing terms of an agreement as dependent obligations, rather than independent obligations, unless the agreement clearly expresses the contrary.

Facts

The appellant entered into three successive loan agreements with the respondents which were on substantially similar terms. For instance, the repayment by the appellant of each of the loans under the agreement were due and payable on the same day, despite the loans being advanced at different times.

The loan agreements

- Under the first loan agreement, the respondents loaned the appellant \$200,000 in consideration for a promise to repay by a fixed date plus interest, and to transfer an 'uplift' of shares or money equal to \$400,000 (being double the principal sum) at the end of the term.
- Under the second loan agreement, the respondents loaned the appellant a further \$155,000, and the uplift was increased to \$710,000 (representing double the cumulative principal sum of \$355,000).
- Under the third loan agreement, the respondents loaned the appellant a further \$100,000. The uplift was correspondingly increased to \$910,000. In addition, it was a term of the agreement that the appellant would provide certain security within a reasonable time.

The respondents failed to transfer a remaining \$75,000 to the appellant under the third loan agreement, and the appellant did not provide the security stipulated or the \$910,000 uplift.

First instance decision

At first instance, the primary judge held that, because the respondents did not transfer the remaining \$75,000 under the third loan agreement, and the appellant did not provide the security or transfer the \$910,000 uplift, the parties were taken to have abandoned the third loan agreement. As such, the primary judge found that the second loan agreement remained on foot, and that the appellant was therefore obliged to pay the respondents the \$710,000 uplift, pursuant to that agreement. The appellant appealed.

The appeal

The questions on appeal were whether:

- the third loan agreement discharged the parties' rights under the second loan agreement, by replacing it;
- the parties abandoned the third loan agreement;
- the respondents were in breach of the third loan agreement by failing to loan the remaining \$75,000; and
- the appellant's obligation to provide the uplift was dependent upon the respondents' obligation to lend the full amount promised under the third loan agreement.

Judgment***Did the third loan agreement replace the second loan agreement?***

Justice Leeming found that when a later agreement between the same parties deals with the whole of the subject matter of the earlier agreement in a way which is wholly inconsistent with the earlier agreement, the parties are impliedly taken to have rescinded the earlier contract. On the facts, the third loan agreement dealt with the prior loans (under the first and second loan agreements) in a manner inconsistent with the second loan agreement. This was because:

- the third loan agreement expressly provided for how interest was to be calculated on the loaned amount, which was inconsistent with how it was to be calculated under the second loan agreement; and
- the third loan agreement expressly provided for security over the loaned amount, whereas the second loan agreement did not.

This inconsistent dealing with the whole of the subject matter in the third loan agreement, as compared to the previous loan agreements, was sufficient to demonstrate an objective intention of the parties to treat the second loan agreement as rescinded.

Did the parties abandon the third loan agreement?

Justice Leeming held that the actions of the parties, including that the appellant repaid the amounts owed in full under the third loan agreement, indicated that the parties did not intend, and had not, abandoned the third loan agreement.

Did the respondents breach the third loan agreement?

Justice Leeming found that the respondents' obligation to loan the remaining \$75,000 under the third loan agreement by a specified date was independent of the appellant's obligation to procure the security stipulated under the agreement, at a later date. Therefore, the respondents' failure to loan the remaining sum was a breach of the third loan agreement. His Honour was influenced by the fact that the parties had expressly recorded the terms of the third loan agreement, indicating the intention of the parties that the respondents advance the \$75,000 before the appellant was to provide security. In failing to do so, the respondents were in breach of the third loan agreement.

Was the obligation to pay the \$910,000 uplift an accrued right under the third loan agreement?

On the facts, Justice Leeming found that the appellant had expressly terminated the third loan agreement. The question before the court was therefore whether the obligation to pay the \$910,000 uplift survived termination. This turned on whether the obligation was dependent or independent of the respondents' obligation to loan the remaining \$75,000. This was a question of construction which, according to the modern day approach, favoured classifying obligations as dependent, absent clear words to the contrary. His Honour found that a natural reading of the third loan agreement, and the commercial nature of the loan agreement, indicated that the obligation to pay the uplift was dependent on the respondents' loaning the full amount under the third loan agreement. Therefore, the appellant was not required to pay the uplift of \$910,000.

The appeal was allowed.

Chand v Commonwealth Bank of Australia [2015] NSWCA 181

- > Causation of loss
- > Novus actus interveniens

In this judgment, the New South Wales Court of Appeal dealt with causation of loss in the context of a failure to reissue instructions to sell an investment portfolio.

Their Honours held that the failure to reissue a request to sell an investment portfolio can be an intervening act which will break the chain of causation. Where one party to a contract knows that the other has breached the contract by failing to execute their order to sell assets, the failure to reissue that order can be an intervening act which means that any further depreciation of the assets is not caused by the original breach of contract.

The High Court refused an application for special leave to appeal the decision.

This case shows that where another party's breach of contract causes a person to retain a depreciating asset, the failure to sell that asset can amount to an intervening act. In this case, the loss suffered from the further depreciation of the asset, may not be caused by the original breach, but rather by the decision not to sell the asset.

Facts

An investor, Mr Chand, faxed a redemption request to the Commonwealth Bank to sell his investments in September 2007. CBA did not process the request as it was required to do under the contract. Upon realising that the request had not been processed, Mr Chand did not reissue the request to sell the portfolio. He remained in the market and looked for a later 'exit point' at which to sell the portfolio.

The bank admitted it was in breach of contract in failing to implement the redemption request, but denied it was liable for more than nominal damages because Mr Chand's conduct in holding onto the portfolio constituted a *novus actus interveniens* breaking the chain of causation.

Mr Chand claimed that it was reasonable for him not to immediately sell the portfolio upon discovering the portfolio had not been sold. Due to the bank's processes, there was a two-day delay between the placing of an order to sell the portfolio and the portfolio being sold. This meant there was a variation between the value at the time the request was sent and the value that would be received. Chand claimed that he needed to evaluate the market due to these fluctuations to pick an appropriate 'exit point'.

He claimed that his methodology required one month of market analysis before picking an 'exit point'. He claimed he was 'stuck' in the market for that period. He further claimed that once this further month had expired, it was reasonable not to sell the portfolio because he needed to wait for dividends to be paid before the next appropriate 'exit point'. Mr Chand wanted to sell the portfolio in a rising market for an amount that was equal to or higher than the amount he would have received if the initial request had been processed. He retained the portfolio which lost the substantial part of its value during the GFC.

Chand claimed the difference in value between the amount he would have received for the portfolio had the bank actioned his initial request and the diminished value of his portfolio after the GFC.

Judgment

The court dismissed the appeal from Justice Robb's decision. The court held that:

- the investor had made a free, informed and deliberate decision to stay in the market;
- the decision to stay in the market was a *novus actus interveniens*, an intervening act; and
- the loss in value of the portfolio was caused by the investor's decision to stay in the market and not the bank's failure to process the request.

The court considered the reasonableness of the Mr Chand's decision not to reissue the request as relevant to determining whether a failure to do so was an intervening act. The court recognised that there could be circumstances in which a person may be 'locked in' to holding a depreciating asset, in which case it would not be unreasonable to retain the asset. However, Mr Chand was not 'stuck' in the market and had been able to reissue the redemption request and suffer minimal loss. It was unreasonable to cast the bank into the position of an insurer for any loss on the portfolio.

The case supports the proposition that a person's failure to reissue instructions to sell an asset, if unreasonable, can amount to an intervening act.

Ng v Filmlock Pty Ltd [2014] NSWCA 389

- > Breach of contract for the sale of land
- > Calculation of damages
- > Relevance of resale price

In this case, the NSW Court of Appeal dealt with the measure of damages for breach of contract in the sale of property.

Their Honours held that the failure to immediately sell property following a breach of contract for the sale of land, does not mean that the eventual resale value shall be held determinative of the loss suffered.

This case means that where no contractual provision exists to allow reliance upon the resale value of property for damages, a practitioner should attain an expert valuation of the land at the date of breach.

Facts

The purchaser breached a contract for the sale of land for \$7.21 million. The purchaser and guarantors became liable for the loss of the vendors. The vendors terminated the contract of sale for the purchaser's breach on 5 May 2008.

The vendors attempted to sell the property. They received offers but the only evidence provided was that they were at 'very low price points'. The property was eventually sold on 3 June 2009 for a value of \$3.1 million (as part of a larger sale). The appeal was between the vendors and the guarantors of the purchaser.

The question before the court was whether the damages for breach of contract in May 2008, could be calculated by reference to the resale value of the land in June 2009.

Judgment

The court held that the general rule for the quantification of damages was the difference between the contract price and the value of the land at the time of the purchaser's breach. In this case, the value of the property at 5 May 2008 needed to be ascertained.

The court rejected arguments that:

- the use of the resale price in the quantification of damages was justified because there was no market for the land at the time of breach; and
- the land value at 1 July 2008 for rating and taxing purposes could be used as evidence of the market value as at 5 May 2008.

While the trial judge could have taken into account the resale value 13 months after the breach in determining the value at 5 May 2008, he had not made any finding as to the value of the land at 5 May 2008. The vendors also did not plead this case at trial.

The court allowed the appeal and remitted the matter back to the trial judge to hear evidence as to the value of the land at 5 May 2008.

The court did not decide whether there may be circumstances in which it is appropriate to depart from the general rule. Justice Gleeson explicitly did not exclude the possibility that damages could be assessed to a later date (such as the date of resale).

This case is significant in emphasising the need for evidence as to the value of the property at the date of breach when calculating damages. If a party seeks to rely upon a resale value, it is important to emphasise this value as evidence of value at the date of breach.

Culleton v Dakin Farms Pty Ltd [2015] WASCA 183

- > Contract for lease and subsequent sale of land
- > Repudiation by lessee/purchaser of contract
- > Where lessor/seller established loss on leasing component of contract
- > Whether lessor/seller was only entitled to nominal damages in circumstances where they had not disproved the prospect of any benefit arising from the non-performance of the sale component of the contract.

This Western Australian Court of Appeal decision dealt with whether a lessor/seller, who had established loss on the leasing component of an agreement for the lease and sale of land, was still entitled to substantial damages in circumstances where it did not disprove the prospect of a benefit arising from the non-performance of the sale component of the agreement.

The court dismissed the appeal and held that the lessor/seller was still entitled to loss of bargain damages in the circumstances.

The case reinforces a number of established principles including that:

- once a plaintiff has established loss arising from breach of contract, it has a prima facie entitlement to substantial damages, and not just nominal damages;
- where a party sustains loss or damage by reason of breach of contract, that party should be placed in the same position (in the context of damages) as it would have been in had the contract been performed;
- conversely, a plaintiff is not entitled to be placed in a superior position than it would have been in had the contract been performed; and
- contractual obligations need not be dependent for all purposes.

Facts

Mr Lester was a director of Balwyn Nominees Pty Ltd. Balwyn owned a large area of farming land in Western Australia. Mr Culleton was a director of Elite Grains Pty Ltd which carried out a grain business on land in which Balwyn was the registered proprietor. Mr and Mrs Culleton (together, the **Culletons**) sought to acquire additional land to expand their operations. The Culletons became aware that certain land owned by Balwyn was for sale. The Culletons decided to purchase this land from Balwyn.

The Culletons and Balwyn entered into a written agreement on 16 December 2009. In summary, the relevant terms of the agreement included:

- the Culletons agreed to lease certain parts of land from Balwyn for a fixed term of one year commencing on 1 March 2010 and ending on 28 February 2011;
- total rent was \$500,000 (excluding GST) payable by quarterly instalments of \$125,000;
- the Culletons also agreed to purchase the majority of the land (including substantially all of the land it had agreed to lease from Balwyn); and
- the purchase price was \$13.2 million with a sum of \$6.5 million to be paid on 28 February 2011 and the balance price of \$6.7 million payable on 28 February 2012.

The Culletons eventually entered into possession of the land on 1 March 2010. However, on 15 March 2010, Mr Culleton delivered a letter to Mr Lester (of Balwyn Nominees) the contents of which, in effect, constituted a repudiation of the written agreement. On 16 March 2010, Balwyn accepted Culleton's repudiation and terminated the written agreement.

Balwyn sought damages of \$205,536 comprising the balance of the rent for the remainder of the lease (less any rent received from the reletting of the property) and a reletting fee. The Culletons contended that as the lease and purchase terms were interconnected, it was not proper for Balwyn to assess damages on the premise that these terms were entirely separate. The primary judge rejected this argument by the Culletons and awarded damages to Balwyn in the sum of \$205,536.

On appeal, the Culletons contended that Balwyn was only entitled to nominal damages. The Culletons again emphasised that the leasing agreement and the sale agreement were interconnected. They submitted that Balwyn had not adduced any evidence as to the amount of any loss or benefit accrued to Balwyn from the sale of the property. In those circumstances, the Culletons contended that Balwyn had not established an entitlement to an award for loss of bargain damages.

Judgment

Justice Murphy first considered the relationship between the leasing and sale components of the written agreement. His Honour considered that it was unlikely the parties had objectively intended for the contractual terms for the sale and purchase of the land to be performed independently of the performance of the contractual terms regarding the lease. This construction was supported by a number of considerations including:

- that if the Culletons had failed to perform their lease obligations, the parties would have hardly intended that Balwyn would remain obliged to hold land until the settlement date and then be willing to sell the land to the Culletons; and

- that it was unlikely that the parties would have intended that Balwyn could refuse to grant a lease but still require the Culletons to purchase the land in February 2011.

However, his Honour also noted that contractual obligations need not be dependent for all purposes. Conversely, Justice Murphy held that the parties could not have intended that the performance of the lease obligations, in turn, was dependent upon the performance of the sale and purchase component of the agreement. This was particularly the case where the lease obligations were to be performed prior to the obligations relating to the sale and purchase of the land.

If the Culletons had fulfilled their lease obligations, Balwyn would have received the rental benefits arising from the lease until 28 February 2011. They also would have been subject to the benefits and obligations created by the sale and purchase component of the agreement.

However, this was not the case. Justice Murphy held that Balwyn had proved that it suffered a loss by the Culleton's repudiation, including its loss of rent (less any net amount recovered by reletting). Balwyn had therefore established a prima facie entitlement to substantial damages, and not just nominal damages.

On the available evidence, Justice Murphy considered that there was no further onus on Balwyn to disprove that the repudiation by the Culletons conferred a windfall on Balwyn which equalled or exceeded its proved loss. In any event, there was no evidence to demonstrate that the damages awarded to Balwyn would have placed it in a superior position to that in which it would have been had the contract been performed.

The appeal was accordingly dismissed.



➤ Chapter 5: Dispute resolution clauses

Commercial agreements often include clauses which require disputes to be resolved by arbitration or expert determination. An issue which frequently arises is whether a party has any recourse should the arbitrator or expert make an error. In the case of arbitration, this issue is usually governed by legislation. In the case of expert determinations, however, the resolution of this issue will usually be a matter of contractual interpretation.

In *Australian Vintage Limited v Belvino Investments No 2 Pty Ltd*²⁶, the NSW Court of Appeal held that an expert applied the wrong formula in determining the impact of a severe frost on a commercial vineyard. The court then considered whether the parties were nevertheless bound by the expert's determination. The court held that if the expert had made an error in applying the correct formula then the expert's determination would nevertheless have bound the parties. In this case, however, the court held that the expert's error was in construing the relevant formula in the agreement. The expert therefore failed to carry out the task required by the contract.

The NSW Court of Appeal (overruling the trial judge) therefore sent the matter back to the expert to complete the task in accordance with the proper construction of the contract. In reaching this conclusion, the court acknowledged that experts may be required to determine mixed questions of fact and law, but rejected the primary judge's assertion that the construction of an expert determination clause was as much part of the expert's task as the application of the clause, and therefore not open to review by a court.

Although the court cited a number of authorities in the course of its judgment, the ability to challenge an expert determination is ultimately a matter of contractual interpretation. Parties should therefore consider whether they wish expressly to expand or narrow the grounds on which an expert determination might be challenged.

Australian Vintage Limited v Belvino Investments No 2 Pty Ltd [2015] NSWCA 275

- > Construction and interpretation
- > Expert determination pursuant to clause of contract
- > Whether decision of expert reviewable

In this decision, the NSW Court of Appeal considered the circumstances in which an expert decision made pursuant to a clause of a contract can be reviewed.

The NSW Court of Appeal confirmed that whether an expert's decision is reviewable depends on whether the expert's determination was made in accordance with the contract. The court held that the expert in this case had not made a determination in accordance with the contract and remitted the decision to the expert to remake in accordance with the court's instructions.

This case shows that where a contract contemplates referral of a matter to an expert for determination, practitioners should take care with how the tasks to be assigned to that expert are drafted, as this may impact on whether or not the expert's decision is final.

Facts

The contract in question was a lease for the development and operation of a commercial vineyard. One of the clauses in the lease provided that if a natural disaster occurred, and the parties could not agree on certain matters regarding the impact on grape production or necessary remediation, either party could refer the matter to an expert. The expert would make a determination as to a number of matters, including the calculation of the reduction of production or production capacity and the remedial work necessary to restore production capacity. If the expert determined that production or production capacity had reduced below a threshold amount, the lessee was entitled to terminate the contract.

In October 2013, a severe frost occurred in the area, substantially diminishing the production of grapes for the 2014 vintage year. The parties could not agree on the impact of the frost and in June 2014 the issue was referred to an expert as envisioned by the clause. In October 2014, the expert issued a final determination. The final determination included, among other matters, a determination that neither production nor production capacity had fallen below the threshold amount such as would entitle the lessee to terminate the contract.

The lessee brought proceedings in the Equity Division, seeking to have the expert determination set aside and declarations as to the correct construction of the clauses in question.

The primary judge dismissed the summons, holding that the expert determination was not reviewable and, even if it was reviewable, the expert had correctly made their determination.

Judgment

Chief Justice Bathurst (President Beazley and Justice McColl agreeing) allowed the appeal by the lessee, holding that the decision of the expert was reviewable and that the expert had not correctly made their decision as required by the contract. The court confirmed that if the expert in fact carried out the task they were contractually required to undertake, their decision would not be challengeable, regardless of whether the expert made an error or had regard to an irrelevant consideration. If however, it could be said that the expert did not perform the task he or she was contractually required to perform or rather performed some different task, or carried out the task in a way not within the contractual contemplation of the parties, objectively ascertained, then the determination would be liable to be set aside. This is despite any language to the contrary in the contract that the determination will be 'final and binding'.

The court held that the contract did not give the expert the decision making authority to determine the formula to use in calculating whether production or production capacity had fallen below the threshold amount. The court disagreed with the finding of the primary judge that, as a matter of law, any question of the construction of the clause is as much the task of the expert as the determination of facts and calculation of figures. As a consequence, while the expert had to choose a particular construction regarding the formula to be applied before proceeding to their calculations, the decision to choose a particular construction was not beyond review. The court held that the determination was reviewable and that the construction of the production formula chosen by the expert in this case was not correct having regard to the relevant provisions of the contract. The court allowed the appeal and remitted the decision to the expert to be remade in accordance with the court's instructions.

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