Allens Contract Law Update 2013
Welcome to the 2013 edition of the Allens Contract Law Update, which summarises important contract law decisions by Australian appellate courts over the past 12 months.

This year, we have seen Australian courts grappling with many of the issues that were covered in last year’s Contract Law Update 2012. These include frequently recurring areas of dispute such as: when are heads of agreement binding; whether certain documents form part of a contract between the parties; and when words might be given an interpretation different from their normal, literal meaning.

One of the most important contract law decisions summarised in last year’s Update was that of the High Court in *Andrews v ANZ*[^1^]. It is likely to be many years before appellate courts in Australia work through all the implications of this decision. For the moment, the most important appellate decision on penalties in 2013 confirmed the old (and much criticised) rule that concessional interest rates for prompt payments cannot be penalties.

During 2013, two appellate decisions considered ‘suspension clauses’ in guarantees (that is, clauses which prevent guarantors disputing their liability by way of set-off or counterclaim). The decision of the NSW Court of Appeal in *O’Brien* is a particularly important development in this area.

This update also looks at the most recent discussion (by the Western Australian Court of Appeal) on when detailed contractual obligations can have the effect of excluding liability negligence, and two recent decisions in which courts have considered the meaning of an obligation to act reasonably.

The last chapter of this update considers a number of issues and traps that can arise with valuation disputes under share sale agreements.

We hope you find this update valuable. Please feel free to contact one of our partners if you would like to discuss any of the issues raised in this update.

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WHO TO CONTACT
Chapter 1: Contract formation

Each year, Australian courts hear many disputes as to whether a preliminary agreement, which contemplates the parties entering into a further, more formal agreement, is itself binding.

In *Factory 5 Pty Limited*, the Victorian Court of Appeal held that one example of such an agreement was not binding. Two major reasons for this conclusion were that:

- the preliminary agreement did not deal with a number of critical terms; and
- the preliminary agreement expressly stated that the appointment of Factory 5 as ‘Concessionaire’ for the Melbourne 2006 Commonwealth Games was subject to both board approval and a legally binding long form agreement being entered into.

Although this conclusion might seem unsurprising, the trial judge had found that the agreement was legally binding, which shows that parties cannot be too explicit in stating whether or not an agreement is intended to be legally binding.

The New South Wales Court of Appeal in *Sayed* found that a heads of agreement was binding because the parties had agreed to amend the description of the agreement from ‘non-binding’ to ‘binding’. The central issue in this case, however, was a more subtle argument: did the binding agreement include terms on which consensus had been reached in a prior exchanges of emails, but which were not included in the heads of agreement itself? Although this argument succeeded at first instance, the New South Wales Court of Appeal held that there was no basis for implying or incorporating such a term into the heads of agreement.

Another common area of contractual dispute arises when a party asserts that its standard terms have been incorporated into a contract. In *La Rosa*, the appellant argued that an exclusion clause included on invoices sent to the respondent (after the relevant work had been performed) was incorporated, by a course of dealing, into oral contracts with the respondent. The Western Australian Court of Appeal rejected this argument, on the basis that the invoices were not themselves ‘contractual documents’, the terms had not been sufficiently drawn to the respondent’s attention and the mere receipt and payment of invoices did not justify an inference that the respondent has accepted the terms on it.


**Factory 5 Pty Ltd (In Liq) v State of Victoria (No 2) [2012] FCAFC 150**

*Heads of agreement*

*Agreement to agree*

*Formation of contract*

*Masters v Cameron*

This decision of the Full Court of the Federal Court of Australia considered whether a heads of agreement executed by both parties was a binding agreement.

When entering into a heads of agreement or other pre-contractual agreements, clients should remember to make it clear in the document whether they intend to be bound immediately or only when a more detailed contract is executed. Furthermore, if clients intend to be bound by a heads of agreement, they should ensure that there are no significant terms that have not been dealt with in the agreement, as in such circumstances the court would be more likely to infer that the parties did not intend to be bound by the agreement.

**The facts**

In September 2004, Melbourne 2006 Commonwealth Games Corporation (*Melbourne 2006*) invited tenders for the provision of services for the sale of Commonwealth Games-related merchandise. In about September 2004, two companies, Stage 5 Pty Ltd and The Promotions Factory Pty Ltd (together, the *promoters*) responded to the tender and subsequently incorporated the appellant, Factory 5 Pty Ltd, as the tenderer. The promoters entered into negotiations with Melbourne 2006 and, by November 2004, they were close to securing the appointment of Factory 5 as official concessionaire to sell merchandise at Games venues.

On 23 December 2004, Melbourne 2006 wrote a letter to Factory 5 headed ‘Concessionaire Agreement’ appointing Factory 5 as the official concessionaire for the Games (the *letter*). The letter set out and incorporated the terms and conditions agreed during the parties’ earlier correspondence. Later that day, both parties signed the letter, which stated:

> We confirm that the parties have agreed that F[actory]5 is to be appointed as Concessionaire subject to reaching agreement on a legally binding Long Form Concessionaire Agreement to be provided by M2006 and subject to M2006 board approval.

During negotiations of the long form contract, Factory 5 expressed concern over what action it could take if Playcorp, the appointed manufacturer, was being unreasonable or could not deliver the products. This, and issues regarding the prices and margins for Games merchandise at which Playcorp was proposing to sell to Factory 5, remained in negotiation, as they had not been dealt with in the letter. These issues could not be resolved during negotiations between Melbourne 2006 and Factory 5, and, on 24 June 2005, the former terminated negotiations with Factory 5.

**The judgment**

At first instance, the court found that the letter constituted a binding agreement between Factory 5 and Melbourne 2006 and that the letter of 24 June 2005 amounted to a repudiation of that agreement. Nonetheless, the court held that Factory 5 had later abandoned the contract and, as a result, was not entitled to damages. Factory 5 appealed that decision.

On appeal, the Full Federal Court held that, when Melbourne 2006 and Factory 5 signed the letter, there was no contractual consensus between them on a number of ‘critical terms’: most importantly, the prices at which Factory 5 would be prepared to deal with suppliers licensed by Melbourne 2006, and when Factory 5 could manufacture its own goods for sale. At first instance, the court did not consider either clause to be of enough significance to preclude the letter from being a binding agreement.
However, the Full Federal Court took a different view, deeming that the clauses referred to above were important enough to preclude the parties from reaching a binding agreement and therefore considered the letter to be nothing more than an agreement to agree.

Further, their Honours noted that their conclusion that the letter was not a binding agreement was ‘consistent with the wording’ of the letter, which made the appointment of Factory 5 subject to three conditions:

- the parties reaching agreement on a legally binding long form agreement;
- that agreement being provided – and drafted – by Melbourne 2006; and
- the board of Melbourne 2006 approving the actual terms of the document to govern the parties’ relationship – none of which were ever satisfied.

Their Honours stated that an additional indication that the appointment of Factory 5 would occur in the future, and therefore that the letter was not a binding agreement, was that the letter stated ‘[f]actory 5 is to be appointed as Concessionaire subject to [emphasis added] the three conditions above being met.’
Chapter 1: Contract Formation

Sayed v National Australia Bank Limited [2013] NSWCA 304

> Whether agreement binding
> Failure to negotiate subsequent deed as agreed

This decision of the New South Wales Court of Appeal dealt with whether an agreement subject to a subsequent deed was binding on the parties where the parties failed to agree on the terms of the subsequent deed.

The New South Wales Court of Appeal held that the initial agreement was intended to be binding at the time it was made, and various offers made during negotiations were not impliedly incorporated into the contract, as the parties intended that any additional terms would only be binding if captured in a deed.

This case is a reminder of the general principles of ‘offer and acceptance’, and provides a good example of how the courts will apply these principles, particularly in the context of contract negotiations via email.

The facts

Mr Bilal Sayed and Mrs Nicole Sayed (the Sayeds) were granted a loan with the National Australia Bank Limited (NAB). A mortgage over a property in Woonona was held as security for the debt. The Sayeds defaulted on the loan.

NAB sought judgment to repossess the property, leave to issue a writ of possession to enforce such judgment and judgment of the sum of $488,881 with interest. The Sayeds filed a cross-claim, arguing NAB had failed to exercise its power of sale in good faith by selling the property at a grossly undervalued price.

Proceedings commenced before Justice Adams between 20-23 August 2012. During the proceedings, on 23 August 2012, the parties signed a handwritten ‘in principle agreement’ (the agreement) to settle the proceedings.

The agreement initially had the words ‘non-binding’ written on it. The word ‘non’ was crossed out at the time of signing. The agreement also contained a clause with the words ‘subject to a formal deed that will contain further terms not inconsistent’. At the time the agreement was signed, the parties had not reached final agreement on the terms of the final deed, and various offers and counter-offers between the parties had not been accepted. The agreement made no reference to the parties providing mutual releases, although there had been consensus on this point in earlier emails (albeit without any reference to NAB’s agents).

Following the signed agreement, the parties continued negotiating the formal deed. A series of email exchanges proposing offers and counter-offers followed between the parties’ solicitors.

The parties were unable to reach agreement on the terms of the formal deed. The Sayeds would not agree to a term that released NAB’s agents.

NAB commenced litigation. NAB sought a declaration that the parties had entered into a binding agreement in the form of the NAB email sent at 1.57pm on 30 August 2012, which provided for both parties to agree to mutual releases of liability. NAB also sought an order for specific performance. Justice Rein made orders in favour of NAB on 22 October 2013, finding the agreement was binding.

INTRODUCTION

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WHO TO CONTACT
The judgment

Justice Emmett (with Justices McColl and Tobias concurring) held that:

- although the parties considered mutual releases during the negotiations, and there may have been consensus on this issue before signing the agreement, a term of this nature was not expressed in the agreement (perhaps due to ‘oversight’) and could not be implied in the agreement for commercial efficacy or otherwise;
- the act of writing ‘non-binding’ and then crossing the ‘non’ out on the agreement signalled an intention by the parties to be legally bound by those terms and to seek to agree on a subsequent deed; and
- as no subsequent deed was required, the agreement remained legally binding. As neither party sought to enforce the agreement: ‘it may be appropriate to conclude ... that both parties had effectively abandoned it’.
La Rosa v Nudrill Pty Ltd [2013] WASCA 18

Carriage of drill rig
Damaged in transit
Exclusion clause on back of invoices
Whether exclusion clause incorporated into contract by prior course of dealings

This Western Australian Court of Appeal decision considered whether an exclusion clause could be incorporated into an oral contract by a prior course of dealings between the parties.

The court unanimously held that the exclusion clause was not incorporated in the oral contract as a result of prior dealings between the parties.

This case reinforces the need to ensure that contractual terms are clearly set out in appropriate documentation. Mere receipt by a party of a non-contractual document containing contractual terms does not necessarily evidence that party’s willingness to be bound by those terms.

The facts

The appellant, Giuseppe La Rosa, is a tow truck driver who, during a telephone conversation with a representative of the respondent (Nudrill Pty Ltd), agreed to transport a drill rig from Perth to Kalgoorlie. The appellant had previously transported the drill rig for the respondent. During the course of the cartage by the appellant, the rig fell from the loader and was substantially damaged.

The respondent sued the appellant for claims in contract, negligence and bailment for damage caused to the drill rig. These claims were upheld by Justice Keen of the District Court of Western Australia. The appellant appealed the decision on the grounds that the trial judge had:

• erred in finding that the appellant drove at an excessive speed in the circumstances; and
• erred in finding that an exclusion clause was not incorporated in the oral contract between the parties by a prior course of dealings between the parties.

The judgment

Excessive speed

The court held that, in the bailment claim, the appellant had not discharged his onus of proving that the damage to the drill rig was not caused by want of care on the appellant’s part. Conversely, the respondent did satisfy its onus, in the contract and negligence claims, of proving that the damage was caused by the appellant’s negligence.

The exclusion clause

The appellant had transported the drill rig for the respondent on previous occasions. All previous cartage contracts between the parties were oral. Following each job, the appellant would send an invoice to the respondent specifying the details of the job and cost of work. This was the only documentary component of the dealings between the parties. At the foot of each invoice was a reference to ‘TERMS’ that were set out on the reverse side of the invoice. The terms on the reverse of the invoice contained a clause that excluded liability on behalf of the appellant for any loss or damage to any property of the client (in this case, the respondent) caused by any act or negligence on the part of the appellant.

The question for the court was whether this term was incorporated into the oral cartage contract as a result of prior dealings between the parties. President McLure (with Justice Murphy in agreement) held that:

• the invoices were not a ‘contractual document’;
• the receipt of the invoices by the respondent was not sufficient to justify an inference of an acceptance by the respondent of the terms on the reverse of the invoice; and
the terms on the reverse of the invoice did not constitute sufficient notice of the terms on which the appellant would conduct business in the future.

Justice Buss held that:

- the previous transactions between the parties were not sufficiently proximate nor frequent to constitute a ‘course of dealings’;
- no representative of the respondent had actual knowledge of the existence of the terms on the invoice;
- a reasonable person in the respondent’s position would have been entitled to regard the invoice as a demand for payment, rather than a document containing contractual terms in relation to work already completed; and
- the relevant course of conduct between the parties was to contract orally without incorporation of written terms.

The appeal was dismissed.
Chapter 2: Contractual interpretation

The judgment of the High Court on a special leave application in Western Export Services\(^3\) stated that a court should only have regard to the surrounding circumstances, when interpreting a clause of a contract, if the clause was, on its face, ambiguous. The difficulties in applying this test were illustrated by the judgment of the New South Wales Court of Appeal in Schwartz v Haddad, in which:

- one judge held that the clause was not only ambiguous but also incomplete, and that a separate document also formed part of the contract;
- a second judge found that the clause was ambiguous, but that the contract was complete and that extrinsic evidence could not be used to give the clause a meaning inconsistent with the actual language used; and
- the third judge held that the clause was unambiguous.

The judgment of the New South Wales Court of Appeal in Horsell International v Divetwo shows how, notwithstanding the judgment of the High Court in Western Export Services, courts can still apply orthodox rules of contractual interpretation to give words a meaning different from their normal, literal meaning. In that case, the word ‘criminal’ in an exclusion clause was confined, having regard to other conduct listed in the exclusion clause, to intentional criminal acts (and therefore did not extend to unintentional criminal acts).

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Schwartz v Hadid [2013] NSWCA 89

Construction and interpretation of contract
Use of extrinsic evidence
Discerning ambiguity

This NSW Court of Appeal decision dealt with the construction and interpretation of a commercial agreement between the parties and the extent to which the court was permitted to look outside the four corners of that document to interpret its meaning.

The majority upheld the appeal, finding that the primary judge had made an impermissible use of extrinsic evidence to interpret the meaning of a key contractual term between the parties.

The New South Wales Court of Appeal confirmed the principle established in Codelfa Construction Pty Ltd v State Rail Authority of NSW [1982] HCA 24 that a court may only have regard to surrounding circumstances if the language of the contract is ambiguous or susceptible of more than one meaning. The case illustrates the difficulty in discerning the existence of an ambiguity.

The court considered appeals from two separate proceedings, deemed the 'joint venture proceedings' and the 'loan proceedings'. Only the joint venture proceedings are considered in this summary.

The facts

In June 2007, Mr Hadid approached Dr Schwartz about an opportunity to buy and consolidate four parcels of land in Cranbourne, Victoria, with a view to later selling the land at a substantial profit (to be shared between the parties). The four parcels of land were referred to as sites A, B, C and D respectively. Site A was already owned by a company associated with Mr Hadid.

In a document given to Dr Schwartz by Mr Hadid (the investment proposal), Mr Hadid described the opportunity as follows: ‘...the plan is to buy B then buy or option C & D...’

By late August 2007, Dr Schwartz had agreed to buy site B. On 23 August 2007, the parties executed the deed of agreement (the deed). The recitals at the beginning of the deed were set out as follows:

Recitals as agreed

1.1 Jerry [Dr Schwartz] and Albert [Mr Hadid] are friends and wish to enter this business agreement.

1.2 Jerry has agreed at his discretion to buy one or more properties at Junction Village Cranbourne Victoria 'Properties'.

1.3 Albert has introduced Jerry to the properties and will negotiate the purchase and sale of the properties at Jerry’s discretion.

Following the execution of the deed, Mr Hadid continued negotiating the ‘purchase and sale of the properties’; however, Dr Schwartz ultimately decided not to proceed with the purchase of sites C or D, nor did he acquire an option to purchase those sites. Mr Hadid subsequently commenced proceedings for breach of contract against Dr Schwartz, claiming that the deed, properly construed, imposed an obligation on Dr Schwartz to purchase, or take out an option to purchase sites C and D. The primary judge, Justice McDougall, found in favour of Mr Hadid. On appeal, Dr Schwartz submitted that Justice McDougall had wrongly had recourse to the investment proposal and earlier conversations between the parties in construing the deed.
The primary issue for the court was whether the discretion in recital 1.2 (to buy one or more properties) should be understood as referring to the discretion in the investment proposal either to purchase, or buy an option to purchase, properties C and D. Hadid argued that either:

- clause 1.2 was ambiguous, and having regard to surrounding circumstances (including the investment proposal) it should be construed as a discretion as to whether to buy properties C and D or only to buy an option to purchase those properties; or
- the investment proposal formed part of the contract between the parties.

Each judge took a different approach to these issues:

- Justice Basten held that the investment proposal was part of the contract and that Dr Schwartz was obliged either to purchase, or to purchase an option over, properties C and D;
- Justice Macfarlan found that the investment proposal was not part of the contract between Mr Hadid and Dr Schwartz. He further found that clause 1.2 was not ambiguous and gave Dr Schwartz a discretion as to whether to buy one, two or three further properties; and
- Justice Meagher found that the language in clause 1.2 was ambiguous, but that the investment proposal could not be used to give words in clause 1.2 a meaning that contradicted the actual language of the clause. As the clause made no reference to any choice between purchasing properties or entering into an option to do so, Justice Meagher therefore agreed with the interpretation of Justice Macfarlan (albeit after having regard to the surrounding circumstances).

While for the moment, the position in Australia regarding the use of extrinsic evidence appears to be settled (it is only admissible when the language of the contract is ambiguous), this case illustrates the difficulty in discerning the existence of an ambiguity and the terms of the contract. What is ambiguous to one judge may not be to another.
This decision of the NSW Court of Appeal dealt with the interpretation of a public liability insurance policy with an exclusion clause covering a 'criminal act or omission'.

Their Honours held that the primary judge did not err in reading down the word ‘criminal act’ to intentional criminal acts.

The court’s construction of the exclusion clause demonstrates that a list of acts or omissions may form a class from which the intention of the excluding clause can be discerned. This may lead to a court giving a word a different effect from its usual, literal meaning.

The facts

Mr Rian Lane (the plaintiff) commenced proceedings against a scuba diving business, Dive Two Pty Ltd (the first defendant), for injuries sustained when the first defendant’s dive vessel collided with a vessel on which the plaintiff was fishing.

The dive vessel was being driven by Mr William Todd (the second defendant) on a recreational trip not made in connection with the first defendant’s business. The second defendant pleaded guilty to ‘dangerous navigation occasioning grievous bodily harm’ in breach of the Crimes Act 1900 (NSW).

The first and second defendants (collectively, the defendants) cross-claimed against their insurer, Liberty Mutual Insurance Co, for an entitlement to indemnity or damages (ie coverage under the insurance policy).

The relevant exclusions to the policy were found in clause 7 as follows:

7.24 Any alleged or actual fraudulent, dishonest, malicious, wilful or criminal act or omission of the Insured or any person covered by Clause 3 of this Policy.

Liberty contended that it was not liable to indemnify the plaintiff for two reasons:

• the claim did not fall within the policy because it did not arise ‘in connection with the Insured’s Business’; and
• the claim was excluded by reason of exclusion clause 7.24 because it involved a criminal act.

In relation to the first reason, the Court of Appeal agreed and held the trip did not fall within the insuring clause.

In relation to the second reason, the Court of Appeal held that the policy has to be read in its ‘totality, commercially and sensibly’ (citing QBE Insurance Australia Ltd v Vasic [2010] NSWCA 166).

While the term ‘criminal acts’ by itself is broad, because the words appear at the end of a list where the preceding words have in common an element of intention, it was considered that they should be read down to include only those criminal acts that are intentional. The exclusion clause did not cover the criminal act in this instance because the criminal act committed by the second defendant was not intentional.

While the second defendant did plead guilty, it was not an element of the offence that he intended the collision or intended that the plaintiff suffer any harm. His conduct, although criminal, was held not to be intentional.

Finally, having regard to the context in which the exclusion clause appears, and having regard to the essence of liability insurance, the court considered it would offend the commercial purpose of the policy to construe it to exclude cover for acts of negligence.
Two recent cases considered the ability of a guarantor to avoid its liability to a bank by disputing the underlying debt. In both cases, the guarantee included a provision specifically preventing the guarantor from disputing an obligation to pay the bank by relying on any set-off or counterclaim (sometimes referred to as a ‘suspension clause’).

In *Oswal*, the guarantor asserted that the primary debtor paid break costs by mistake, and that his liability to the bank should therefore be reduced by the amount of those break costs. The Western Australian Court of Appeal rejected this argument (by a majority), however, because a claim to recover amounts paid by mistake would have to be brought by a counterclaim, and the contract of guarantee obliged the guarantor to make payments ‘without counterclaim’. The guarantor was therefore obliged to make the payment, and to assert the counterclaim in separate proceedings.

In *O’Brien*, the guarantors also disputed the liability of the primary debtor to a bank. In that case, however, the arguments raised by the guarantors included arguments that were able to be pleaded by way of defences such as estoppel and certain statutory relief, rather than by way of set-off or counterclaim. The NSW Court of Appeal therefore held that the ‘suspension clause’ did not permit the bank to obtain summary judgment for the amount it had demanded from the guarantors. The NSW Court of Appeal further held that the suspension clause could not be relied on by the bank in a claim for summary judgment because:

- the clause operated on the assumption that amounts remained unpaid; if the guarantors’ arguments were correct, then there was no amount owing and unpaid; and
- granting the banks summary judgment would potentially conflict with statutory remedies available to the guarantors – particularly as such relief could include varying the terms of the contract.

This last reason will be of particular concern to banks because, if followed in other cases, it may make it impossible to draft clauses that permit summary judgment claims on guarantees where guarantors raise defences of (eg) misleading or deceptive conduct.

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4 Per Justice Macfarlan, Justice Ward preferring not to decide the case on this argument. As Justice Beazley agreed with both Justice Macfarlan and Justice Ward, there was a majority in favour of each ground given by Justice Macfarlan or Justice Ward for upholding the guarantors’ appeal.
Chapter 3: Guarantees

Oswal v Commonwealth Bank of Australia [2013] WASCA 58

- Guarantees
- Obligation to pay without set-off
- Ability of guarantor to raise arguments not made by principal debtor

This Western Australia Court of Appeal decision dealt with a guarantor’s partial appeal of a summary judgment in favour of the Commonwealth Bank in relation to a guaranteed loan under which the principal debtor defaulted.

The court held that:

- a clause requiring payment without set-off or counterclaim was sufficiently clear to justify a summary judgment that did not make an allowance for a potential counter claim that was otherwise reasonably arguable; and
- although a guarantor could seek to prove a claim that the principal debtor may have against the creditor in some cases, in the present circumstances only the principal debtor could do so.

The main points for practitioners to note as a result of this case are that:

- when dealing with pay without set-off clauses, it is important to consider what types of payment (for example, payments to be made under the agreement or payments for damages arising from breach of the agreement) and what forms of set-off, counterclaim or defence are captured by such clauses, especially since these clauses have not been treated uniformly in Australia and are likely to attract further judicial attention in the future; and
- although it is clear that a guarantor can seek to prove a claim that the principal debtor might have against the creditor in some circumstances, there is uncertainty about how often a guarantor is able to do so.

The facts

In October 2007, the appellant (Oswal) executed a deed of guarantee under which Oswal guaranteed amounts owed to the Commonwealth Bank of Australia (CBA) by Garuda Aviation Pty Ltd under a loan agreement. The loan agreement contained a clause requiring all payments to be made by Garuda under the loan agreement to be made ‘without set-off or counter-claim’ (the no set-off clause).

In May 2010, Garuda repaid part of the principal debt early. This early repayment caused CBA to unwind an interest rate hedge associated with the principal debt at a cost of $945,000. Garuda paid this $945,000 as break costs to CBA in addition to the repaid principal debt, purportedly in accordance with Garuda’s obligations under the loan agreement. As such, the $945,000 was not applied to reduce the principal debt.

Garuda subsequently breached the loan agreement, and CBA demanded repayment of the outstanding principal debt in accordance with the loan agreement. Neither Garuda nor Oswal paid, leading CBA to commence proceedings against Oswal. At first instance Justice Le Miere granted summary judgment in favour of CBA for the majority of its claim, leaving the balance to be determined at a full trial.

These proceedings concern Oswal’s partial appeal of the summary judgment. Oswal argued that:

- it was reasonably arguable that the break costs were not payable by Garuda, entitling Oswal to make a claim for restitution under the doctrine of unjust enrichment; and
the summary judgment should be reduced to reflect the value of the restitution claim, as a successful restitution claim could be set-off against any other judgment in favour of CBA (despite the no set-off clause).

CBA resisted the appeal on the basis of the no set-off clause, arguing that the clause barred consideration of Oswal’s restitution claim in these proceedings and required any restitution claim to be heard separately.

The judgment

The Court of Appeal dismissed Oswal’s appeal.

The court held that it was reasonably arguable that break costs were not payable by Garuda, and that Garuda might have a restitutionary claim to recover the break costs it paid. However, the court found that the obligation to make payment “without set-off” or counterclaim was sufficiently clear to exclude ‘all forms of set-off, no matter what jurisprudential basis might exist for the set-off’. This led to the conclusion that Garuda would be barred from seeking a set-off (if restitution was ordered for the break costs) against its liability to repay its debt to CBA. As Oswal guaranteed the payments that Garuda was required to make, Oswal was also barred in these proceedings from seeking a set-off for break costs that might be awarded in a restitution claim. Any right of Oswal to recover the payment of break costs would therefore be determined in later proceedings.
This NSW Court of Appeal decision considered the construction of a suspension clause in two contracts of guarantee.

Their Honours allowed the appeal and held that summary judgment should not have been granted in favour of Bank of Western Australia (BWA) because the suspension clause and the no waiver clause in the guarantees did not prevent the guarantors raising statutory defences and other defences that were not by way of set-off or counterclaim.

Suspension clauses (or ‘pay now, litigate later’ clauses) which prevent guarantors asserting set-off or counterclaims do not prevent guarantors raising other defences. In this case, it was further held that:

• if there was no sum due and payable under by the primary borrower, there was no liability to which the suspension clauses could attach; and
• a suspension clause could not be allowed to operate inconsistently with statutory rights.

The facts

BWA entered into a facility agreement with FOB Airlie Beach Pty Limited (the borrower) for the purposes of refinancing a property development. Among other security, the borrower’s obligations were secured by two guarantee and indemnity agreements entered into by Bakota Holdings Pty Limited and Mr Rory O’Brien. The borrower failed to pay the debt owing under the facility agreement by the due date. The bank appointed receivers and managers to the borrower under a fixed and floating charge. The property development for which finance was sought was sold and the proceeds were used to satisfy part of the debt owing to BWA. BWA commenced proceedings demanding the shortfall from Mr O’Brien and Bakota as guarantors.

BWA relied on the suspension, preservation and no waiver clauses and argued that the guaranteed money was owed under the guarantees. Mr O’Brien and Bakota filed defences arguing that the guaranteed money was not owing when the demand was made. The guarantors alleged that representations were made to the borrower by BWA to the effect that BWA would rollover the facility and that further funding would be provided until completion of the property development. It was argued that these representations relieved payment by the borrower on the due date. Accordingly, the guarantors submitted that:

• BWA was estopped from arguing that the borrower was under an obligation to pay the debt owing by the due date; and
• various statutory remedies for misleading and deceptive conduct and unconscionability under the ASIC Act 2001 (Cth) and the Australian Competition and Consumer Act 2010 (Cth) absolved the guarantors’ liability to pay the guaranteed money.

At first instance, Justice McDougall ordered summary judgment in favour of BWA. Mr O’Brien and Bakota appealed.
The judgment

The NSW Court of Appeal upheld the appeal brought by Mr O’Brien and Bakota and set aside summary judgment. Justices Macfarlan and Ward gave slightly different reasons for upholding the appeal. As Justice Beazley agreed with both judges, the judgment of Justices Macfarlan and Ward both represent the ratio of this case.

Justice Ward agreed with the guarantors’ argument that the suspension clauses (and the no waiver clauses) applied only once a liability arose under the guarantees. She held that the operation of the suspension clauses was contingent on an amount being due and unpaid by the borrower. Since the guarantors raised an arguable defence that the amount was not due and owing by the borrower at the time of the demand, then there was no liability which could attach to the suspension clauses.

Justice Macfarlan held that the suspension clause only purported to apply to rights of set-off or counterclaim. It did not purport to apply to other defences, such as claims founded in estoppel, unconscionability or misleading or deceptive conduct. Consequently, as the guarantors demonstrated arguable defences (other than by way of set-off), the suspension clauses had no application.

Justice Macfarlan further held that suspension clauses could not prevail over statutory remedies. The bank was not entitled to summary judgment (if the suspension clause otherwise applied) because it was possible that statutory remedies would be granted varying the relevant terms of the guarantees. In that case any summary judgment could be inconsistent with statutory relief that might later be granted.

This last reason is particularly important, as it suggests that it may not be possible to draft suspension clause widely enough to permit summary judgment where a guarantor raises statutory remedies (including relief for misleading or deceptive conduct).
Many contracts contain clauses that oblige one party to act reasonably when exercising rights or performing obligations that are likely to affect the other party. In two cases last year, appellate courts considered the circumstances which might be taken into account in determining whether a party has acted reasonably.

In *Verve Energy*, the Western Australia Court of Appeal held that a gas supplier breached its obligation to take ‘reasonable endeavours’ to supply supplementary gas to Verve Energy and, in particular, that its right to consider ‘all relevant commercial … matters’ in determining whether to supply gas to Verve Energy did not undermine the primary obligation to take reasonable endeavours.

The court further held that the obligation to take ‘reasonable endeavours’ would ordinarily require a party to do all that can be reasonably done in the circumstances to achieve the contractual object. This formulation is very similar to the interpretation of ‘best endeavours’ and ‘all reasonable endeavours’ – see, for example, the decision of the New South Wales Court of Appeal in *Waters Lane Pty Ltd v Sweeney* 5. *Waters Lane* indicated that ‘best endeavours’ and ‘or reasonable endeavours’ may often have the same meaning. It is therefore unclear whether, under Australian law, ‘reasonable endeavours’ imposes a legally (let alone practically) lower obligation than ‘best endeavours’ or ‘all reasonable endeavours’. On 12 September 2013, the High Court granted special leave to appeal on this issue and some related issues. The appeal was heard on 4-5 December and the court’s judgment has been reserved.

*Fulham Partners v National Australia Bank* is an example of a case where the court found NAB had acted reasonably in withholding its consent to an assignment of rights. In particular, the court found that the long-running dispute between parties to the agreement was not an irrelevant factor for NAB to take into account.

This case also confirmed that, subject to the particular terms of the contract, if consent to an assignment is reasonably withheld, then any purported assignment without consent would be ineffective. The court indicated, however, that it did not necessarily follow that, if consent were unreasonably withheld, an assignment would be effective. Although the court did not need to decide the issue, it indicated that, in the latter case, the assignment may still be ineffective but the assignee would have a claim in damages for breach of contract.
Electricity Generation Corporation t/as Verve Energy v Woodside Energy Ltd [2013] WASCA 36

This is a Western Australian Court of Appeal decision that dealt with the proper construction of a reasonable endeavours clause and examined whether a party to a contract exerted economic duress.

This case, concerning the sale of gas from a large supplier to an electricity company, illustrates that significant obligations can be imposed by 'reasonable endeavours' clauses, even when care has been taken to include qualifications to that duty. This case also provides an example of how a party can be seen as exerting illegitimate pressure on another, even in the absence of threats or demands.

The facts

The respondent (the seller) supplied gas to the appellant, Verve Energy, under a gas sale agreement dated 4 March 2004 (the agreement).

Under the agreement, the seller provided Verve with a daily quantity of gas, known as the maximum daily quantity. The agreement also provided a mechanism by which Verve could seek an additional quantity of gas above the maximum daily quantity. This additional amount was known as the supplementary maximum daily quantity. Under clause 3.3 of the agreement, the seller was obliged to use reasonable endeavours to supply the supplementary maximum daily quantity to Verve, if it made such a request.

On 3 June 2008, an explosion at a gas facility on Varanus Island reduced the supply of gas into Western Australia. As a result, the market price of gas increased significantly.

The next day, the seller stated that it was unable to supply Verve with any supplementary maximum daily quantity gas under the agreement, due to the issues at Varanus Island. However, the seller offered to supply Verve with an equivalent volume of additional gas under a separate short-term contract. Under this separate contract, the price of gas was much higher than the price of the gas otherwise provided under the agreement. Verve entered into this contract 'under protest'.

In mid-June 2008, the seller sought tenders for the purchase of gas for the period 30 June 2008 – 30 September 2008. Verve, which was under statutory and contractual obligations to provide electricity, tendered (once again, 'under protest') at a price that would ensure its tender would be successful. There was unchallenged evidence that, in practical and financial terms, Verve had no option but to enter into these supplemental agreements when the supplementary maximum daily quantity of gas was not provided under the agreement.

Verve sought damages for breach of the agreement. In particular, Verve alleged that:

- the seller breached clause 3.3 of the agreement because it failed to use reasonable endeavours to supply the supplementary maximum daily quantity of gas from 4 June 2008 – 30 September 2008; and
- it was forced to enter into the supplemental gas supply agreements in June 2008 under economic duress due to illegitimate pressure from the seller.

The judgment

The Court of Appeal found that the seller breached its obligation to take 'reasonable endeavours' to supply the supplementary maximum daily quantity of gas to Verve because:

- the seller relied on words in clause 3.3 of the agreement which stated that the seller could take into account 'all relevant commercial, economic and operational matters' in determining whether to supply the supplementary maximum daily quantity of gas to Verve. The Court of Appeal found that if the construction
advanced by the seller were accepted, it would effectively allow the seller to determine whether or not to supply the supplementary maximum daily quantity of gas purely by reference to its own commercial interests. According to the court, this would undermine the effectiveness of the reasonable endeavour obligation in clause 3.3, as well as contradict its natural and ordinary meaning. More importantly, the court found that clause 3.3 was drafted in such a way that the seller’s ability to refer to commercial and economic matters was subject to its primary obligation to use reasonable endeavours to supply the additional gas to Verve; and

- while a ‘reasonable endeavours’ clause had to be interpreted in light of its contractual context, it would ordinarily require a party to do all that can be reasonably done in the circumstances to achieve the contractual object.

The court also found that Verve was forced to enter into supplemental gas supply agreements in June 2008 as a result of illegitimate pressure from the seller. In particular, the court held that:

- the seller’s refusal to supply the supplementary maximum daily quantity of gas to Verve after the Varanus Island explosion was an application of illegitimate pressure;
- the fact that a party has a genuine belief that they are not acting in breach of an agreement does not preclude a finding of economic duress; and
- a party can apply illegitimate pressure on another, even if no threats or demands are made. In this case, the court accepted that the seller knew that Verve was left with no option but to accept the supplemental agreements offered to it, given Verve’s need to supply electricity to its own customers.

On 12 September 2013, the High Court granted special leave to appeal in relation to the findings on reasonable endeavours, economic duress and contractual limitations on liability. The appeal was heard on 4-5 December and the court’s judgment has been reserved. The judgment of the court, when delivered, may shed more light on the meaning of an obligation to use ‘reasonable endeavours’ and on the requirements for an action in economic duress.
This decision of the NSW Court of Appeal concerned a contractual clause which prohibited one party to a contract from assigning its contractual rights without the consent of the other contracting parties. The clause stipulated that such consent was not to be ‘unreasonably withheld’.

The court held that, in deciding whether to grant consent, a contracting party could have regard to a number of considerations relevant to the relationship between the parties under the contract. These included the legal and financial status of the party proposing to assign its rights, and the legal and financial status of the prospective assignee.

Where a contract prevents a party from assigning its contractual rights without the consent (not unreasonably withheld) of the other contracting parties, the other contracting parties may have regard to a number of considerations in deciding whether to grant such consent. If the parties are in dispute about their rights under the contract, these considerations may include the legal and financial status of the prospective assignor and of any prospective assignees.

Such a contract should also set out what happens when consent is withheld unreasonably — namely, whether the party wishing to assign its rights can proceed with the assignment.

The facts

The contract at the heart of this dispute was a consultancy agreement between the National Australia Bank and related companies (together, the banks) and a company named Idoport Pty Ltd. Under the agreement, Idoport was to provide consulting services to the banks in exchange for a service fee. Idoport sought to bring proceedings against the banks seeking damages for breaches of the agreement, but was barred from doing so until it had paid costs awarded against it in earlier proceedings. Idoport sought to pay those costs by way of a loan from Fulham Partners LLC and Portsmouth Partners LLC (together, the lenders). In exchange for the loan, Idoport purported to grant the lenders a charge over its rights under the consultancy agreement.

At issue before the Court of Appeal was whether Idoport’s attempt to assign its rights to the lenders had been effective. Relevant to this question was a particular clause of the agreement that prevented a party from assigning rights arising under the agreement ‘without the prior consent of the other parties (not to be unreasonably withheld)’. Idoport sought the banks’ consent, but consent was not granted. Idoport later became insolvent. Its receivers once again requested the banks’ consent to assign Idoport’s rights under the agreement. The banks continued to withhold consent.

The banks commenced proceedings in the Supreme Court of NSW, seeking declarations to the effect that the purported assignment had been ineffective. The primary judge (Justice Ball) granted the declarations sought. The lenders appealed.
The judgment

The Court of Appeal held that the banks had not acted unreasonably in withholding their consent. In reaching this conclusion, the court made several important observations.

First, the onus of proving that consent had been withheld unreasonably rested with the lenders. Secondly, in considering whether to grant consent, the banks were entitled to take into account a number of factors, including:

• that there had been a long-running dispute between the parties as to the construction of the agreement; and
• that the banks were unsecured creditors of Idoport, which was now insolvent.

Justice Basten rejected the lenders’ submission that these were matters extraneous to the consultancy agreement. His Honour held that these were legitimate considerations that arose directly from the dispute among the parties as to their respective rights under the consultancy agreement.

His Honour also considered what legal consequences would have flowed from a finding that the banks had acted unreasonably. The case seemed to have been argued on the assumption that the unreasonable withholding of consent would have amounted to an affirmative grant of consent, permitting Idoport to proceed with the assignment. His Honour expressed some doubt that this would have been the case. However, since the issue was not pressed by the parties, and no finding of unreasonableness was made, his Honour concluded that it was ultimately unnecessary to resolve the question.

Conversely, this case confirmed the usual rule (which is subject to the particular wording of the prohibition on assignment) that, if consent were reasonably withheld, any purported assignment would be ineffective.
Chapter 5: Excluding a duty of care

It is well accepted that:

- parties to a contract can agree to exclude any liability in negligence for work performed under the contract;
- a party will not owe a duty of care that is inconsistent with terms of the contract; and
- a contract that sets out the parties' obligations in detail may have the effect of excluding the implication of a duty of care.

In Apache Energy, the Western Australia Court of Appeal considered whether a party can bring proceedings in negligence notwithstanding that the relevant contracts excluded all common law duties (including claims in negligence).

As the proceedings concerned a summary dismissal application, the court did not need to determine whether a duty of care existed; only whether it was arguable that a duty of care existed. The court held that it was arguable. Two reasons of particular importance were:

- there was a difference between the duty of care that was alleged to have been breached and the duties imposed on the defendants under their contract; and
- in relation to one of the defendants, they could not rely on the contractual exclusion of a duty of care as they were not a party to the relevant contract.

The judgment also contained an interesting discussion of when, under Australian law, a duty of care to prevent pure economic loss might be found. In particular, it is not finally settled under Australian law whether the absence of ‘vulnerability’ and, in particular, the ability of a party to protect itself through the terms of a contract, prevents a court finding that a party owes a duty of care to prevent economic loss.
EXCLUDING A DUTY OF CARE

Apache Energy Ltd v Alcoa of Australia Ltd (No 2) [2013] WASCA 213

> Pure economic loss
> Concurrent liability in tort and contract

The Western Australian Court of Appeal held that a claim in negligence for pure economic loss could proceed even though a contract between some of the parties excluded liability in negligence. This case recognises that, generally, a duty of care in tort will not be recognised if the scope of that duty is inconsistent with the express or implied terms of the contract. However, a duty of care may be recognised where the alleged duty differs from duties imposed by the contract.

The facts

Alcoa of Australia Ltd, which owned and operated alumina refineries, entered into two contracts for the supply of natural gas to those refineries. One contract was with Apache Northwest Pty Ltd, Harriet (Onyx) Pty Ltd and Kufpec Australia Pty Ltd dated 20 August 2001 and varied in April 2005; the other was with Apache Northwest dated 12 June 2006.

Each gas supply contract contained a clause excluding all duties implied by general law (such as, relevantly, a duty of care).

Apache Northwest, Harriet and Kufpec part-owned natural gas processing plants. Another company, Apache Energy Ltd, operated the plant, but was not a party to the gas supply contracts. Each of these entities were joint licensees of a gas pipeline that ruptured and caused a fire at the processing plant on 3 June 2008. The fire interrupted the supply of gas to Alcoa’s refinery. Consequently, Alcoa had to source an alternative supply of gas at substantial cost.

Alcoa sought damages against Apache Energy, Apache Northwest and others. Alcoa contended that they owed it a duty of care on the basis that Alcoa was vulnerable to suffering economic loss if its gas supply was disrupted, due to its reliance on that particular pipeline, and the respondents had knowledge of that reliance. In its claim for negligence, Alcoa alleged that the rupture was caused by corrosion due to breaches of the following duties of care owed, being:

• Apache Energy’s failure to properly operate, maintain and repair the pipeline;
• Apache Northwest’s failure to supervise, oversee and monitor the operation of the pipeline.

In response, Apache Energy sought a summary dismissal of Alcoa’s claim in negligence for pure economic loss, arguing the terms of the relevant contracts excluded all common law duties (express and implied), and, consequently, excluded a claim in negligence.

The judgment

Justice Buss (with Justice Newnes concurring) relevantly held that:

• the requirements for a duty of care to prevent pure economic loss are not yet settled, particularly in relation to ‘vulnerability’ and whether a contracting party could have protected itself via the terms of the contract to obviate that vulnerability (Woolcock; Barclay; Bryan v Moloney (1995) 182 CLR 609; Perre v Apand (1999) 198 CLR 180);
• in particular, a party who is ‘vulnerable’ to liability in negligence cannot always protect itself in the same way a party in contract can; that is, vulnerability in contract is different to vulnerability in negligence and obtaining protection from each occurs differently;
• a party’s capacity to protect itself via contractual mechanisms is not determinative of a decision to reject concurrent liability in tort and contract, but it may be a good reason to do so (Woolcock); and
a party asserting concurrent liability in tort and contract is not
required to prove it could not have bargained to obtain that
protection in contract, and the ‘presence or absence of a claim in
contract’ does not necessarily determine a claim in tort (Barclay;
Astley v Austrust Ltd (1999) 197 CLR 1);

a contract will not necessarily wholly determine the rights and
liabilities between the parties, but it may have that effect,
depending on:

- how the contract was drafted; and
- whether it was the objective intention of the parties to exclude
  concurrent liability in tort and contract for that type of damage;

a duty of care will not arise if it is inconsistent with the terms of
the contract, or would allow a plaintiff to ‘circumvent or escape a
contractual exclusion or limitation of liability for the act or omission
which would constitute the tort’;

the breach duty of care alleged against Apache Energy and Apache
Northwest was not inconsistent with the terms of the contract, as
the scope of the duty of care alleged was a duty to take reasonable
care in supervising, overseeing and/or monitoring the operation or
maintenance and/or repair of the pipelines, and the clauses in each
gas supply contract do not limit or exclude liability on that basis,
but only exclude liability in relation to acts or omissions in relation
to the supply of gas;

Apache Energy was not a party to any of the relevant agreements
and therefore did not have the benefit of any exclusion clause in
the contract; and

whether, in this case, concurrent liability in tort and contract
actually arises is a question of fact on which further evidence may
be adduced at trial, having regard to the terms of the contracts, the
nature of the negotiations and the risk allocation in the contracts.
Chapter 6: Penalties

In *Andrew v ANZ*, the High Court emphasised the existence of an equitable doctrine of penalties in addition to the common law doctrine. The High Court’s formulation of the equitable doctrine is likely to be developed in a number of appellate decisions in the coming years.

In *Kellas-Sharpe*, the Queensland Court of Appeal was asked to reconsider the principle that concessional rates of interest for prompt payment could not be penalties (as distinct from clauses imposing higher rates of interest for late payment which, although in substance the same, can be penalties). The court decided that the principle was too well established to be overturned by an intermediate appellate court.

The High Court declined to grant special leave in this case because of a factual finding that, even if the doctrine applied, the particular clause was not penal. There is, however, a fairly strong prospect that the High Court will overturn this principle when it next has a chance to do so, as it is difficult to reconcile with the reasoning of the court in *Andrew v ANZ* and the maxim that equity prefers substance over form.
This Queensland Court of Appeal decision considered whether a clause establishing a concessional interest rate for prompt payment is a penalty, with the effect of rendering the interest rate provision void.

The Court of Appeal held that there is a distinction between a clause that provides an incentive for prompt payment, and a penalty clause where the interest rate is increased for failing to make a prompt payment. A clause establishing a concessional interest rate for prompt payment is therefore not a penalty.

This case upholds the long-established distinction between an increase in the rate of interest (which attracts the doctrine concerning penalties) and a covenant offering an incentive by reduction of the rate for prompt payment (which does not attract the doctrine). However, this distinction is arguably inconsistent with the judgment of the High Court in Andrews v ANZ and may one day be overturned by the High Court (or another appellate court).

The facts

The first appellant, Wendy Kellas-Sharpe, entered into an agreement in 2009 whereby the second appellant, Goldiway Pty Ltd (a company of which Ms Kellas-Sharpe was the sole director) agreed to purchase rural land at Cooroy, Queensland, from receivers appointed by a mortgagee. The respondent, PSAL Limited agreed to provide finance to Ms Kellas-Sharpe and Goldiway (together, the appellants).

The appellants and PSAL entered into the loan agreement in December 2009. The loan agreement provided that the standard rate of interest was 7.5 per cent per month, but while the borrower was not in default, the concessional rate of interest of 4 per cent per month applied.

The appellants failed to make repayments in accordance with the loan agreement. Consequently, PSAL made a written demand for payment in 2010. In May 2011, PSAL filed a claim in the Queensland Supreme Court, seeking a total sum of $1,745,166. The sum was derived by calculating interest after the repayment date at the standard rate of 7.5 per cent per month.

The appellants alleged that the interest rate provisions in the loan agreement constituted a penalty and were therefore void. The trial judge declined to find that the interest rate structure constituted a penalty. The appellants appealed against the decision.

The judgment

Justice Gotterson delivered the main judgment, with Justice McMurdo and Justice Fryberg in agreement. The appellants appealed on two grounds. That the trial judge had:

- erred in finding that the interest rate in the loan agreement between PSAL and the appellants was not subject to the doctrine concerning penalties; and
- erred in failing to hold that the interest rate provision was a penalty and therefore void.

Justice Gotterson referred to the fact that the rule which distinguishes a clause providing an incentive for prompt payment from a penalty clause (where the interest rate is increased for failing to make prompt payment) has been criticised for contradicting equity’s preference for substance over form. Further, he questioned the appropriateness of such a rule in ‘contemporary times’.
However, he was of the view that it was not open to the court to abolish this rule, noting that an attempt to do so may serve only to introduce new anomalies. His Honour held that the trial judge did not err in applying the rule in the manner he did, and, as such, the interest rate provision was not a penalty. Failure of this ground of appeal necessarily precluded success for the appellants on the second ground.

The appeal was dismissed with costs. The appellants sought special leave to appeal to the High Court. Special leave was refused because of the trial judge’s finding that, even if the doctrine of penalties applied, the clause in this particular case was not penal.
Share sale agreements frequently include clauses that provide for the purchase price to be adjusted depending on valuations that are undertaken after the contract is entered into. It is also very common for such clauses to give both parties the right to appoint valuers and for a timetable to be imposed for the provision of any report challenging such valuations.

The decision of the Queensland Court of Appeal in Mango Boulevard provides guidance on a number of important issues in relation to these clauses.

One of the most important findings of the court was that the share sale agreement contained an implied term that the identity of a valuer instructed to prepare a valuation report had to be communicated to the other party before arranging the valuation. The consequences of this implied term are potentially very serious, as a failure to give notice of the identity of a valuer can make the valuation ineffective. Depending on the drafting of the contract, this could result in a party forfeiting its right to challenge a valuation. Although it is difficult to reconcile this finding with the usual law concerning the implication of terms in contracts, the Queensland Court of Appeal reached its decision by applying the judgment of the High Court in Gollin. 6

Another common issue in valuation disputes is the consequence of failing to serve a valuation within the time required by the contact. The court confirmed the general principle that (subject always to the terms of the particular contract):

- if the contract does not state that time is of the essence, and does not state what consequence flows if the report is not served on time, than a report served late will still be a valid report;
- in those circumstances, if a time obligation is breached, the other party may serve a notice making time of the essence and requiring the report to be served within a reasonable time; and
- if a contract states that time is of the essence, or states what consequences flow if a report is not served on time, than a report served late will not be a valid report.


7 The terminology ‘time is of the essence’ is arguably inaccurate, unless a failure to serve the report on time is a breach of contract (as distinct from a mere failure to exercise a right). Nevertheless, it is now well accepted that in many contexts (including rent review clauses but not including, for example, failures to exercise options) a notice served out of time will still be a valid notice even if the failure to serve the notice on time was not a breach of contract.
CHAPTER 7: VALUATION CLAUSES

Mango Boulevard Pty Ltd & Anor v Mio Art Pty Ltd & Ors [2013] QCA 271

Interpretation of valuation mechanism

This Queensland Court of Appeal considered clauses in a share sale agreement under which the price of the shares in a company was determined by reference to valuations prepared by one or both parties.

The court upheld the decision of the trial judge and confirmed that an alternative valuation obtained by the vendor was effective.

When independently appointing a valuer to conduct a valuation, a contracting party should ensure they notify the other parties to the contract of the valuer’s identity before the valuation is undertaken.

Where a contract requires the valuer to assume certain facts in making a valuation, there is room for the valuer to err in making the calculations necessary to determine the value of those assumed facts withoutinvalidating the valuation.

The facts

In 2003, the appellants entered into a share sale agreement (SSA) with the respondents to acquire 50 per cent of the shares in Kinsella Heights Development Pty Ltd, a company that had contracted to purchase land north of Brisbane at Mango Hill (the property).

The appeal turned upon the proper construction of clause 4 of the SSA, which provided that:

• the purchase price of the shares would be calculated by reference to the improved market value of the property immediately after the date that preliminary development approval took effect (which was 30 January 2007);
• in a situation where the parties did not agree on the market value, an agreed valuer would carry out a valuation (the valuation);
• if a party was dissatisfied with the valuation, it could arrange an alternative valuation (the alternative valuation). Both the valuation and the alternative valuation were to be based on certain broad assumptions about the property;
• if the valuation and the alternative valuation differed by 10 per cent or less, then the average of both valuations would be the market value for the purposes of clause 4, and
• if the valuation and the alternative valuation differed by more than 10 per cent, then the question of the value could be submitted to mediation, and, if that failed, arbitration.

The valuation determined the value of the property as at 18 January 2007 to be $12.19 million. After extensive communications between the parties, the respondents sent an alternative valuation at November 2007, of $186 million, to the appellants. The alternative valuation was undertaken by a Mr Sergiacomi, without prior notification to the appellants of the valuer’s identity.

After proceedings commenced, the appellants raised the point that the alternative valuation valued the property after the effective date. Therefore, on 21 June 2011, Mr Sergiacomi undertook a further alternative valuation that assessed the property value as at 30 January 2007 to be $170 million.

The case on appeal centred on the effectiveness of both of the alternative valuations.

The major questions on appeal were:

Was it an implied term of the SSA that the identity of the valuer instructed to prepare an alternative valuation must be communicated prior to arranging a valuation?

The Court of Appeal applied the High Court case of Gollin & Company Ltd v Karenlee Nominees Pty Ltd & Anor (1983) 153 CLR 455 to find that such a term was implied in the contract. The court discussed a number of reasons for the implication of the term, including that:

• the consequences of the valuation were binding on the appellant (ie that the valuation would change or go to mediation);
• the appellant should therefore have had the chance to object to the valuer before the valuation took place;
• notification before the valuation has occurred prevents parties from ‘shopping around’ for a lower or higher valuation; and
• the valuer gains authority through being effectively approved by all parties.

As a result, the first valuation undertaken by Mr Sergiacomi was not an effective alternative valuation under the contract. However, further notification of Mr Sergiacomi’s appointment as valuer for the 2011 valuation was not required, as, by that time, the appellants were aware of the valuer’s identity.

Were the alternative valuations provided within a reasonable time?
It was uncontroversial on appeal that as the contract did not expressly provide a time limit for the alternative valuations, they must be done within a reasonable time. The appellants argued that the delay of more than four years between the valuation in February 2007 and the effective alternative valuation in June 2011 was not reasonable. However, the appellants had failed to make that complaint until after June 2011 and there were other matters in dispute – the delay in obtaining the alternative valuation was not holding up completion of the dealings between the parties. The delay was not prejudicial to the appellants.

The Court of Appeal found that the reasonable time limit had not been exceeded by the respondents. If it had been, the appellants would have been entitled under the contract to give the respondents a notice making delivery of an alternative valuation within a reasonable time essential.

What was the effect of any error in the alternative valuations?
Mr Sergiacomi had calculated the alternative valuations on the basis of a number of assumptions and measurements regarding area, density, yield and costs. The appellants argued that these were errors of principle akin to an error as to the identity of the property being valued.

The court rejected this argument and decided that any error in calculation of assumed facts by the valuer was not sufficient to render the valuation ineffective for its intended purpose. In doing so, it commented that the valuer was required to exercise a variety of judgments under the contract, and that, even if the errors were found, correction of them would have an immaterial impact on the final outcome of the alternative valuation.
Who to contact

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

Alex Cuthbertson
Partner, Melbourne
+61 9613 8740
Alex.Cuthbertson@allens.com.au

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

Marshall McKenna
Partner, Perth
+61 8 9488 3820
Marshall.McKenna@allens.com.au

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