Allens › ‹ Linklaters

Allens Contract Law Update 2016

next ›

Introduction

'Is there a legally binding contract between the parties?' is one of the most fundamental questions in contract law. A surprising trend of appellate courts considering this question, which we first noted in our *Contract Law Update 2015*, continued in 2016. There were a number of cases in which appellate courts needed to consider whether, in the absence of a signed contract, there was nevertheless a binding contract between the parties. (See Chapter 1).

Another issue that attracted the attention of appellate courts was whether a court, when interpreting a contract, may only have regard to evidence of the surrounding circumstances (known to the parties) if the contract is, on its face, ambiguous. This issue has attracted a lot of judicial and academic interest since the decision of the High Court, in a special leave application, in *Western Export Services*[1]. During 2016, the NSW Court of Appeal firmly expressed the view that ambiguity is not required before a court may have regard to evidence of surrounding circumstances known to the parties. The Victorian Court of Appeal has, however, taken a different approach. These conflicting decisions are discussed in Chapter 2.

We also examine four cases decided by the High Court. The case that attracted the most attention was the second judgment of the High Court in the bank fees class actions[2] (see Chapter 3). The High Court's decision, and a subsequent decision by the NSW Court of Appeal, provide comfort that the High Court's restatement of the penalties doctrine in the first bank fees case will not lead to the floodgates opening on penalties litigation.

In Chapter 4, we consider an issue that often arises in practice: when does a party's breach of contract constitute a 'repudiation' of that contract? This is an important question, because a party which purportedly, but incorrectly, 'accepts' a repudiation, will usually itself thereby repudiate the contract. We also look at a recent discussion of principles of mitigation, which has become a controversial area following the High Court's decision in 2013 in *Clark v Macourt*.[3]

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

2 *Paciocco v Australia and New Zealand Banking Group Limited* [2016] HCA 28.

3 (2013) 253 CLR 1, discussed in our 2014 *Contract Law Update.*

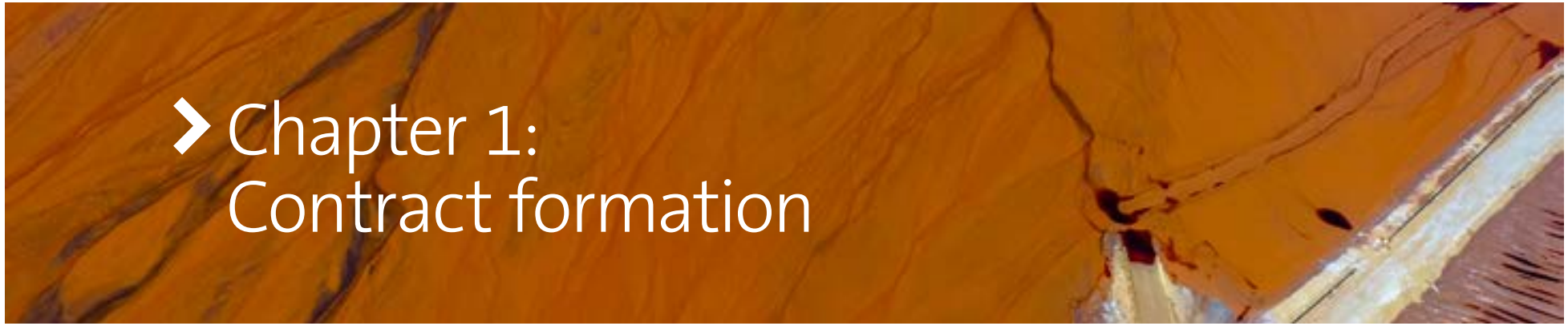
Table of Contents

Allens › ‹ Linklaters

- INTRODUCTION
- TABLE OF CONTENTS
- CHAPTER 1: CONTRACT FORMATION
- CHAPTER 2: INTERPRETATION OF CONTRACTS
- CHAPTER 3: PENALTIES
- CHAPTER 4: BREACH AND REPUDIATION
- WHO TO CONTACT

‹ back next ›

Allens › ‹ Linklaters



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. Three cases showed the difficulties for parties (in these cases, tenants) seeking to prove such an intention in the absence of signed contracts.

In *Crown Melbourne Limited v Cosmopolitan Hotel (Vic) Pty Ltd*[4], the High Court considered the legal effect of negotiations between a tenant and a landlord. The tenant was concerned about the cost of refurbishment, when its lease was for only five years with no option to renew. In response, Crown assured the tenant that it would be 'looked after at renewal time'. When renewal time came, however, Crown invited tenders for new leases and granted a lease to a different entity.

The High Court held that a reasonable person in the position of the parties would not have understood that the representations were intended to be binding. The representation was also too uncertain to be a binding contractual promise. The tenant's estoppel claim was also unsuccessful.

The NSW Court of Appeal considered similarly vague language in *OXS Pty Ltd v Sydney Harbour Foreshore Authority*[5]. The lessor told the lessee that it would be prepared to offer a new lease on 'commercial terms' but the lessor subsequently declined to renew. The court concluded that there was no intention to be legally bound by this correspondence, one reason being the absence of agreement on key commercial terms, such as the amount of rent.

A third case involving a dispute between a landlord and a tenant was the decision of the NSW Court of Appeal in the *Harold R Finger & Co Pty Ltd v Karellas Investments Pty Ltd*.[6] Once again, there was no signed agreement for lease. However, the parties did have a written heads of agreement that was stated to be legally binding. The same agreement, however, noted that certain key terms of the lease were still to be negotiated. The court resolved these apparently contradictory clauses by holding that the heads of agreement was legally binding, but that it was only a legally binding agreement to negotiate, rather than a legally binding agreement to grant a lease. The aspects of this judgment concerning the law of repudiation and mitigation of damages are considered in Chapter 4.

4 [2016] HCA 26.

5 [2016] NSWCA 120.

6 [2016] NSWCA 123.

Although the intention to be legally bound is usually evidenced by the affixation of a signature, the appearance of an electronic signature does not necessarily mean that the person whose e-signature appears did in fact agree to enter into a legally binding contract. The facts and decision of *Williams Group Australia v Crocker*[7] provide a cautionary lesson about reliance on e-signatures. The court at first instance had found that the relevant director did not know that his signature had been affixed to a guarantee. The court of appeal confirmed that he was therefore not bound by the guarantee. Although the facts of this case were a little unusual, they do suggest that persons relying on e-signatures should satisfy themselves that the person whose signature appears on a document has in fact consented to their signature being affixed.

Where parties have clearly entered into a legally binding agreement, there can still be uncertainty as to the terms of that contract. In *Doggett v Commonwealth Bank of Australia*[8], the Victorian Court of Appeal had to consider a guarantee that incorporated 'relevant' provisions of the Code of Banking Practice. There was a dispute between the parties as to whether a particular provision of the code was 'relevant' to the guarantee. Although the relevant provision obliged a lender to exercise care and skill in forming an opinion about the borrower's ability to repay the credit facility, the court held that the clause nevertheless also formed part of the guarantee. As a result of certain mistakes by the bank in assessing the ability of the borrower to repay the credit facility, the guarantor was therefore excused from its liability under the guarantee. A clear lesson from this case is the desirability of specificity when incorporating terms into a contract.

Another issue that frequently comes before courts is whether or not an agreement between parties is intended to replace an earlier agreement between them. This was particularly important in *Australia and New Zealand Banking Group Ltd v Manasseh*,[9] because the terms of a guarantee required the guarantor's consent to any replacement of the finance facilities. The Western Australian Court of Appeal held that an agreement in 2009 between the bank and borrower 'replaced' the original agreement, thereby excusing the guarantor from her liability.

Where a contract is formed by offer and acceptance, the 'acceptance' must correspond with the 'offer'. In *Secure Parking Pty Ltd v Woollahra Municipal Council*[10], the council purported to 'accept' a tender on different terms from the offer – the difference being whether the tenderer would provide a bank guarantee (as the council required in the contract it 'accepted') or a performance bond (as the tenderer offered in its tender). The 'acceptance' therefore failed to create a binding contract. A more difficult issue for the court was whether the tenderer's silence, in response to the purported acceptance, itself amounted to an acceptance of the obligation to provide a bank guarantee. The Court of Appeal, disagreeing with the trial judge, held that silence did not (on the particular facts of this case) amount to acceptance.

7 [2016] NSWCA 265.
8 [2015] VSCA 351.
9 [2016] WASCA 41.
10 [2016] NSWCA 154.

Crown Melbourne Limited v Cosmopolitan Hotel (Vic) Pty Ltd [2016] HCA 26

› Requirements for collateral contract and promissory estoppel

In this case, the High Court considered whether comments to the effect that a tenant would be 'looked after at renewal time' created a collateral contract requiring the landlord to renew leases for a further term.

In their majority judgment, their Honours held that the statement was not sufficiently promissory to amount to a binding agreement, and, in turn, that no collateral contract arose.

This case should provide comfort to parties engaging in contractual negotiations where vague statements encouraging the other party will not form a binding collateral contract unless they are specific and promissory in nature. Any agreement that a party intends to rely on should be put in writing and expressly stated to be legally binding.

Facts

Crown owns the Melbourne Casino and Entertainment Complex. In early 2005, the tenant entered into negotiations with Crown for new leases of two premises in the complex, which the tenant would subsequently run as restaurants. Both parties were experienced in negotiations of this kind.

The new leases offered by Crown were each for a five-year term, at the end of which Crown could either:

- notify the tenant the lease will be renewed, and on what terms;
- allow the tenant to occupy on a monthly tenancy; or
- require the tenant to vacate.

The new leases required the tenant to refurbish the premises. The tenant was concerned about the cost of refurbishment and asked Crown to commit to a further term of five years (an option to renew).

Crown refused to commit to a further term on the basis the leases were in standard form, but said the tenant would be 'looked after at renewal time'.

In late 2008, Crown invited tenders for new leases of the premises and the tenant put in tenders. In December 2009, Crown gave notice requiring the tenant to vacate, under the lease.

Judgment

The tenants claimed the representation created a collateral contract requiring Crown to renew the leases, or in the alternative, gave rise to an estoppel. By majority, the High Court found the tenants failed on both points.

Collateral contract

A collateral contract is a side agreement that induces a party to enter into the main contract.

A representation made in the course of negotiations may result in an agreement collateral to the main agreement if it can be concluded that the parties intended that the representation be binding.

Intention is judged objectively, so the question to ask is, 'what would a reasonable person in the position of the parties have understood to have been intended by the representation?'

The representation must amount to a contractual promise; the majority found that the statement that the tenants would be 'looked after at renewal time' did not amount to a binding contractual promise to renew the leases for a further term because it was not sufficiently promissory – the statement was no more than 'vaguely encouraging'.

Even if the representation had been promissory, it would not have created a collateral contract because the statement was too uncertain. There can be no enforceable agreement to renew a lease unless at least the essential terms of the lease have been agreed.

So, for example, had the statement been a promise to renew the lease for an additional five years on the same terms, this would likely have given rise to a collateral contract requiring Crown to renew.

Allens › ‹ Linklaters

Estoppel

Estoppel protects a party who relies, to their detriment, on an assumption that was induced by the other party. In this case the tenant argued it assumed it would be a offered a further lease because of the statement made by Crown that the tenant would be 'looked after at the renewal time'.

A statement must be capable of misleading a reasonable person, in the way that the person relying on the estoppel claims he or she was misled.

The majority found that the statement that the tenant would be 'looked after at the renewal time' is not capable of conveying to a reasonable person that the tenants would be offered a further lease. In turn, the statement did not satisfy the requirement of creating an assumption.

Keeping records

Issues relating to evidence were also relevant in this case. The tenant alleged there were various conversations in which representatives of Crown made representations about the renewal of the leases. The tenant was unable to convince the court of these. The court instead relied on the contemporaneous notes of the tenant's bank manager, who was present in one of the meetings between the tenant and Crown. This is an important reminder of the need to have written evidence of any agreement or key conversations.

Allens › ‹ Linklaters

OXS Pty Ltd v Sydney Harbour Foreshore Authority [2016] NSWCA 120

› Whether correspondence offering a lease on 'commercial terms' constituted a binding agreement for lease

In this judgment, the NSW Court of Appeal dealt with, among other issues, whether a concluded agreement for lease arose from an exchange of correspondence between the lessor and lessee.

The court upheld the primary judge's finding that no concluded agreement for lease existed. While the lessor had advised the lessee in writing that it was 'prepared to offer' the lessee a new lease on 'commercial terms', the court held that the commercial parties did not intend to be bound by the informal correspondence. Therefore, the proposal for a lease on 'commercial terms' was not sufficiently certain to form a concluded agreement.

This case provides a useful reminder for both lessors and lessees that during lease negotiations the parties must ensure that their correspondence and conduct expressly reflect their intentions. In the event a party receives correspondence that suggests otherwise, it is important to respond and clarify the position. Lessors and lessees should also note that an enforceable agreement for lease should at least stipulate the essential terms of the proposed lease.

Facts

The respondent, Sydney Harbour Foreshore Authority as lessor, leased a premises in Sydney to the appellant, OXS Pty Ltd as lessee. The lessee requested a 10-year extension of the lease and the parties exchanged the following correspondence regarding the request:

in February 2011, the lessor advised the lessee that it was 'prepared to offer' the lessee a new 10-year lease 'on commercial terms at the prevailing market rate', provided that the lessee lodged a development application and entered into an outdoor seating licence with the lessor. The lessee responded and purported to accept the offer, stating 'please advise when the new lease will be made available for review' (together, the ***February correspondence***);

- in August 2011, the lessor advised the lessee that the Minister 'has indicated that he will not consent to the proposed lease' and the lessor 'withdraws its offer';
- in September 2011, the lessee asserted that the February correspondence constituted an enforceable agreement for lease;
- in August 2012, the lessor again confirmed that it would not 'enter into any negotiations for a new lease' until the DA and seating licence issues were resolved. By November 2013, the lessee addressed the DA and licence issues; and
- in December 2013, the lessor confirmed that the lease would not be renewed.

The lessee commenced proceedings against the lessor and the Minister seeking, among other things, specific performance of the alleged agreement for lease or, alternatively, damages on the basis that the lessor had breached the alleged agreement. At first instance, Justice Black held that no binding agreement for lease existed and dismissed the lessee's claim.

The lessee appealed against the decision. A key issue on appeal was whether there was a concluded agreement for lease. The court primarily examined the parties' intentions and the certainty of the terms of alleged agreement when considering this issue.

Allens › ‹ Linklaters

Judgment

Did the parties intend to enter into binding agreement for a lease in the terms of the February correspondence?

The court unanimously held that the parties did not intend to be bound by the February correspondence.

Where parties have been negotiating contractual terms and the negotiations are subject to further documentation, the case may belong to one of four categories previously identified by the High Court in *Masters v Cameron* [1954] HCA 72 and in *Baulkham Hills Private Hospital Pty Ltd v GR Securities Pty Ltd* (1986) 40 NSWLR 622 (set out in the table below).

Category	Description	Test	Intention / Binding contract	February correspondence
First	Agreement subject to documentation	Parties have reached final agreement on the terms of their contract and agree to be immediately bound but wish to restate those terms in a more precise way in a formal document.	Intention to be bound Binding contract	Lessee argued that the February correspondence fell into the first or fourth category.
Second	Performance subject to execution of contract	Parties have reached final agreement on all the terms and intend not to depart in any way from them, but the performance of some part of the contract is made conditional on the execution of a formal contract.	Intention to be bound Binding contract	
Third	No agreement unless document executed	Parties intend there is no concluded contract unless and until a formal document is executed.	No intention to be bound No binding contract	Lessor argued that the February correspondence fell into the third category. The court held there was no intention to be bound.
Fourth	Agreed terms to be substituted by further contract	Parties are content to be bound immediately and exclusively by the terms which they had agreed upon while expecting to make a further contract in substitution for the first contract, containing, by consent, additional terms.	Intention to be bound Binding contract	Lessee argued that the February correspondence fell into the first or fourth category.

The court held that the parties did not intend to be bound by the February correspondence, which was supported by the following factors:

- the context of the words 'prepared to offer' suggested that parties only intended to be bound by the terms of a formal lease, not the February correspondence. It was unlikely that the parties intended to be bound by the informal consensus in the February correspondence considering:
  - a formal written contract offered advantages to both parties having regard to the subject matter of the contract (a lease of land and a licence of an outdoor area) and the status of the lessor (being a statutory authority which required ministerial consent to a lease exceeding a five-year term);
  - Interestingly, in *ANZ v Ciavarella* [2003] NSWCA 304, the words 'prepared to offer' were found, in context, to reflect an intention to be bound. The opposing interpretations of the phrase highlight the importance of considering the commercial context and prior dealings of the parties when determining the parties' intentions.
- the lack of specificity in critical terms, such as initial rent;
- the proposed new lease was offered on 'commercial terms' rather than the 'same terms'. The court held that the reference to 'commercial terms' was significant, as it suggested that the lessor intended to decide the terms of the lease after further negotiation;
- the lessee requested that the lessor provide a draft lease for review, which suggested the lessee reserved its rights to negotiate further terms; and
- the lessor invited the lessee to call the lessor, which suggested that further discussion regarding the lease would occur before the parties intended to be bound to an agreement.

Was a proposal for a lease on 'commercial terms' sufficiently certain?

The court unanimously found that the February correspondence was not sufficiently certain primarily because of the lack of precision in the expression 'commercial terms'. There is a wide variety of terms in a leasing transaction that could be described as 'commercial'. The parties had not agreed to enter into a lease on the 'same terms', nor had they agreed on any essential or critical terms. The lack of precision in the reference to 'commercial terms' was not able to be overcome by a process (such as arbitration or valuation) or a formula. Nor was it possible for the court to determine the 'normal commercial terms'.

The court concluded that there was no binding agreement for lease because the parties did not intend to enter into a binding agreement for lease and the February correspondence lacked certainty. The appeal was dismissed.

Allens › ‹ Linklaters

Harold R Finger & Co Pty Ltd v Karellas Investments Pty Ltd [2016] NSWCA 123

- Agreement to negotiate in good faith
- Repudiation
- Mitigation of damages

This NSW Court of Appeal decision dealt with the issues of repudiation and avoided loss in respect of a binding agreement to negotiate in good faith.

The court held that acceptance of a letter of offer gave rise to a binding agreement to negotiate in good faith to enter into a formal agreement for lease/lease. That agreement was not repudiated by one party's refusal to proceed with the proposed lease on the then proposed terms.

This case highlights the issues that can arise with respect to agreements to negotiate in good faith. In particular, parties should exercise caution before assuming a right to terminate for repudiation: unless a party has conveyed an unequivocal intention to cease negotiations and not honour its obligations under the contract, termination for repudiation may be invalid.

In addition, the case highlights the importance of careful drafting in drawing up agreements for lease. Where such a document contemplates further negotiation as to terms, it may not constitute a valid lease agreement but rather an agreement to negotiate.

Facts

The appeal involved a dispute between Finger & Co, the owner of supermarket premises in Newtown, and the prospective lessee of those premises, Karellas Investments Pty Ltd.

In January 2010, after some preliminary discussions, Finger & Co accepted a letter of offer from Karellas, described as a binding heads of agreement. The letter of offer also stated, however, that a number of terms required to be included in the proposed agreement remained to be agreed between the parties.

In June 2010, following a period of negotiation during which the parties provisionally agreed on lease terms that represented a significant departure from the terms set out in the heads of agreement, Karellas notified Finger & Co that it would not be proceeding with the proposed lease 'on the current proposed terms' as they were not viable for the business. It indicated that it was prepared to continue negotiations to see if the proposed lease terms could accommodate its concerns.

Finger & Co asserted that this amounted to repudiation of the contract and, in August 2010, notified Karellas that it accepted the repudiation and terminated the contract. Finger & Co subsequently leased the premises to another entity and carried out a development of residential units on the first floor, which were sold at a profit.

At first instance, Justice Robb dismissed Finger & Co's claim for damages. Although Karellas had repudiated the contract in June 2010, by the time Finger & Co expressly terminated the contract in August 2010 it was itself not ready and willing to perform by reason of its refusal to renegotiate. Accordingly, its termination of the contract was invalid.

Finger & Co appealed his Honour's findings as to the invalidity of its termination of the contract and the assessment of damages. Karellas filed a notice of contention, arguing that his Honour had erred in finding that there was a binding contract and, if there was, that Karellas had repudiated it.

Judgment

The main issues on appeal were:

- whether acceptance of the letter of offer gave rise to a binding contract between the parties;

- whether Karellas' refusal to proceed 'on current proposed terms' amounted to a repudiation justifying termination by Finger & Co; and
- the principles to be applied in quantifying damages where Finger & Co had derived a benefit from termination.

The court held that:

- the agreement between the parties was best characterised as a binding agreement to negotiate in good faith to enter into a formal agreement for lease/lease on the terms set out in the letter of offer and additional terms to be agreed between the parties. The parties were bound to enter into a formal agreement for lease/lease on the terms set out in the letter of offer if, and only if, agreement was reached regarding the additional required terms within 12 months. There was no enforceable contractual lease and Finger & Co could not call for specific performance by requiring Karellas to execute an agreement for lease;
- Karellas' letter of June 2010 did not amount to a repudiation of that agreement because it invited further negotiation. Viewed objectively, Karellas' communications did not convey an intention not to honour its obligations (to negotiate in good faith) under the agreement. Accordingly, Finger & Co did not validly terminate the agreement in August 2010; and
- even if Karellas' conduct did amount to a repudiation and Finger & Co had validly terminated the agreement as a result, it would not have been entitled to any damages for loss.

Applying the avoided loss principle, the court found that the benefit derived by Finger & Co was a direct consequence of the termination of the agreement: Finger & Co's ability to redevelop the first floor of the building as it saw fit flowed from it no longer being bound by the terms of the agreement. The benefit was sufficiently close to the claimed head of damages to be an appropriate set off against it.

Williams Group Australia Pty Limited v Crocker [2016] NSWCA 265

- Electronic signature affixed to application and guarantee without director's knowledge or authority
- Whether director bound by application of principles of ostensible authority

This NSW Court of Appeal decision considered whether a guarantee purportedly signed by e-signature without the guarantor's knowledge was validly executed.

The Court of Appeal upheld the first instance decision, finding there was no sufficient ground for a finding of ostensible authority, nor was the contract ratified. The guarantee was therefore not binding.

E-signatures, like all methods of executing documents, are not immune from fraud, forgery or unauthorised use. Those relying on e-signatures need to assess the risk of an unauthorised signature being affixed.

Facts

A director of a company (using a platform described as 'HelloFax') put in place a system so that directors could sign documents electronically on behalf of the company. He set up user names and passwords for the other directors, including a Mr Crocker. Mr Crocker did not change his password.

A supplier supplying goods on credit to the company sent a credit application to be signed by the company, and by each director individually as a guarantor. It was signed through the system purportedly by a director on behalf of the company and by each director (including Mr Crocker) individually as guarantor, but actually it was signed by persons unknown.

Typically, the system would email signatories informing them that a document was to be signed, and email them once the document was signed. But there was no evidence that such emails were sent, or if sent, were received and read by Mr Crocker. The system also kept a list of documents signed by Mr Crocker, which was available when he logged on. He did log on in connection with other transactions before and after the purported signing.

The company defaulted and the supplier sued Mr Crocker under the guarantee, claiming that he was bound because it was executed with his actual or ostensible authority and in any event he had ratified it.

At first instance, the supplier failed. The court found Mr Crocker was not bound. There was no actual authority, the system was only set up for use by signatories on behalf of the company, not Mr Crocker as an individual. Nor was there ostensible authority, as there was no holding out by Mr Crocker. The mere fact that he had not changed the password was not a holding out. There is case law (including High Court authority) cited by the supplier to the effect that a company, by setting up its organisational structure, can institutionally hold out officers or employees as having authority. But that did not have any application in this case where the principal was an individual. There was no ratification because Mr Crocker had no knowledge of the guarantee.

Judgment

The court held there was no ostensible authority. Nothing moved from Mr Crocker. His mere use of the system as a director did not amount to a holding out so as to bind him personally. The reasonableness of the supplier's conduct is not relevant in the absence of representational conduct by Mr Crocker.

Mr Crocker had insufficient knowledge for a ratification. On the facts, there was no knowledge, nor wilful shutting a blind eye to the obvious which might constitute knowledge. There is no evidence that emails referring to the document were received. And, though when he subsequently used the system Mr Crocker would have seen a list of signed documents, even if he had read the list it would have only referred to the relevant document as a 'credit application'.

While ratification is not available for forgeries, and there is some authority that the placement of a 'genuine' electronic signature on the document without any authority could amount to forgery at common law, the court did not need to decide that issue in this case.

Allens › ‹ Linklaters

Doggett v Commonwealth Bank of Australia [2015] VSCA 351

› Whether certain provisions of Code of Banking Practice incorporated into guarantees

This Victorian Court of Appeal decision dealt with the incorporation of a clause of the Code of Banking Practice into guarantees.

Their Honours held that the terms of the guarantees, which purported to incorporate 'relevant' provisions of the Code of Banking Practice, incorporated the obligation on a bank in clause 25.1 to exercise the care and skill of a diligent and prudent banker in forming an opinion about a borrower's ability to repay a credit facility. The ability of the borrower to repay was the contingency upon which each guarantors' ultimate liability depended, and so a promise by the bank as to the level of care it would exercise in assessing the borrower's ability to repay was significant to the guarantees. On that basis, their Honours held that clause 25.1 was a 'relevant' provision and a term of the guarantees.

Banks should specify any provisions of the Code of Banking Practice that are incorporated into their contracts.

The obligation to exercise the care and skill of a diligent and prudent banker in forming an opinion about a borrower's ability to repay a credit facility may be owed to the borrower as well as any guarantors of the borrower's debts. Guarantors will therefore be able to sue the bank for failing to adequately assess a borrower's capacity to repay the guaranteed debt and, if a breach is found, reduce or avoid their liability.

Facts

The appellants owned investment properties in a complex known as 'Trickett Gardens' in the Gold Coast, Queensland. In 2008, they incorporated a company called 'Dogvan' and used it to purchase the management rights of Trickett Gardens for $1.15 million and the manager's apartment for $350,000.

Dogvan financed the entire purchase with a loan from the Commonwealth Bank. The bank was a party to the 2004 Code of Banking Practice (the ***Code***), clause 25.1 of which provided that the lender would 'exercise the care and skill of a diligent and prudent banker...in forming our opinion about your ability to repay the credit facility' before offering a borrower a loan. The appellants both executed guarantees of Dogvan's obligations, and they intended that the loan would be funded by income from the management rights business.

Occupancy rates and rentals fell after the global financial crisis, and it became clear that the management rights business was undercapitalised and could not trade profitably. That was partly because the appellants, in contrast to the sellers, did not operate the business themselves and needed to employ salaried managers. At the time of entering into the loan, the bank had material available to it that showed that the business could not operate profitably.

The appellants made numerous complaints about the bank's conduct, but the bank wrote to the appellants threatening that it would enforce its securities if the appellants did not sign a release. On 6 April 2010, they signed a letter compromising their claims against the bank in return for the bank making certain payments, reducing charges and making other accommodations for them.

Despite the accommodations made by the bank, the management rights business defaulted and the bank sued on the guarantees. The appellants argued that the Code was incorporated into the guarantees, and they had the benefit of clause 25.1, even though it appeared to be addressed to the borrower rather than the guarantors.

The trial judge agreed and held that the bank breached clause 25.1. However, he held that the release of liability in the 6 April 2010 letter was effective and not obtained under economic duress. The appellants appealed.

Judgment

The appeal was dismissed. The appellants were successful on their arguments concerning the incorporation and effect of clause 25.1 of the Code, and the Court of Appeal held that the bank had breached it. However, the Court of Appeal held that the release of liability in the 6 April 2010 letter of compromise was effective and had not been obtained under duress.

Clause 25.1 of the Code required the bank to exercise the care and skill of a diligent prudent banker in considering the borrower's ability to repay the loan. Although in making that assessment, the bank may have regard to the financial position of any guarantors or third parties, the unambiguous terms of the clause meant that the bank's obligation to exercise care and skill applied to its consideration of Dogvan's ability to repay the loan only.

The test for incorporation of terms taken from another instrument

The guarantees stated that 'Relevant provisions of the Code of Banking Practice apply to this guarantee'. The Court of Appeal held that clause 25.1 was a 'relevant provision' by applying the two-step process of incorporation of words taken from another instrument:

- construe the incorporating clause to decide on the width of incorporation; and
- read the incorporated words into the contract to see whether parts of the incorporated wording must nevertheless be rejected as inconsistent or insensible when read in their new context or whether they conflict with the expressly agreed terms in any way.

The first step

The Court of Appeal applied a rule that had developed in bills of lading cases to read down the general words of incorporation used in the guarantees by reference to the subject matter of the obligations and transactions for which the guarantees provided. The obligations in question were the agreement of the appellants to guarantee that Dogvan would repay its loans to the bank until those amounts had been repaid in full, and that the bank would give credit to Dogvan in return.

The Court of Appeal said that the ability of a borrower to repay the loan was the contingency upon which each party's ultimate liability depended. The bank's conduct in assessing the borrower's ability was therefore of the utmost significance to the parties to the guarantee. The Court of Appeal held that, as a result, a promise by the bank as to the level of care it would take in making that assessment was 'relevant' and was therefore incorporated into the guarantees.

The second step

The bank argued that the reference to 'you' and 'your' in clause 25.1 referred only to the party to the contract into which clause 25.1 was incorporated. Therefore, 'you' and 'your' in the guarantees could not be read as referring to Dogvan because it was not a party to the guarantees. On that argument, the bank would only owe a duty to 'you' (the guarantors) to exercise the required level of skill and diligence in assessing 'your' (the guarantors') ability to repay the credit facility, which would give clause 25.1 no sensible operation.

The Court of Appeal did not accept the bank's arguments. It pointed to the broad definition of the words 'you' and 'your' in the Code and held that, as a result, they readily included Dogvan when incorporated into the guarantees, just as when incorporated into the bill facility. This was despite the fact that the guarantees warned the guarantors to make their own inquiries as to the borrower's financial position.

Allens › ‹ Linklaters

Breach

The Court of Appeal held that the bank breached clause 25.1. Although the Court of Appeal found that the relevant bank officer gave detailed consideration to the borrower's position, he made two key mistakes: he incorrectly assumed a deposit had been paid, and he failed to recognise that an accountants' report on the business did not take account of the fact that the appellants, unlike the seller of the business, would have to pay wages of managers and therefore could not trade profitably.

The majority (Justices Whelan and Garde) upheld the trial judge's finding that the bank's breach caused the loss because, had the bank adhered to the care and diligence required by clause 25.1, the loan and the guarantees would not have been made. Justice McLeish dissented on that point because, in his Honour's view, that could not be established on the evidence.

The offer of compromise

The appellants signed a letter on 6 April 2010 compromising their claims against the bank. The letter indicated that if the appellants did not accept the settlement proposal, the bank would defend any action brought against it by the appellants and possibly proceed with the enforcement of its security.

The Court of Appeal held that the compromise letter extended to a dispute regarding the bank's breach of clause 25.1, even though the appellants were not aware at the relevant time that they had such a claim. The appellants' complaints had been about the unaffordability of the loan, which the Court of Appeal interpreted as claims of a failure by the bank to undertake proper cash flow analysis or to properly assess Dogvan's capacity to repay. Therefore, the terms of the letter seeking to compromise 'claims/accusations that have been alleged' extended to a claim for breach of clause 25.1.

The appellants argued that the 6 April 2010 letter was signed by the appellants under economic duress. Economic duress vitiates an agreement where that agreement is induced by illegitimate economic pressure. Pressure involving or threatening unlawful acts such as breach of contract is prima facie illegitimate, and lawful pressure may be illegitimate where there is no reasonable or justifiable connection between the pressure applied and the demand. In this case, the Court of Appeal held that, even though Dogvan's financial situation was difficult, the bank was entitled under the contract to enforce its security. Therefore, the pressure was not illegitimate and the release of liability was effective.

Australia and New Zealand Banking Group Ltd v Manasseh [2016] WASCA 41

› Whether amendments to facility bind guarantor

This Western Australian Court of Appeal decision considered whether a guarantor who did not consent to a change to the underlying obligations was still bound by the guarantee in respect of the changes.

The court unanimously found that the guarantor was not bound by the guarantee in these circumstances.

This judgment highlights the importance of lenders ensuring they obtain the appropriate consent of any guarantors when replacing or varying a financial obligation the subject of a guarantee.

Facts

Ms Manasseh guaranteed the repayment obligations of Vivaldi Investments Pty Ltd under a finance facility agreement between Vivaldi and ANZ. Under the guarantee, Ms Manasseh's consent was required if a new agreement was to be covered by the guarantee or the agreement was to be replaced or changed in a way that increased her liability.

In November 2009, Vivaldi and ANZ agreed to increase the facility limit and fees payable by Vivaldi, extend the facility's term and reduce the applicable interest rate (the ***2009 Agreement***). Ms Manasseh did not consent to the 2009 Agreement.

Vivaldi defaulted on the agreement and ANZ sought to call on the guarantee.

The primary judge found that the 2009 Agreement was a new agreement and, as a result, Ms Manasseh's consent was necessary to make her liable under the guarantee. The primary judge also found that the 2009 Agreement increased Ms Manasseh's liabilities under the guarantee such as to discharge her from her obligations. Consequently, the primary judge concluded that ANZ could not enforce the guarantee against Ms Manasseh.

Judgment on appeal

Was the 2009 Agreement a new or replacement agreement?

The court noted that, under the terms of the guarantee, as Ms Manasseh had not consented to the 2009 Agreement, the guarantee would not apply to that agreement if it was a new or replacement agreement. The court first concluded that, as the 2009 Agreement was not separate from and additional to the original agreement, it could not be a 'new' agreement.

President McLure and Justice Buss then proceeded to consider whether the 2009 Agreement replaced the original agreement, noting that this depended on whether the parties intended the variation to terminate and replace the original agreement or merely to alter it without affecting its existence. This intention was said to be ascertained from an objective consideration of the terms of the 2009 Agreement and the surrounding circumstances. From such a consideration, their Honours concluded that the 2009 Agreement was intended to be an exhaustive statement of all the terms and conditions governing the facility and the rights and obligations of ANZ and Vivaldi. Consequently, it was found that the 2009 Agreement replaced the original agreement and, as a result, Ms Manasseh's consent was required. As Ms Manasseh had not consented, her obligations under the guarantee were discharged.

Justice Murphy took the alternative view that 'replacement' signifies an agreement that rescinds any earlier agreements. His Honour found that the 2009 Agreement merely varied the original agreement rather than rescinding it, as it did not explicitly provide for the termination of the original agreement or the advance of any new funds. Consequently, his Honour concluded that the 2009 Agreement was not a replacement agreement and did not require Ms Manasseh's consent on that basis.

Allens › ‹ Linklaters

Did the 2009 Agreement increase the liability of the guarantor?

The court accepted the equitable principle that a guarantor will be released from their obligations under a guarantee if the principal loan agreement is varied in a way that is not insubstantial or incapable of prejudicing the guarantor without the guarantor's consent: *Ankar Pty Ltd v National Westminster Finance (Australia) Ltd* (1987) CLR 549. The court also accepted that the application of this principle had been modified by agreement in this case, with the consequence that Ms Manasseh would only be released from her obligations if a variation increased her liability under the guarantee.

Justice Murphy concluded that the variations affected by the 2009 Agreement had the effect of increasing Ms Manasseh's liabilities under the guarantee by virtue of the fact that Vivaldi's obligations to ANZ were increased under that agreement, particularly through the imposition of additional fees. His Honour also found that ANZ had not proven that the increase in liabilities was insubstantial or incapable of prejudicing the guarantor. On this basis, his Honour held that Ms Manasseh's consent had been required and therefore that she would be discharged from her obligations under the guarantee.

While it was not necessary for President McLure or Justice Buss to consider this question, their Honours held that the increased liabilities under the 2009 Agreement were offset by the reduction in interest payable and therefore that, overall, Ms Manasseh's liabilities did not increase.

Allens › ‹ Linklaters

Secure Parking Pty Ltd v Woollahra Municipal Council [2016] NSWCA 154

- Whether tender and subsequent correspondence gave rise to binding contract
- Whether party entitled to accept a repudiation

This NSW Court of Appeal decision considered whether or not the communications between a tender offeror and offeree resulted in the creation of a binding contract and, if there was a binding contract, whether the offeree was entitled to terminate the contract for repudiation.

The court allowed Secure Parking's appeal from the Supreme Court and held that the communications between Secure and the Woollahra Municipal Council during the tender process for the management of a number of car parks did not create a binding contract, and that, even if a binding contract had been created, it would not have been open to the council to terminate the contract for repudiation.

This case provides an example of the level of certainty required for a contract to be formed from the acceptance of a tender offer, at least in the context of a council working within the parameters of a legislation-governed tender process.

Facts

The key facts and communications that took place during the tender process and leading up to the council's notification of acceptance of Secure's tender offer are set out below.

- In November 2010, the council issued an invitation for tender for the management of any or all of four car parks located around Sydney. One of the attachments to the invitation for tender was a 'draft management agreement' (***DMA***) (which included a 'DRAFT' watermark on each page).
- The DMA provided that the successful tenderer should deliver to the council an 'Initial Bank Guarantee' for each car park.
- In December 2010, Secure submitted its tender.
- During a meeting between members of the council's tender evaluation panel and two senior executives from Secure on 16 February 2011, one of the executives explained that, on direction from the board, Secure would not provide a bank guarantee but could offer a 'performance bond'. A panel member responded that the council could only accept a bank guarantee. The Secure executive said again that Secure could not offer a bank guarantee. The meeting ended with the issue of the bank guarantee being unresolved.
- Despite the conversation that occurred during the meeting on 16 February 2011, in an email dated 28 February 2011, the council sought to increase the amounts of each guarantee to cover an equivalent of three months of the total guaranteed income as tendered by Secure. Secure responded the same day saying it was 'happy' to agree to a 'Performance Guarantee Bond' for the amount of two months. The panel member responded saying he would 'put a requirement of 2 months Bank Guarantee ... in my report to Council'.
- The council passed a resolution on 14 March 2011 to 'accept' Secure's tender offer and to amend the bank guarantees as recommended. The council notified Secure of its acceptance the following day. Attached to the communication of acceptance was an amended draft management agreement that incorporated the council's proposed changes to, among other clauses, the bank guarantee clause. Relevantly, for reasons that will become clear, an email from the council to Secure the same day also said, 'The Agreement has been amended only to reflect the Council resolution passed ...'. A letter from the council's solicitors given to Secure the same day also said words to the same effect. It was on this date, 15 March 2011, the council believed a binding contract had been formed.

- Secure did not respond to the communication of acceptance. The council eventually notified Secure on 9 March 2012 that it would terminate the contract it believed had been formed on 15 March 2011 for repudiation unless Secure acknowledged the existence of the contract and began performing its obligations under it, and, on 8 June 2012, the council purported to terminate the contract for repudiation.
- The council commenced proceedings against Secure seeking a declaration of the existence of the contract and validity of its termination, and damages for loss of the benefit of the contract. The council alleged in the alternative that Secure had engaged in misleading or deceptive conduct before and during the tender process by representing that it intended to enter into the management contract should its tender be accepted.

The legislation

Under s55 of the *Location Government Act 1993* (NSW), the council was required to undertake the tender process before entering into any car park management contract, and to conduct the tendering process in accordance with Part 7 of the *Local Government (General) Regulation 2005* (the ***LGR***).

Regulation 176 of the LGR permitted certain variations to a tender by an offeror when either requested to by the council or with the council's consent. Importantly, regulation 176(4) prohibited the council from considering a variation if it would 'substantially alter' the original tender.

Judgment

Did the communications create a binding contract?

The court found that no contract had been formed. In coming to this decision, the court had to deal with three primary issues:

- whether Secure had varied its tender offer so as to increase the amounts of the bank guarantees;
- whether the council's communicated acceptance of Secure's tender corresponded with Secure's offer; and
- whether the parties had agreed to a commencement date for the management of the car parks, which was a requirement of the tender conditions.

With respect to the first issue, the court found there was no agreement to vary the tender offer in this way. It said there was 'a difference of substance between a performance bond and a bank guarantee' (at [47]), and that the primary judge had erred in finding that Secure's silence conveyed its agreement to accept the council's requirement for a bank guarantee for an amount equal to two months' guaranteed income (at [48]).

The court reiterated the principle that for silence to constitute the acceptance of a contractual offer there must be other circumstances which, taken with the silence, objectively convey that the offer has been accepted, and that the relevant test is whether a reasonable bystander would regard the conduct of the offeree as signalling to the offeror that their offer has been accepted (at [48]) (citing *Empirnall Holdings Pty Ltd v Machon Paull Partners Pty Ltd* (1988) 14 NSWLR 523). The court's view was that Secure's conduct, in the circumstances, did not convey that it agreed to the requirement for a bank guarantee of two months' guaranteed income, and therefore that Secure's offer was not varied in that respect (at [56]). Resolving this issue was critical to the determination of the exact content of Secure's offer, and therefore also critical to the second issue of whether the council's acceptance corresponded to Secure's offer.

With respect to this second issue, the court found that the primary judge had erred in holding that the council's communicated acceptance of Secure's tender corresponded with Secure's offer, because the terms of the tender purportedly accepted by the council included the provision of bank guarantees for two months' guaranteed income, but Secure's offer was not amended to include this undertaking (at [67]). Ultimately, the council erred in accepting Secure's tender offer before important issues related to the terms of the agreement were resolved.

The third issue of whether the parties had agreed to a commencement date is tied very closely to the specific facts and circumstances of this case. Clause 3.1.2 of the tender required that the successful tenderer/s must, within 14 days from the council's notification of acceptance, agree on a commencement date for the management agreement.

It was not disputed that the parties had not agreed on a fixed day of commencement, but the council contended that it was an express term of the management agreement that the parties would agree on a commencement date and that this term was contained in the invitation for tender. The council further contended that, failing such an agreement, the commencement date would be a date within a reasonable time after notification of acceptance by way of an implied-by-law term or as a question of fact so as to give business efficacy to the agreement.

The court found that the obligation to agree to a commencement date within 14 days was not an express term of the DMA; rather, it was an obligation imposed by clause 3.1.2 of the tender, and that, in the absence of that obligation being an express term of any purported contract, there was no basis in law for what the council pleaded was the implied term (at [74]). While less relevant to the key issue of offer and acceptance in this case, this issue demonstrates the importance of parties adhering to the obligations imposed upon them by the terms of a tender.

Could the council have terminated the contract?

The court held that, if a contract had been formed, the council would not have been able to terminate the contract for repudiation. Applying the principle that a party seeking to terminate an agreement before the time for performance on the basis of renunciation by the other party must establish that, up to that time, it was ready and willing to proceed with the contract and to perform the agreement for its part (citing *Foran v Wight* (1989) 168 CLR 385), the court explained that, in its view, the council was, by way of its letters sent in 2012, insisting that Secure execute and perform the amended management agreement, which included changes that had not been agreed upon, rather than the DMA. Therefore, the court said, the council was not ready and willing to perform the contract which the primary judge held existed between the parties (at [87]-[89]).

Allens › ‹ Linklaters

Chapter 2: Interpretation of contracts

One of the most contentious issues in Australian contract law is the extent to which a court may, when interpreting a contract, have regard to evidence of surrounding circumstances known to the parties. This issue is contentious because there appear to be two inconsistent lines of authority in High Court cases. One line of authority has its origin in the so-called 'true rule' stated by Justice Mason in *Codelfa*[11]:

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

This 'true rule' is sometimes said to prevent a court from having regard to surrounding circumstances, when interpreting a contract, unless the contract is, on its face, ambiguous.[12]

On the other hand, there is a line of authority – including a High Court decision in 2016 in *Victoria v Tatts Group Limited*[13] – in which the High Court has stated a general principle that, when construing a contract, a court should have regard to the context and purpose of the contract, and that evidence of surrounding circumstances may assist. These authorities have not stated that regard to surrounding circumstances is only permissible if the contract is, on its face, ambiguous.

11 *Codelfa Construction Pty Ltd v State Rail Authority of NSW* [1982] 149 CLR 337.

12 It is arguable that, when read in context, Justice Mason was not intending to state a rule in these terms.

13 [2016] HCA 5.

In *WIN Corporation Pty Ltd v Nine Network Australia Pty Ltd*[14], the NSW Court of Appeal expressly addressed the 'potential' tension between these two lines of authority. The court held that the 'true rule' did not in fact prevent the admission of evidence of surrounding circumstances when interpreting a contract. The same court took a similar approach in *Zhang v ROC Services (NSW) Pty Ltd*.[15] However, in *Apple and Pear Australia Limited v Pink Lady America LLC*[16] the Victorian Court of Appeal took a different approach, and held that a court should not have regard to evidence of surrounding circumstances unless a contract was, on its face, ambiguous. We are therefore still waiting on the High Court to resolve this issue, although it has to date shown a reluctance to do so.

Evidence of surrounding circumstances cannot be used to contradict the clear words of a contract. If the surrounding circumstances show that parties intended a different meaning from the unambiguous language that they in fact used, it may, however, be possible to obtain an order of rectification. In *Simic v NSW Land and Housing Corporation*[17], the High Court held that a performance bond that named the incorrect entity as a beneficiary could not be interpreted so as to require the bank to pay the intended beneficiary instead. The court did, however, rectify the bond so that the correct entity's name was inserted in place of the incorrect name.

The clear words of a contract are not necessarily the same, however, as the literal meaning of a contract. In *Zhang*[18], the majority of the NSW Court of Appeal rejected the insurer's interpretation of an exclusion clause, which appeared to accord with the literal meaning of that clause (having regard to the placement of commas in the clause), on grounds that included the haphazard use of commas elsewhere in the policy.

It is well accepted that, when interpreting a clause of a contract, a court may have regard to other clauses in the contract. In *Gee Dee Nominees Pty Ltd v Ecosse Property Pty Limited*[19], the Victorian Court of Appeal considered conflicting indications, in the contract itself, as to the parties' intention. One clause in the contract expressly stated the parties' intention in a manner that was inconsistent with the deletion (apparent on the face of the contract) of certain words from a different clause in the contract. The court adopted an interpretation which, arguably, was inconsistent with the stated, commercial intent of the contract. The High Court has granted special leave to appeal against this decision and is likely to deliver its judgment on the matter in 2017.

14 [2016] NSWCA 297.
15 [2016] NSWCA 370.
16 [2016] VSCA 280.
17 [2016] HCA 47.

18 *Zhang v ROC Services (NSW) Pty Ltd* [2016] NSWCA 370.
19 [2016] VSCA 23.

Victoria v Tatts Group Limited [2016] HCA 5

› Construction of terms in light of context and purpose

This High Court decision considered whether the Tatts Group was entitled to a contractual payment after the Victorian Government restructured the gaming industry.

The court allowed the appeal and held that Tatts was not entitled to the contractual payment.

This case serves as a reminder that contracts between government and commercial entities will often not be able to protect commercial entities against legislative change.

Facts

In 1991, the Victorian Government issued TAB and Tatts Group with gaming operator's licences for 20 years, effectively creating a duopoly in the gaming industry. After TAB was privatised, the state granted it a statutory right to payment if a new licence was not granted after its licence had expired. At the same time, the state also entered into a contract with Tatts (the ***Agreement***) which provided Tatts with a right to payment 'if its gaming operator's licence expires without a new gaming operator's licence having issued to Tatts'. The Agreement also provided that 'no amount would be payable if a new licence was not issued at all, or was issued to Tatts, or a related entity of Tatts'.

In 2008, the state restructured the gaming industry, granting 27,500 gaming machine entitlements (***GMEs***) to smaller venue licence holders. As part of these changes, the licences granted to TAB and Tatts were not renewed. Tatts then issued proceedings, seeking $490 million in compensation under the Agreement.

The primary judge ordered the state to pay Tatts more than $450 million plus interest. The court found that Tatts was entitled to receive payment as the state had issued new licences (in the form of GMEs) after Tatts' licence had expired. A reasonable business person would understand the phrase 'new licence' to refer to the issue of any licence substantially similar to Tatts' existing licence. This decision was confirmed by the Court of Appeal.

Judgment

The High Court overturned this decision and found that Tatts was not entitled to payment, as no 'new licence' had been issued. The reference to a 'licence' in the Agreement was narrow and referred to a licence under the Gaming Act of 1993, not GMEs.

A reasonable business person reading the agreement and related documents would understand the phrase 'new licence' to refer to a right to participate in the duopoly. In arriving at this decision, the court considered that:

- the purpose of the Agreement was to compensate Tatts for loss of investment, if a new person was granted a licence to participate in the duopoly;
- the Agreement incorporated a letter from the Treasurer stating that the gaming licence granted to Tatts was a concurrent right with Tabcorp to conduct gaming for a fixed period; and
- the rights granted under the GMEs were limited to a venue operator's licence, and were limited in effect and value, both geographically and functionally, when compared with the value of the authority conferred on Tatts and Tabcorp under the legislative regime that sustained the duopoly.

Tatts would be entitled to compensation if a new gaming licence was issued to another person, providing them with a similar commercial advantage to Tatts' gaming licence. However, as the rights under the GMEs were more limited, Tatts was not entitled to payment under the Agreement.

WIN Corporation Pty Ltd v Nine Network Australia Pty Ltd [2016] NSWCA 297

› Interpretation of 'exclusive licence' to 'broadcast' programs

This NSW Court of Appeal decision considered whether the Nine Network was prevented from live-streaming television programs for which it had granted WIN an exclusive licence to broadcast over its free-to-air transmission television channels. The court held that Nine was not so restricted.

This case demonstrates that when determining if a party has breached an implied term to: (a) do all things necessary for the other party to have the benefit of the contract; and (b) refrain from doing anything that would deprive that party of that benefit; there is no obligation to maximise the other party's return on the contract. Rather, the court will look at the scope of the relevant duty and define the obligations and the circumstances in which the parties have agreed that they be performed.

The court reaffirmed the previous decisions of the High Court that extrinsic evidence of pre-contractual negotiations is only admissible in limited circumstances, including if it assists in establishing objective facts known to the parties, or if there is a phrase or expression that is ambiguous or susceptible of more than one meaning then evidence of surrounding circumstances can be considered.

Facts

- WIN Corporation Pty Ltd is a regional free-to-air television station that held an exclusive licence to carry Nine Network Australia Pty Ltd programs until June 2016. The relevant licences were governed by a series of program supply agreements (***PSAs***).
- The question to be determined on appeal was whether the PSA precluded Nine from 'live-streaming' the same content so that it could be accessed within the WIN areas at the same time as it could be received by WIN's free-to-air transmission.

Judgment

- Justice Barrett, with whom the other judges agreed, held that the PSA did not prevent Nine from live-streaming. Free-to-air broadcasting was the only form of dissemination of the programs that the PSA contemplated.
- In commenting on whether the parties could adduce extrinsic evidence, he held that, in accordance with the recent decision of the High Court in *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* (2015) 256 CLR 104, a contract should be construed by an objective consideration of its text, context and purpose. This should be done by considering what a reasonable business person would apprehend the contract's terms to mean, the contract's commercial purpose and the circumstances the contract addressed. Extrinsic evidence should only be considered if it assists in establishing the objective facts known to the parties. Justice Barrett further held that, where there is a phrase or expression that is ambiguous or susceptible to more than one meaning, then evidence of surrounding circumstances can be considered. Applying well-established principles, Justice Barrett held, however, that it was impermissible to have regard to extrinsic evidence of the parties' pre-contractual negotiations.
- Regarding the term that WIN argued was implied by law – that Nine would do all things necessary for WIN to have the benefit of the PSA, and not do anything that would deprive WIN of that benefit – Justice Barrett held that no breach of that term had occurred. He held that, to assess the scope of the implied term, the relevant PSA obligations must be defined. Therefore, a party is not obliged to maximise the other party's return from the contract. In this case, the PSA required that Nine not undertake free-to-air transmission of its programs within the WIN licence areas, and ensure that Nine did not allow others to do so. The relevant benefit to WIN under the PSA was the right to transmit the Nine programs over its free-to-air channels without competition from others. Therefore, preventing Nine from live-streaming would impose a restriction on Nine and a benefit on WIN over and above those created by the contract. Nine was not obliged to maximise WIN's return from the contract.

Zhang v ROC Services (NSW) Pty Ltd; National Transport Insurance by its manager NTI Ltd v Zhang [2016] NSWCA 370

› Whether court could depart from grammatically correct interpretation of insurance contract

This NSW Court of Appeal decision dealt with the construction of an exclusion clause in an insurance contract relating to motor vehicles.

The court held that an insurance limitation clause did not apply in circumstances where the insurer sought to rely on the absence of a comma in the clause. Justice Leeming, with Justices Macfarlan and Sackville in agreement, held that the insurer was unable to rely on the punctuation in circumstances where the punctuation was haphazard throughout the policy. Instead, the court had regard to the commercial and statutory context of the policy, finding that the exclusion clause did not apply.

This case shows that courts will sometimes adopt interpretations that are not consistent with the grammar or punctuation used in the relevant clause. In particular, where punctuation in the contract is used haphazardly, a court will be less willing to accept submissions based on a careful reading of a clause's punctuation.

Facts

The plaintiff, Mr Zhang, was seriously injured when the weld attaching a hydraulic ram supporting a metal ramp to a stationary trailer failed. The incident occurred at Port Botany.

Mr Zhang sued the fleet insurer of the driver of the truck pulling the trailer, known as National Transport Insurance (***NTI***), along with the driver of the truck, the company which installed the hydraulic ram, and the owner of the trailer.

At first instance, the primary judge found NTI liable under the insurance policy, and rejected NTI's submission that the following exclusion applied in the policy:

> We will not pay: (8) for any liability for death or bodily injury arising out of or in any way connected with a defect in Your Motor Vehicle or in a Motor Vehicle, but in Queensland only if it causes loss of control of the vehicle whilst it is being driven;
>
> except where such Motor Vehicle is a Queensland registered backhoe, end loader, forklift, mobile crane or hoist or other mobile machinery, and the death or bodily injury occurs whilst such Motor Vehicle is, on land which is not designated as a road according to law, or in a public place

Critically, the primary judge held that clause was ambiguous, because it was not clear whether the words 'whilst it is being driven' applied to all the preceding words, or just the words after the first comma. Accordingly, after giving consideration to the statutory context of the provision, and the haphazard grammar within the policy as a whole, the judge applied an interpretation favourable to the insured, and held the clause did not operate to exclude liability.

NTI appealed, arguing that the clause was unambiguous. It submitted that, on a fair reading of the words, there was a single meaning, which was that the words 'whilst it is being driven' applied only to the words after the comma.

Judgment

Justice Leeming (with Justices Macfarlan and Sackville agreeing) upheld the findings of the trial judge in relation to the construction of clause 2(b)(8).

In his judgment, Justice Leeming took the opportunity to set down and clarify some established principles of contractual interpretation:

- it is critical, in the construction of a complex contractual provision, that the starting point is to determine the literal and grammatical meaning or meanings of the clause. This exercise is a matter of English, not a matter of law [53];
- while there is no 'sharp line' between determining the grammatical meaning and determining the legal meaning, it is 'vital to bear in mind the range of potential meanings which the clause is capable of sustaining, and to have some appreciation for how natural or strained those potential meanings are, at the time one turns to the balance of the contract and the surrounding circumstances and purpose and object' [77];

- the legal meaning of a text is not inevitably the most natural literal or grammatical meaning [82]. Where 'there is one available legal meaning, a court looks at the text, context and purpose, with a view to determining which potential meaning best accords with those considerations. Sometimes, text, context and purpose point in different directions. But it remains necessary to assess the potentially available legal meanings against those matters.' [86];
- a party seeking to tender documents as evidence of surrounding circumstances in order to establish the legal meaning 'ought to be able, readily and precisely, to identify how it is said that its reception will bear on the process of ascertaining the legal meaning of a clause' [81];
- in establishing the legal meaning, it is not necessary to first identify ambiguity before resorting to the legislative or wider contractual context which a policy or contract is written [99]. This can be distinguished from the requirement for a 'genuine ambiguity' to arise before applying the *contra proferentem* maxim; and
- consistent with the High Court's decision in *Victoria v Tatts Group Ltd* [2016] HCA 5, evidence of surrounding circumstances can be considered in determining whether a phrase or expression is ambiguous or susceptible of more than one meaning. However, it does not follow that the evidence of surrounding circumstances will be of assistance and relevance [80].

Justice Leeming then engaged in a close grammatical examination of clause 2(8)(b), along with an examination of its commercial and legislative context.

NTI submitted that there was no ambiguity in the clause, and its punctuation was clear. NTI argued that the natural and grammatical meaning of the clause was such that it excluded liability in relation to accidents caused by vehicle defects. In dissent, Justice Macfarlan agreed with NTI's submission in relation to punctuation, and found that NTI was entitled to rely on the exclusion clause.

However, Justice Leeming disagreed, noting that:

- it is impossible to conclude, as a matter of grammar, that the third phrase in clause 2(8)(b) beginning with 'it has been driven' necessarily qualifies the second phrase (beginning with 'In Queensland') and not the first phrase (beginning with 'we will not pay') [69]; and
- while grammar and punctuation can be used to resolve ambiguity in some circumstances, in the case of this policy, it does not assist, as grammar was used haphazardly in the contract as a whole, and including within clause 2(8)(b) [74].

Having resolved that a grammatical reading of the clause would not resolve the matter, Justice Leeming considered the contract and the clause within the context of s5 of the *Queensland Motor Accident Insurance Act 1994*, and s3A of the *NSW Motor Accidents Compensation Act 1999*.

After giving some consideration to the differences between these schemes, his Honour concluded that nothing within these statutory schemes could justify a construction of clause 2(8)(b) that would seek to limit stationary defect liability throughout Australia, except in Queensland [133]. His Honour was influenced by the fact that NTI's construction appeared capricious and uncommercial, given that NTI's construction would mean that injuries caused by a defect in a vehicle in Queensland are not excluded by the policy, whereas those in any other state are excluded.

Justice Macfarlan (in dissent) held that the wording of clause 2(8)(b) was most likely based on the Queensland statute, and that the use of the same language as the Queensland statute is a 'strong indication' that the same meaning was intended for clause 2(8)(b), being that the words 'while it is being driven' in the statute relate directly to 'a defect in the motor vehicle'.

Finally, Justice Leeming considered the application of the *contra proferentem* rule. While Justice Leeming considered it unnecessary to rely on this maxim, his Honour nevertheless held he would come to the same conclusion on construction had the maxim been applied.

Justice Sackville agreed with the interpretation of Justice Leeming, noting that the clause still had 'work to do' with Justice Leeming's interpretation, given that there would be a number of circumstances where liability could arise, notwithstanding the fact that the defective vehicle in question was not being driven at the time.

Apple and Pear Australia Limited v Pink Lady America LLC [2016] VSCA 280

› Admissibility of surrounding circumstances for purpose of construction of trademark licensing agreement

This Victorian Court of Appeal decision dealt with the interpretation of a trademark licensing agreement and whether surrounding circumstances are relevant to the interpretation of that agreement in the absence of ambiguity on the face of the agreement (in light of recent High Court and intermediate appellate court decisions).

The court disagreed with the recent decisions of the NSW and WA Courts of Appeal which suggested that the High Court in *Woodside* had determined that recourse could be had to surrounding circumstances without identifying ambiguity in the words of the contract.

This decision marks another twist in the ongoing controversy about the admissibility of evidence of surrounding circumstances to interpret commercial contracts. As the position remains unresolved by the High Court, and there are now conflicting intermediate appellate decisions, practitioners will need to take care in advising clients on whether extrinsic material can be used to interpret the meaning of a commercial contract, particularly where the contract is otherwise clear on its face.

Facts

Apple and Pear Australia Limited (***APA***) is an Australian industry body responsible for the development of the Cripps Pink variety of apple that is sold internationally under the brand name 'Pink Lady'. Pink Lady America LLC (***PLA***) is the entity licensed to sell 'Pink Lady' apples in the United States and Mexico.

APA and PLA fell into dispute over the registration of 'Pink Lady' trademarks in Chile, a major producer and exporter of Cripps Pink apples. PLA had filed applications to register three specific 'Pink Lady' trademarks in Chile and APA opposed this application on the basis that it owned the 'Pink Lady' copyright and was the international licensor of the brand.

To resolve the dispute, APA and PLA eventually entered into an Option Deed that provided for:

- PLA to assign the Chilean trademarks, once registered, to APA; and
- APA to grant PLA an exclusive, perpetual licence to use those trademarks in Chile.

The trademarks which were subject to the Deed were clearly identified in a schedule to the Deed by reference to their trademark application numbers.

After the Option Deed had been entered into, the parties fell back into dispute. A new 'refreshed' trademark had been developed for the 'Pink Lady' brand to replace the existing trademarks and APA had this 'refreshed' trademark registered in Chile in its name. PLA argued that the Option Deed should be interpreted to cover the replacement trademark, despite the fact that it was not identified in the Schedule to the Deed.

Judgment

At first instance, the trial judge accepted that the definition of 'Trade Mark' in the Option Deed encompassed the 'refreshed' trademark on the basis that it was a perpetual agreement and interpreting the agreement to only cover the existing trademarks would lead to an absurd result. Importantly, in coming to this conclusion, the trial judge relied on evidence that at the time the Option Deed was entered into both parties knew that a 'refreshed' trademark was being developed and that the trademarks listed in the Schedule to the Option Deed would thereby be superseded.

The trial judge's reliance on evidence of surrounding circumstances (including pre-contractual negotiations) to interpret an agreement that was otherwise clear on its face was argued by APAL to be inconsistent with the 'gateway' or 'threshold' requirement that ambiguity must first be established before evidence of surrounding circumstances can be admitted. This principle was allegedly established by Justice Mason in *Codelfa Constructions Pty Ltd v State Rail Authority (NSW)* (1982) 149 CLR 337, and approved in the special leave hearing for *Western Exports Services Inc v Jireh International Pty Ltd* (2011) 282 ALR 604.

The existence of the 'gateway' requirement has long been contentious. The more recent High Court case of *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640 had been taken by other intermediate appellate courts as a rejection of the 'gateway' requirement. In particular, in *Technomin Australia Pty Ltd v Xstrata Nickel Australasia Operations Pty Ltd* (2014) 48 WAR 261 and *Mainteck Services Pty Ltd v Stein Heurtey SA* (2014) 89 NSWLR 633, the Western Australian and New South Wales Courts of Appeal respectively have held that Woodside was inconsistent with Jireh and that evidence of surrounding circumstances was admissible to interpret a commercial contract, including to determine whether particular provisions of a contract were ambiguous. The recent High Court decision of *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* (2015) 256 CLR 2014 declined to resolve the controversy.

Reviewing the previous decisions, Justice Tate (with whom Justices Ferguson and McLeish agreed) disagreed with *Technomin* and *Mainteck* that *Woodside* and *Jireh* were necessarily inconsistent, in particular because in *Woodside* there was a clear ambiguity in the language of the contract so that the 'gateway' question did not arise. She held that she was required to follow her interpretation of the High Court's decision in *Codelfa* and not be 'indirectly bound' by other intermediate appellate courts' interpretations of that decision.

Citing the more recent High Court decision in *Mount Bruce*, which expressly did not seek to resolve the 'gateway' question, Justice Tate said:

> It would be wrong to conclude that the High Court has endorsed an approach to the construction of commercial contracts, whereby the surrounding circumstances, including, relevantly, pre-contractual negotiations, can invariably be relied upon to assist construction.

and later:

> ...it does not follow from...Woodside...that it is now permissible to take into account surrounding circumstances in the construction of a commercial contract either to determine whether a term of the contract is ambiguous or in the absence of any ambiguity.

As a consequence, Justice Tate rejected the trial judge's interpretation of the Option Deed. He held that the agreement identified the trademarks to which it applied by numerical identifiers which were 'quintessentially unambiguous'. Her Honour also rejected that such a literal interpretation of the Option Deed would lead to an absurd result. PLA still received some commercial benefit out of the agreement and it was not part of the court's role to construe an agreement that otherwise has an explicable commercial result in a manner that increases the commercial benefits to one party to the agreement.

In the end, however, Justice Tate did not need to finally decide the contentious 'gateway' issue, as she found that, in this case, even if the surrounding circumstances were considered, they did not properly support the trial judge's interpretation. A reasonable person in the position of the parties would have understood that the purpose of the Option Deed was to resolve the disagreement that had arisen with respect to the three specific trademarks identified in the Schedule.

Simic v New South Wales Land and Housing Corporation [2016] HCA 47

› Reference to non-existent entity in performance bond: construction and rectification

In this judgment, the High Court dealt with the principles of construction applying to performance bonds and the availability of remedies to correct errors in these instruments.

The court held that it was not possible to construe the undertakings to overcome the incorrect reference to the beneficiary. However, it ordered that the undertakings be rectified so that each referred to the corporation. As a result, ANZ was bound under the performance bonds to pay the corporation.

This decision reinforces the importance of precision and accuracy in the drafting of performance bonds and other similar financial instruments. In particular, it is clear from this decision that:

- where such a bond does not correctly identify the beneficiary, the intended beneficiary will not generally be able to make a claim under the bond;
- courts will construe such bonds according to their terms, and independently of any related commercial contract or agreement; and
- where a bond does not reflect the parties' true agreement as a result of a 'common mistake', a court may rectify the bond to conform with the actual or true common intention of the parties. However, the court will only make such an order where it is clear that the terms of the agreement do not reflect the parties' actual common intention, viewed objectively from their words or actions.

Facts

Nebax Constructions Pty Ltd entered into a construction contract with New South Wales Land and Housing Corporation (the ***Corporation***). On Nebax's instructions, ANZ issued two instruments, each in the form of an unconditional promise to pay (the ***Undertakings***), in which the named beneficiary of the bond was incorrectly named as 'New South Wales Land & Housing Department' (rather than the Corporation, who was the party with which Nebax had entered into the construction contract). The Corporation subsequently made a demand for payment under each Undertaking. ANZ did not pay the demands because the Corporation was not the named beneficiary.

The issues before the court were whether it was possible to construe the Undertakings as being in favour of the Corporation instead of the incorrectly named beneficiary, or alternatively, if this was not possible, whether the Undertakings should be rectified so that each referred to the Corporation.

Judgment

The court held that it was not possible to construe the Undertakings to overcome the incorrect reference to the beneficiary. However, it ordered that the Undertakings be rectified so that each referred to the Corporation. As a result, ANZ was bound under the performance bonds to pay the amount under the bond to the Corporation.

The court reasoned as follows.

- It was not possible to construe the Undertakings as referring to the Corporation because, inter alia:
  - the Corporation and the government department incorrectly identified in the Undertakings as the beneficiary were legally distinct entities;

  - the principle of autonomy and considerations of commercial reality (discussed further below) meant that the Undertakings were to be construed according to their terms, and independently of the related construction contract;
  - the Corporation had the opportunity to review the Undertakings to determine whether the instruments satisfied Nebax's obligation to provide security under the construction contract and, having failed to do so, it was appropriate that the Corporation should bear the costs of any errors in the instruments; and
  - the principle of strict compliance meant that the issuer was entitled to only accept documents that complied strictly with the requirements stipulated in an instrument of that nature.
- In holding that the Undertakings should not be construed as referring to the Corporation, the court was particularly swayed by considerations of 'commercial reality'. In issuing a banking instrument, an issuer relies upon, and acts in accordance with, the instructions of the applicant. To hold that such instruments should be construed by reference to the underlying commercial contracts they serve would undermine the status of the performance bonds as being 'equivalent to cash'. This is because, among other things, it would require issuers to undertake further inquiries to confirm the correctness of the written instrument before paying on the bond.
- However, in finding that the Undertakings should be rectified, the court held that the unusual facts of the case clearly demonstrated a 'common intention' held by Nebax and ANZ that the Undertakings should provide security for the entity with which Nebax had entered into the construction contract (the Corporation). This was because, at the time the applications were completed and given to ANZ, Nebax told ANZ that it had obtained a contract with the entity trading as 'Housing NSW' (the Corporation's trading name at the relevant time) and that the Undertakings were required for the purposes of that underlying commercial contract. That the written instrument named the incorrect beneficiary was therefore as a result of a 'common mistake' held by ANZ and Nebax as to the name of Nebax's counterparty to the construction contract.

Gee Dee Nominees Pty Ltd v Ecosse Property Pty Ltd [2016] VSCA 23

- Contractual interpretation
- Significance of struck out or deleted words, and of statements of parties' intent

This Victorian Court of Appeal decision dealt with the contractual interpretation of a standard form lease where certain deleted clauses remained legible and the parties had inserted a statement of subjective intent.

Justices Santamaria and McLeish held that struck-out words in a standard form lease containing ambiguous clauses could be used to negate an alternative possible construction. The statement of subjective intent was useful as background to the commercial context of the contract but was not decisive.

The decision clarifies the role struck-out or deleted words may play in contractual interpretation, as an aid to construing ambiguous language. Special leave to appeal to the High Court of Australia has been granted, which may shed further light on the role of statements of subjective intent and the concept of commerciality in the construction of contracts.

Facts

The case concerned the proper construction of the terms of a 99-year lease. The parties had extensively amended a standard form 'farm lease' by striking out various parts, which remained legible in the executed document.

The key issue was whether the tenant was liable to pay the costs of rates, taxes, assessments and outgoings levied to the landlord. The trial judge had decided that the tenant was liable for all such payments, including land tax, which had been struck out from the original agreement. The tenant appealed this finding.

It was common ground that the relevant clause of the lease directed to this issue was ambiguous. Accordingly, it was open to the court to have regard to the surrounding circumstances known to the original contracting parties at the time the lease was executed.

The parties submitted that the surrounding circumstances included the fact that the leased land was intended to be sold by one party to the other but that this could not be achieved due to planning restrictions. The lease was said to have been a mechanism to indirectly achieve the substance of the parties' agreement. This intention was set out in a clause that had been added to the standard form lease. The agreed rent for the period ($70,000 paid in advance) was said to be more or less equivalent to the market freehold value of the leased land.

Judgment

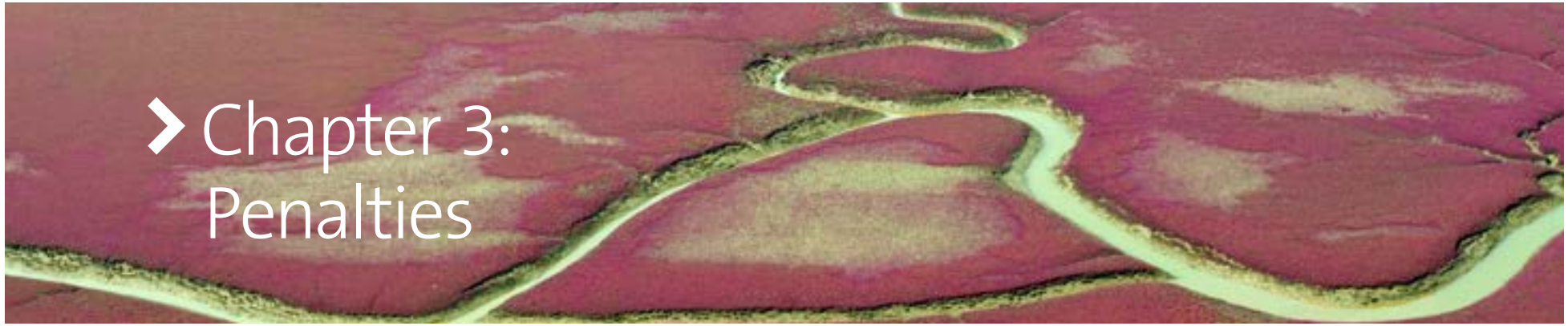
The court allowed the appeal and found that the tenant was only liable to pay rates, taxes, assessments and taxes payable by the tenant. The mere fact that the words 'landlord or' had been struck out from the relevant clause did not impose an obligation on the tenant to pay all rates etc. which arose in relation to the land. Moreover, Justice McLeish considered the clause outlining the subjective intent of the parties to be useful by way of background only.

The case is significant because it considers the role of deleted words in construction of ambiguous terms of a contract. Justice McLeish noted that deleted words can be considered a 'secondary, even if not strictly extrinsic, material' and can be used as an aid to construction without forming part of the language being construed.

The High Court of Australia granted special leave to appeal in *Ecosse Property Holdings Pty Ltd v Gee Dee Nominees Pty Ltd* [2016] HCATrans 231.

Key issues for the High Court will be the role of statements of subjective intent in contractual interpretation and the role that the concept of commerciality has to play in cases of ambiguity.

Allens › ‹ Linklaters



Chapter 3: Penalties

In 2012, the High Court held that the penalty rule was an equitable doctrine as well as a contractual doctrine.[20] One consequence of this judgment was that the penalties doctrine was not limited to penalties that were imposed for a breach of contract.

At the time, there were fears that the restatement of the penalty rule might lead to a significant number of contractual clauses being found to be penalties. Two appellate decisions during 2016 suggest that these fears will not be realised.

In *Paciocco v Australia and New Zealand Banking Group Limited*[21], the High Court handed down another judgment in the bank fees class actions. The High Court held that credit card late payment fees were not penalties because the fees were not 'out of all proportion' to the interests that ANZ was seeking to protect. Importantly, the High Court held that the legitimate 'interests' that might be protected by a putative penalty are not limited to interests that could be compensated by an award of damages in court proceedings. ANZ's legitimate interests in this case included its increased operational costs, loss provisioning and increased regulatory capital costs.

A similar approach was subsequently taken by the NSW Court of Appeal in *Arab Bank Australia Ltd v Sayde Developments Pty Ltd*[22]. The court held that a default interest rate of 2 per cent, charged on the entire balance for so long as the customers were behind in monthly payments, was not a penalty, having regard to the costs of provisioning and the increased credit risk from customers in breach.

In light of these judgments, the rule against penalties arguably now has, in some respects, a narrower operation than it did before the bank fees class actions began.

20 *Andrews v ANZ Banking Group Limited* [2012] 247 CLR 205.

21 [2016] HCA 28.

22 [2016] NSWCA 328.

Paciocco v Australia and New Zealand Banking Group Limited [2016] HCA 28

› Whether late payment fees were penalties or otherwise unconscionable

The High Court held that late payment fees charged on credit card accounts were not a penalty and were not unconscionable, unjust or unfair under the relevant statutory prohibitions.

This decision provides welcome clarity on the application of the penalty rule. It permits parties to agree on contractual clauses that protect a broader array of 'legitimate interests' without running the risk that those clauses will be found to be penalties.

Facts

The appellants held credit card, savings and business deposit accounts with ANZ. Between September 2008 and July 2013, ANZ charged the appellants 'Exception Fees' (being late payment fees, overlimit fees, honour and dishonour fees and non-payment fees). The appellants alleged that:

- the contractual terms that entitled ANZ to charge the Exception Fees were penalties; and
- the fees charged were unjust transactions under the National Credit Code, were unfair terms under the *Fair Trading Act 1999* (Vic) and the *Australian Securities and Investment Commission Act 2001* (Cth) and that ANZ engaged in unconscionable conduct under these same acts.

At first instance, Justice Gordon held that the credit card late payment fees were the only fees that were penal in nature. She dismissed the statutory claims.

On appeal, the Full Federal Court overturned the finding in relation to late payment fees, but otherwise upheld Justice Gordon's findings. The Full Federal Court found that the late payment fee was neither extravagant nor unconscionable when compared with the greatest conceivable loss flowing from the breach.

Judgment

Chief Justice French and Justices Kiefel, Gageler and Keane dismissed the appeal. Justice Nettle, in dissent, would have allowed the appeal on the ground that the late payment fees were penalties.

The relevant question for the High Court was the applicable test to determine whether a sum paid on default is to be characterised as a penalty.

The majority held that the overarching test is whether such a sum is 'out of all proportion' to the interests of the party that it is the purpose of the provision to protect. These interests may be of a business or financial nature. Importantly, the 'interests' are not confined to damages that might be recoverable in court proceedings.

The majority noted that late payment impacted on ANZ's interests in three areas: operational costs, loss provisioning and increases in regulatory capital costs.[1] As these costs were greater than the fee imposed, the fee was not a penalty.

The High Court also confirmed its decision in *Andrews v Australia and New Zealand Banking Group Ltd*[2] that the penalty rule is an equitable, as well as a contractual, doctrine. The High Court disagreed with a recent decision of the UK Supreme Court, which described this as a 'radical departure from the previous understanding of the law'.[3]

1 *Paciocco v Australia and New Zealand Banking Group Limited* [2016] HCA 28, [58].
2 (2012) 247 CLR 205.
3 *Cavendish Square Holding BV v Makdessi* [2015] 3 WLR 1373, 1396 [41].

Allens › ‹ Linklaters

Justice Nettle dissented. He was influenced by the fact that the payment fee was fixed regardless of whether the late payment is 'serious or trivial with respect to time or amount'.[4] Unlike the majority, Justice Nettle held that Justice Gordon was correct to assess 'greatest recoverable loss' by reference to what would be recoverable as unliquidated damages.[5] His Honour found that ANZ's costs of loss provisioning, regulatory capital and some operational costs could not be taken into account because, in many cases, they were future costs not actually incurred by ANZ and therefore would not have been recoverable in court proceedings.

The statutory appeal

The High Court also dismissed the appeal in respect of the statutory causes of action. The majority held that ANZ's conduct was not unconscionable, unjust or unfair, having regard to ANZ's legitimate interests, which were not limited to losses occasioned by the appellants' breach.

4 *Paciocco v Australia and New Zealand Banking Group Limited* [2016] HCA 28, [348] (Justice Nettle).

5 *Paciocco v Australia and New Zealand Banking Group Limited* [2016] HCA 28, [340]-[341] (Justice Nettle).

Arab Bank Australia Ltd v Sayde Developments Pty Ltd [2016] NSWCA 328

› Whether default interest, payable when monthly payments were not made within time, are a penalty

This NSW Court of Appeal judgment considered whether default interest payable under a commercial loan facility (when monthly payments were not made within time) constituted a penalty following the High Court's restated approach to the doctrine in *Paciocco v ANZ*.

The court held that the default interest rate in question (the regular interest rate plus 2 per cent) was not a penalty because it was not extravagant or out of all proportion.

There have been many cases in which the courts have upheld relatively high default interest margins (within limits) for interest charged on overdue amounts. This case, however, concerned a provision under which the interest rate on the entire principal stepped up to a default interest rate on the occurrence of an 'event of default'.

This decision applied a commercial approach, it swept aside the distinction between major and minor breaches and it applied principles in Paciocco to look at the overall interests of the bank, and its general costs, and not just the specific operational costs arising from the breach.

Facts

A corporate customer had a commercial loan facility agreement with a bank for an interest only loan. Under the agreement, if the customer was late in making monthly payments, then for so long as the default continued, default interest would accrue at a higher default interest rate on the entire principal, not just on the overdue amounts. This applied whether or not the bank accelerated repayment of the loan, and irrespective of the amount or how long it had been in default. The default interest rate was an additional 2 per cent above the regular interest rate.

This approach was different from the old 'higher rate/lower rate' approach – long upheld by the courts (so far) – of providing that interest would accrue at a 'higher rate' (equivalent to the default interest rate) but reduce to a 'concessional' lower rate (equivalent to the normal rate) so long as there was no default (though the substantive result may be the same).

The customer failed to make several monthly repayments on time and consequently paid a significant amount of default interest to the bank. The customer sued the bank, arguing that the default interest rate was a penalty, and that the customer was entitled to be repaid the default interest it had paid to the bank.

At first instance, the customer was successful in arguing that the default interest rate was a penalty, and the court ordered that the bank repay the default interest paid by the customer. The default interest rate was not a genuine pre-estimate of the cost to the bank of the customer's failure to make monthly repayments on the due date. The trial judge distinguished between major and minor defaults, and said that, in the particular case, there had only been a minor default of the commercial loan facility. As a result, the greatest loss for such a minor breach would only be the loss of the use of that month's interest payment for the time that it remained unpaid. Consequently, charging 2 per cent on the whole of the loan outstanding could not conceivably be a genuine pre-estimate of the cost to the bank for the minor breach, and was extravagant and unconscionable.

Between the first instance and appellate decisions, the High Court handed down its decision in *Paciocco*.

Judgment

On appeal, the court held that the default interest rate was not a penalty. It was not extravagant or out of all proportion. In holding so, the court made a number of points:

- the primary judge was incorrect in making a distinction between 'minor' and 'major' defaults. The loan agreement did not make any such distinction, nor did it treat late payments differently according to amount or duration, but gave the bank powers on any default, including to accelerate the loan. Whether a breach was minor or major could not be judged at the time of contract but only in retrospect, looking at the actual consequences. At the time the agreement was made, all that could be said was that default may have a number of consequences (which could include being required to monitor the loan, and decide whether to treat it as impaired and make provision for it);
- the presumption expressed in *Dunlop* that there is a penalty if 'a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage', is only a weak one;
- costs of 'minor' defaults were not factored into the actual (non-default) interest rate;
- the costs of the default were not limited to opportunity costs. Costs of provisioning were real costs that could be foreseen at the time of the agreement;
- the actual amount of those provisions (which could normally be expected to exceed 5 per cent of the principal) gives some indication that the stipulated default rate of 2 per cent could not be regarded, even with the benefit of hindsight, as extravagant or unconscionable;
- an uplift in interest rate reflects the increased credit risk that a customer poses upon breach. Banks have a legitimate commercial interest in preventing increased credit risk, and default interest rates are a legitimate means of protecting this interest. Justice McDougall quoted an English case, and Justice Keane's approval of the case in *Paciocco*. He said '[w]e have moved well beyond the days when judges lived in (real or pretended) ignorance of the facts of commercial life.' Unlike *Paciocco*, the court did not mention the need to set aside more regulatory capital for a higher risk (though Basel II was mentioned in cited expert evidence);
- the fact that the bank had other methods for satisfying the consequence of a default (including an indemnity) did not make the default interest rate a penalty. The doctrine of freedom of contract remains important. Commercial parties are free to agree on contractual terms as they see fit, and banks should not be compelled to rely on other contractual remedies where a default interest provision has been agreed upon;
- following *Paciocco,* the onus was on the customer to show there was a penalty. However, if the bank had pleaded that the default interest charge was a genuine pre-estimate of loss, that would be a separate issue on which the bank, the party asserting, would bear the onus of proof; and
- the court did not need to decide whether punishment needed to be a sole or a dominant purpose, for there to be a penalty.

Allens › ‹ Linklaters

Chapter 4: Breach and repudiation

A common problem faced by parties to commercial contracts is whether they are entitled to terminate the contract following the other party's breach. In the absence of an express contractual right to terminate, a party seeking to terminate the contract would usually need to show that the other party has 'repudiated' the contract.

Deciding whether to 'accept' the other party's repudiation, and therefore terminate the contract, can be a very risky decision; if a court later holds that the other party did not repudiate the contract, then the party purportedly 'accepting' their repudiation will usually be found itself to have repudiated the contract.

These risks were evidenced by the decision of the NSW Court of Appeal in *Wesiak v D&R Constructions (Aust) Pty Ltd*[23], in which different courts and tribunals held that different parties had repudiated the contract. The case concerned a contract between two homeowners and their builder. The NSW Court of Appeal ultimately found in favour of the homeowners. The court observed that 'repudiation' has two different meanings:

- the manifestation of an intention no longer to be bound by a contract (or fulfilling it only in a manner substantially inconsistent with the parties' obligations); and
- a breach of a fundamental term of a contract, or which is otherwise sufficiently serious to justify termination (applying the usual common law principles).

The NSW Court of Appeal held that, on the facts of this case, the builder had repudiated the contract in both senses.

The court also confirmed that, as a general rule, a party that is in breach of a contract may still accept the other party's repudiation, unless the first party's breach was not independent of the other party's repudiation.

The two meanings of 'repudiation' were also discussed by the Queensland Court of Appeal in *Gilligan's Backpackers Hotel & Resort Pty Ltd v Mad Dogs Pty Ltd*[24]. That case, which involved repudiation in the first sense, considered the general principle that a party, having accepted a repudiation, is only entitled to loss of bargain damages if that party itself is 'ready, willing and able' to perform the contract. The court agreed with the appellant's submission that, because the innocent party was insolvent, it was not able to perform the contract and was therefore not entitled to loss of bargain damages.

23 [2016] NSWCA 353.

24 [2016] QCA 304.

The decision of the NSW Court of Appeal in the *Harold R Finger & Co Pty Ltd v Karellas Investments Pty Ltd*[25] (also referred to in Chapter 1) is, like *Wesiak*, an example of different decision makers taking different views on whether certain conduct amounted to a repudiation of a contract. Perhaps, more importantly, the NSW Court of Appeal also considered whether, if the landlord had validly terminated the heads of agreement (for a commercial lease), its damages should be reduced to take into account profits actually made on a residential development, which was only possible because the lease did not proceed.

The landlord argued that the profits on the alternative development were not taken to mitigate its loss, but were a collateral benefit and therefore should not reduce its entitlement to damages (relying on the recent decision of the High Court in *Clark v Macourt*[26]). The court disagreed, and held that the benefit 'was sufficiently close to the claimed head of damages as to be appropriate to set off against it'. However, the court further held that the party in breach had the onus of proving both that: (a) loss had been avoided; and (b) the extent to which loss had been avoided. The second requirement needed a comparison between the profit made from the actual development and the profit that would have been made from an alternative development (if a lease had been entered into). As there was no evidence of the profit from an alternative development, there would have been no reduction in an award of damages (had the landlord otherwise succeeded).

This case illustrates the practical difficulties in running and proving mitigation of loss arguments.

25 [2016] NSWCA 123.

26 (2013) 253 CLR 1, discussed in our 2014 *Contract Law Update*.

Allens › ‹ Linklaters

Wesiak v D&R Constructions (Aust) Pty Ltd [2016] NSWCA 353

› Whether a party that is itself in breach may accept the other party's repudiation and terminate the contract

In this case, the NSW Court of Appeal considered the application of the doctrine of repudiation, and in particular the circumstances in which contractual parties' conduct will evince an intention to repudiate the contract, and accept that repudiation as terminating the contract.

The court held that the tribunal erred in its consideration of the question of repudiation by failing to take into account all of the relevant facts. The only decision reasonably open to the tribunal on the whole of the evidence was that the respondent, and not the applicants, repudiated the contract. Accordingly, the decision of the tribunal was wrong at law. Leave was granted and the appeal was allowed.

This case considers the authorities on repudiation, emphasising that in determining whether a party evinces an intention to no longer be bound by the contract, the court is required to consider all facts and circumstances surrounding the alleged repudiatory conduct. It also confirms that a party to a contract that is itself in breach may accept another party's repudiation and terminate the contract unless it was the first party's breach that caused the repudiatory conduct.

Facts

- Under a written contract made on 18 December 2011, the respondent, D&R Constructions (Aust) Pty Ltd, undertook to perform residential building work for the applicants, Leela and Bernard Wesiak. The contract was for a lump sum amount of $589,900.
- D&R Constructions made nine progress claims between March 2012 and March 2013. The total amount claimed was around $605,000. On 4 June 2013, D&R Constructions sent a tax invoice to the Wesiaks claiming $27,000 for works 'to date'. The Wesiaks refused to pay the amount claimed and instead sought details of the amounts they had paid to date. D&R Constructions sent a schedule setting out the amounts paid, the amount claimed for variations and that a further $75,862 remained owing.
- In email correspondence that followed, the Wesiaks asserted that there was still a substantial amount of work to be done, and that they had paid more than the contract required them to do at that stage. D&R Constructions' position was that the $27,000 should be paid.
- By 26 July 2013, the dispute remained unresolved and D&R Constructions purported to issue a notice of suspension of work, in accordance with the terms of the contract.
- Correspondence between the parties' solicitors ensued, including the following letters:
  - A letter from D&R Constructions' solicitors to the Wesiaks' solicitors dated 16 September 2013, maintaining that the $27,000 payment claim was payable and that there was a further $34,673 owing for variations. The letter also stated that D&R Constructions would only complete the works if certain conditions (including the payment of the balance of the contract price into a controlled account) were met (the ***16 September letter***). These conditions were inconsistent with the terms of the contract in certain respects.
  - A letter from the Wesiaks' solicitors to D&R Constructions' solicitors dated 17 September 2013, stating that the $27,000 payment claim remained disputed but that their clients would be prepared to consider some of D&R Constructions' conditions if the dispute was resolved. The letter concluded, however, that as the parties remained at odds in numerous material respects, their clients intended to mitigate their losses by terminating the contract. It also stated that their clients were seeking quotations for completion of the works (the ***17 September letter***).
- Following further correspondence from the Wesiaks, on 20 October 2013, D&R Constructions' solicitors issued a notice purporting to terminate the contract on the grounds that the Wesiaks wrongfully repudiated the contract.

- At first instance, the New South Wales Civil and Administrative Tribunal held that D&R Constructions had repudiated the contract by wrongfully terminating it. In its reasoning, the tribunal found that the $27,000 claim was not a valid progress claim, as it related to works which were substantially incomplete at the time it was issued and failed to comply with the terms of the contract.
- On appeal, the tribunal overturned this decision, holding that Wesiaks had, by the 17 September letter, repudiated the contract, and that D&R Constructions had accepted this repudiation as terminating the contract. Relevantly, the first instance finding that the $27,000 claim was not a valid progress claim and related to works that were substantially incomplete at the time it was issued were left unchallenged on appeal.
- The Wesiaks sought leave to appeal to the NSW Supreme Court. The appeal was heard concurrently with the leave application.

Judgment

The Court of Appeal considered:

- Whether the tribunal erred in finding that the Wesiaks had, by the 17 September letter, repudiated the contract.
- Whether, contrary to the tribunal's finding, D&R Constructions had repudiated the contract.
- Whether, in any event, D&R Constructions was not entitled to rely on the Wesiaks' repudiation of the contract as it was itself in breach of the contract.

The judgment was handed down by Justice McDougall, with Justices Beazley and Simpson agreeing.

Their Honours made orders that the decision of the tribunal on appeal be set aside. Leave to appeal was granted and the appeal was allowed.

Test for repudiation

The court applied *Koompahtoo Local Aboriginal Law Council v Sanpine Pty Ltd* (2007) 233 CLR 115, which identifies that repudiation may be used in two senses, including:

- Repudiation that encompasses conduct which evinces an intention no longer to be bound by the contract or to fulfil it only in a manner substantially inconsistent with the party's obligations. The test for repudiation in this sense is whether the conduct of one party is such as to convey to a reasonable person, in the situation of the other party, renunciation either of the contract as a whole or of a fundamental obligation under it.
- Repudiation that refers to any breach of contract which justifies termination by the other party. Repudiation in this sense arises where the breach of contract by one party entitles the other party to terminate either because the obligation breached is agreed by the parties to be an essential condition or where it is a sufficiently serious breach of a non-essential term.

The court held that repudiation in the first sense requires the court to consider the alleged repudiatory conduct with reference to its entire factual setting.

Findings in relation to repudiation

In the present case, in finding that the Wesiaks had, by the 17 September letter, repudiated the contract, the tribunal failed to take into account a number of relevant, surrounding circumstances. These circumstances included that:

- D&R Constructions suspended work on the basis of the $27,000 payment claim. The first instance finding (left unchallenged by the tribunal on appeal) was that this claim was not a valid progress claim under the contract and related to works that were substantially incomplete at the time it was issued. Accordingly, D&R Constructions had no contractual justification for suspending its work and breached an essential term of the contract by doing so.
- In the 17 September letter, the Wesiaks indicated a willingness to consider the variations to the contract sought by D&R Constructions, and invited a continuation of negotiations.

Furthermore, the Wesiaks did not, by any further correspondence or conduct, evince an intention to repudiate the contract.

In any event, the court found that, by 17 September 2013, D&R Constructions had already repudiated the contract in both senses identified in *Koompahtoo*. By stopping work until the $27,000 progress claim was paid, D&R Constructions breached an essential term of the contract (requiring it to complete the contractual works). Furthermore, D&R Constructions made it clear, by the 16 September letter, that it was not prepared to perform the contract in accordance with its terms.

The court concluded that the tribunal's finding that the Wesiaks had repudiated the contract was not reasonably open to it on the whole of the evidence. The only finding reasonably open on the whole of the evidence is that D&R Constructions had repudiated the contract. Accordingly, the tribunal's decision was wrong in law.

Effect of breach on acceptance of repudiation

While these findings were sufficient to justify granting leave and allowing the appeal, the court also considered the Wesiaks' submission that it was not open to D&R Constructions to accept the Wesiaks' purported repudiation of the contract as it was itself in breach.

The court rejected this submission, citing *Foran v Wight* (1989) 168 CLR 385; *Peter Turnbull & Co Pty Ltd v Mundus Trading Co (Australasia) Pty Ltd* (1954) 90 CLR 235; and *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26 in support of the proposition that, as a general rule, a party that is itself in breach of a contract is not, merely because of that breach, prevented from relying on the other party's repudiation to terminate the contract. An exception to this rule applies in certain circumstances, including where the parties' obligations are interdependent, and where one party's breach has caused the other party's alleged repudiatory conduct.

Gilligan's Backpackers Hotel & Resort Pty Ltd and Anor v Mad Dogs Pty Ltd [2016] QCA 304

> Can an insolvent part accept a repudiation?

This Queensland Court of Appeal decision considered a claim for damages by a hotel services contractor in response to the hotel's repudiation of a contract.

His Honour held that the services contractor was not entitled to an award for damages, because (contrary to the finding of the trial judge) it had been insolvent at the time the contract was terminated.

This case reinforces the well-established principles around repudiation of contracts, and clarifies that an insolvent company, assuming it is not ready, willing and able to perform the contract (because of its insolvency) will not be able to claim damages upon termination of a contract.

Facts

The appellant operated a hotel business in Cairns. The respondent was a cleaning company and contracted in 2005 with the appellant to provide food and catering services to the hotel.

It was accepted that, on 26 September 2007, the agreement was terminated by the respondent following the appellant's repudiation.

The respondent sued the appellant for damages for the loss of its bargain. The respondent was successful at trial.

The appellant appealed, arguing that the respondent had been insolvent at the time the contract was terminated. This meant that the respondent had not been ready, willing, and able to perform, and was thus barred from claiming damages for the loss of the bargain.

Judgment

The Queensland Court of Appeal agreed with the appellant's argument, allowing the appeal.

Justice Philip McMurdo (writing the court's judgment) outlined the circumstances in which the appellant had repudiated the contract, and discussed the meaning of repudiation.

The court referred to the High Court majority's statement in *Koompahtoo Local Aboriginal Land Council v Sanpine Pty Ltd* (2007) 233 CLR 115, distinguishing between two senses in which the term repudiation is used.[at 17]

It is sometimes used in the sense of a 'breach of contract which justifies termination by the other party', but otherwise (and relevantly to this case) used in the sense of 'conduct ... which evinces an intention no longer to be bound by the contract'. It is this second sense, which the High Court in *Koompahtoo* described as renunciation of the contract, in which the term repudiation is used in this case.

The respondent's termination was on 'the basis of anticipated rather than actual breach.'[at 18] It is settled law that, in such a situation, the party seeking damages under this termination must be ready willing, and able to perform its part of the contract.[*Foran v Wight* (1989) 168 CLR 385, 408-409]

The appellant's argument was essentially that, contrary to the trial judge's finding, the respondent had been insolvent at the time of termination. The necessary consequence of the statutory bar on a corporation trading while insolvent (*Corporations Act 2001* (Cth), s588G) is therefore, on the appellant's account, that the respondent was not able to perform its half of the bargain and was therefore not entitled to damages for the loss of its bargain (ie the remaining value of the contract).

The court held that the appropriate definition of insolvency in assessing the respondent's readiness, willingness, and ability to perform the contract (the common law test) was that set out in s95A of the *Corporations Act 2001* (Cth).[at 21]

The court then analysed the factual circumstances surrounding the respondent's solvency at the relevant point in time in great detail, and concluded that the respondent had in fact been insolvent at the time of termination of the contract.[at 53]-[55]

On this basis, the respondent had not been able to perform the contract, and was therefore not entitled to recoup damages for the loss of bargain.

In summary, this case clarifies:

- that insolvency will usually bar a claim for damages on the basis of termination for another party's repudiation; and
- the well-settled requirement for a party to successfully claim damages is that the terminating party must nevertheless be 'ready, willing, and able' to perform its part of the contract.

Allens › ‹ Linklaters

Who to contact

Malcolm Stephens
Partner, Sydney
T +61 2 9230 4828
Malcolm.Stephens@allens.com.au

Michael Ilott
Partner, Brisbane
T +61 7 3334 3234
Michael.Ilott@allens.com.au

Phil Blaxill
Partner, Perth
T +61 8 9488 3739
Philip.Blaxill@allens.com.au

Andrew Maher
Partner, Melbourne
T +61 3 9613 8022
Andrew.Maher@allens.com.au

‹ back

Allens › ‹ Linklaters

‹ back next ›