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The Power of Together

Looking back

KWM Contract Law Review 2019

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Michael Swinson
Partner
T +61 3 9643 4266
M +61 488 040 000
michael.swinson@au.kwm.com

Cheng Lim
Partner
T +61 3 9643 4193
M +61 419 357 172
cheng.lim@au.kwm.com

Kate Creighton-Selvay
Partner
T +61 3 9643 4071
M +61 405 993 122
kate.creighton-selvay@au.kwm.com

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Welcome to the 2019 edition of our Contract Law Review. As in previous years, we have sought to distil the practical lessons to be learnt from the key contract law cases and legislative developments that have captured our attention over the last 12 months.

A key theme this year is that parties can find themselves in trouble as much for what they have left unsaid in a contract as for the express commitments they have made.

Disputes are far less likely to arise if the parties confront and deal expressly with key commercial features of their relationship at the time of entering a written contract. Similarly, parties may find their position compromised if during the performance of a contract they do not speak up to clarify or reserve their position on the written terms of the contract.

While there may be a natural reluctance to take an overly legalistic approach to relationship management, some level of formality and commitment to follow agreed processes is justified if a party wishes to maximise the protection that a written contract can offer. We hope that you find this year's edition of the Contract Law Review useful reading.

Formation

Plankton Australia v Rainstorm Dust Control [2018] FCAFC 205 (McKerracher J, Reeves J and Farrell J)

What was this case about?

This case illustrates the process by which courts will weigh up exchanges between the parties and relevant surrounding circumstances when deciding whether the parties have entered into an enforceable contract.

Summary

The parties, Plankton and Rainstorm, proposed to enter a joint venture for the purpose of securing the transfer and extension of a lease which was subject to the approval of the Western Australia Department of Lands (**Department**). While preparing submissions to the Department, the parties engaged in ongoing negotiations regarding the proposed structuring of the joint venture and future leasing arrangements. These negotiations and correspondence were subject to frequent comments and changes strategically calculated to obtain Department approval. The question on appeal before the Full Federal Court was whether the parties had, in the course of their negotiations and correspondence, entered into a binding contractual relationship as a joint venture.

In looking at the parties' negotiations, their Honours noted that "an agreement said to have been formed as a result of correspondence requires consideration of that correspondence as a whole" and that it was incorrect to concentrate solely on one element of conduct, that being the correspondence between the parties. Their Honours found that what the parties had developed was not a binding agreement but "a business case" made to the Department in a bid to secure the lease extension. Through their words and conduct, and against an analysis of the surrounding circumstances, the Full Court concluded that the execution of a formal agreement rested upon whether the Department approved the submission. Their Honours noted that for "parties to refer to the fact [that] they have agreed to something, does not mean, without more, that they are contractually bound." Instead, the parties showed themselves to be "anxious to secure the necessary leases so that they could then proceed with committing to an agreement." This conclusion was reached on the basis that:

- the documents used language of discussion and with a view to the establishment of a common ground;
- there was no invitation for particular terms to be accepted, agreed or concluded in some way; and
- various matters were left outstanding, such as the subsequent execution of a shareholders' agreement and a memorandum of understanding.

On an objective view, these matters in totality manifested an intention that any agreement was to be recorded in a subsequent formal instrument with not insignificant terms to be added to the agreement when the parties became aware of the Department's response. That one of the parties had commenced work on and heavily invested in the site failed to serve as evidence that the parties had concluded an agreement as, by the party's admission, they did so on the basis of demonstrating their capabilities to the other party.

Key takeaways and practice points

Courts will take a broad approach to determining whether the parties manifested the requisite intention to be bound by a set of contracted terms. Expressions such as 'we agree' are rarely considered in isolation and are not sufficient on their own to establish an intention to create a binding contractual relationship. This is particularly so where, in context, this type of language is used with a view toward establishing common ground as opposed to a binding agreement.

While parties may through their conduct indicate an intention to be bound to a contract, for this to be the case the conduct must be clear and unequivocal. Courts will not treat conduct that can be explained on other grounds, such as trying to facilitate negotiations rather than the performance of an alleged contract, as evidence that the parties had the consensus necessary to enter into legally binding relations. For this reason, parties should be wary of 'starting work' or otherwise incurring material costs without first clearly establishing that a binding contractual relationship has been established.

LSKF Holdings Pty Ltd v Shield Lifestone Holdings Pty Ltd and Others [2018] NSWCA 129 (Leeming JA, Payne JA and White JA)

What was this case about?

This case required the court to consider whether an agreement was void for the consideration being illusory and uncertain.

Summary

LSKF Holdings Pty Ltd (**LSKF**) and Shield Litestone Holdings Pty Ltd (**SLH**) each acquired a 50% shareholding in Litestone Holdings Pty Ltd (**Litestone**). LSKF, SLH and Litestone subsequently entered into a shareholders' agreement which provided that Litestone, by the unanimous decision of its board, "may request" shareholder loans from SLH. The board was comprised of Mr Y and Mr K, each the sole director and shareholder of SLH and LSKF respectively.

Following a complex dispute, LSKF and SLH entered into mediation which resulted in settlement subject to the determination of one final issue, namely, whether the parties would part in accordance with the shareholder agreement's prescribed buy-out procedure or whether Litestone would be wound up. Determination of this issue turned on whether the shareholder's agreement was valid and enforceable.

LSKF contended that the agreement as a whole was unenforceable because the consideration given by SLH was illusory and uncertain. It argued that SLH's promise to lend money to Litestone was essentially discretionary because it was subject to a request which, as a practical matter, could only be made with the agreement of Mr Y. It asserted that Mr Y had unfettered discretion in deciding whether to issue a request and that, as he was not a party to the shareholder agreement, he could not be compelled by LSKF as a matter of contract to do so. SLH acknowledged that Mr Y's discretion was limited by his statutory and equitable obligations as a director (i.e. to act in the good faith and best interests of the company), but maintained that these obligations could not be used to compel Mr Y to initiate a funding request to SLH. Such obligations could only be enforced against Mr Y personally by Litestone, the remedy being damages and not specific performance.

His Honour, Leeming JA, found that the shareholders' agreement neither lacked consideration nor was uncertain. The test applied by Leeming JA in determining whether a promise constitutes good consideration was adopted from *Giansoumi v Ribbera* [2017] VSC 631: "As long as there is some vestige of an objectively ascertainable obligation that can be broken by the promisor, then the promise probably amounts to a good consideration." His Honour also acknowledged the basic legal principle that where a contract reserves for a party an unfettered discretion or option as to whether or not to carry out what appears to be a promise, such promise will be void from a contractual perspective.

Ultimately, Leeming JA found that SLH's promise under the shareholders' agreement to provide funding pursuant to a request was not illusory and constituted good consideration. The fact that Mr Y in his capacity as a director of Litestone could not be compelled to issue a loan request to SLH did not affect the enforceability of SLH's promise to provide funds if such a request was made. In other words, if SLH refused a funding request, Litestone could unquestionably sue in damages for breach of contract – that commitment was clearly described and SLH's compliance could be objectively assessed.

Key takeaways and practice points

This case highlights the low threshold for showing that a contract is supported by effective consideration. Even where a promise is contingent on another event that may be considered discretionary, that promise may still constitute good consideration as it will be enforceable if the contingency comes to pass. Despite this low threshold, before entering into a transaction it is important to always consider whether the requirements for a valid contract have been satisfied – should you ever need to enforce the commitments made by the counterparty, it will clearly be undesirable to become entangled in arguments as to whether or not those commitments are, in fact, contractually binding due to lack of consideration, uncertainty, or some other deficiency.

Terms and Interpretation

Cellarit Pty Ltd v Cawarrah Holdings Pty Ltd [2018] NSWCA 213 (McColl AP, Macfarlan JA and Leeming JA)

What was this case about?

This case concerned the terms of an oral agreement and whether those terms had been varied by the conduct of the parties.

Summary

In 2006, Cellarit Pty Ltd (**Cellarit**), a company that facilitates the storage, logistics and sale of wine, entered into an oral agreement with Cawarrah Holdings Pty Ltd and Crusader Pty Ltd (together **Cawarrah**) for the use of Cellarit's services. Cellarit generated revenue for its services by charging its clients both a buyer's and seller's commission on bottles of wine that it stored and sold through its website. It was common ground that the parties had agreed to a commission rate of 15% on the sale of Cawarrah's wine. However, there was a dispute as to whether this rate was fixed for the entirety of their business relationship or whether Cellarit was entitled to vary the commission rates from time to time, which it had purported to do on a number of occasions. On each occasion, the parties had acted as though the altered commission rate had taken effect.

While recognising there were alternative interpretations available, the Court of Appeal was not prepared to overturn the trial Judge's finding that the parties had agreed for the commission rate to be fixed for the duration of their relationship, and that Cellarit should not have a unilateral right to vary the commission rate. However, the Court did find that the parties had by their conduct agreed to vary their contract to apply the higher commission rates proposed by Cellarit.

The Court noted that silence is generally insufficient to indicate an intention to create or vary a contract. However, silence in conjunction with other circumstances could indicate assent. The ultimate question before the Court was whether a reasonable bystander would regard the conduct of the Cawarrah, including its silence, as indicating an intention to accept the higher commission rates proposed by Cellarit. Applying this test, the Court found that Cawarrah's conduct in continuing to trade with Cellarit after Cellarit had proposed the higher commission rates indicated an intention to accept Cellarit's offer to alter the rates. In this respect, the Court accepted that a lengthy and consistent course of dealings, together with a failure to object to proposed new terms, could be relied upon to establish a binding variation. In this case, consideration for the variation was provided by Cawarrah by forgoing the benefits of the original agreement and continuing to incur liability for the increased commission.

Key takeaways and practice points

This case highlights how in the absence of a written agreement, courts are willing to look to objective considerations (including conduct) even where that may differ from a party's subjective intentions. When engaged in a lengthy and consistent course of dealing, it is important for the parties to a contract to ensure that their conduct corresponds with what they consider to be the terms of the contract. Otherwise, if they vary their conduct, this may be taken as indicating an intention to vary the terms of the contract. If a party does not agree to a change in contract terms proposed by the other party, it is important that they do not alter their conduct in a way that could suggest otherwise and, ideally, they should clearly communicate to the other party in writing that the proposed change is not agreed.

Donau Pty Limited v ASC AWD Shipbuilder Pty Ltd [2018] NSWSC 1273 (Ball J)

What was this case about?

This case required the Court to decide whether certain contingent provisions of a contract had come into effect and also whether the contract had been effectively terminated notwithstanding affirming conduct by the party purporting to terminate.

Summary

ASC AWD Shipbuilder Pty Ltd (**ASC**) was contracted to build at least three air warfare destroyer ships for the Commonwealth. ASC entered into a sub-contract with Donau Pty Ltd (**Donau**) for the construction of certain blocks that together would form the hull of each ship. Over time, a number of difficulties arose in implementing the contract due to a series of design changes. Conscious of these difficulties, the parties negotiated a 'contract refresh', resulting in a new Heads of Agreement (**2HA**). The 2HA purported to vary a number of key aspects of the original contract, including the fees payable to Donau.

In dispute was the amount of fees payable to Donau as a result of its continued work on the ship after the contract refresh. To resolve the matter, Ball J had to address two key issues, namely: (1) whether the relevant provisions of the 2HA had come into effect; and (2) whether ASC had effectively terminated the 2HA by giving written notice.

On the first issue, the terms of the 2HA specified that the relevant provisions would come into effect on the earlier of two dates, one being a fixed date and the other being the date on which the parties agreed to a 'Baseline True Up'. Donau argued that the 2HA should be applied literally, so that the provisions would come into effect even if the Baseline True Up had not been agreed. By contrast, ASC contended that it made no commercial sense for the relevant provisions to come into effect unless the parties agreed on a "Baseline True Up" and the 2HA should be interpreted accordingly. In reaching a decision, Ball J applied conventional principles of contractual interpretation, construing objectively the words of the parties while also taking into account the surrounding circumstances and commercial purpose of the 2HA. Ultimately, Ball J found that ACS's interpretation required a major departure from the language of the provision and that, notwithstanding minor practical problems, there was no compelling commercial reason why the provision couldn't take effect prior to the Baseline True Up. Accordingly, the Court found that the relevant provisions had come into effect as contended by Donau.

On the second issue, the 2HA stated that if the parties had not agreed to certain elements of the work by a specified date, ASC could terminate on written notice. ASC only served written notice on Donau when it became clear that no agreement would be reached, several months after the specified date. Donau contended that ASC's purported termination of 2HA was not effective on two grounds. The first was that ASC by its conduct had elected to affirm the 2HA before purporting to terminate. In this regard, Donau pointed to ASC's exercise of rights under the 2HA in the period after the right to terminate arose. The second ground put forward by Donau was that ASC's right to terminate was subject to an implied limitation that the right be exercised within a reasonable time.

Justice Ball rejected Donau's arguments and found that the 2HA had been effectively terminated by ASC. In reaching this finding, Ball J found:

- an election to affirm must be unequivocal, and in this case ASC's conduct was ambiguous. While the conduct was consistent with the 2HA remaining in force, it was also consistent with ASC reserving its position on termination to see whether the parties could agree on the Baseline True Up; and
- while ASC's right to terminate was subject to an implied limitation that it be exercised in a reasonable time, ASC had exercised its right within a reasonable time given the fact that the parties had been operating under a hiatus for a substantial period. In this regard, Ball J noted that what constitutes a "reasonable time" is a question of fact that will depend on the context in which the right arises and the circumstances of each case.

This outcome meant that the fees payable to Donau were to be calculated under the terms of the original agreement, resulting in a substantial judgement in ACS's favour.

Key takeaways and practice points

While the Courts will generally seek to take a pragmatic and commercial approach to construing a written contract, this does not enable them to ignore the plain meaning of the words used in the contract. Any interpretation must be sustained based on the terms of the contract.

A party's right to terminate a contract may be forfeited if they engage in conduct that is unequivocally inconsistent with that right and, therefore, affirms the contract. While the Courts will not readily find that such a significant right has been forfeited in this way, it will usually be better for the party in question to clarify its position in writing (e.g. by expressly stating that relevant rights are reserved).

Rights to terminate may be subject to implied conditions, such as that they must be exercised within a reasonable period. Again, while the Courts will take account of relevant context and will not readily find that such significant rights have expired, it will usually be preferable for the parties to promptly clarify their position in writing as to minimise any scope for uncertainty.

Parkinson v Mackay Sugar Ltd [2018] QSC 168 (Holmes CJ)

What was this case about?

This case concerned the construction of a clause which allowed for one party to make certain changes to the price-setting mechanism in the agreement but only "in consultation with" the other parties. The Court considered whether the other parties had to agree to the price change or whether the price change could be pushed through without agreement.

Summary

Mackay Sugar Ltd (**Mackay**) is an incorporated entity exclusively owned by cane growers that own three sugar mills in Queensland to which growers supply cane. In 2007, cane growers entered into a standard-form contract with Mackay known as the Cane Supply and Processing Agreement (**Agreement**) that, among other things, included mechanisms for determining the price Mackay would pay for cane supplied by the cane growers. Under the Agreement, Mackay could at any time alter operational matters in order to meet the operational needs of the mill provided the alteration was made "in consultation with" the cane growers.

Facing financial difficulties, Mackay sought to introduce by way of deed poll a levy on cane to cover operating costs. The cane growers challenged this on the basis that, while they were consulted on the proposed levy, they did not agree to its introduction. They contended that although the Agreement spoke of "consultation", it should be read as requiring the agreement of the growers as a precondition to any pricing changes. In response, Mackay contended the provision entitled it to unilaterally amend the terms at its discretion. It submitted that, in ordinary usage, an obligation to consult entailed the giving of notice of the subject on which views were sought so as to provide a meaningful opportunity for the other party to present its views, but it did not amount to a right of veto.

Chief Justice Holmes found that Mackay could not unilaterally introduce the levy, and that any such change required the agreement of the other cane growers. The decision turned on three key interpretive issues:

- **Ambiguity** – the term "in consultation with" was not unambiguous as suggested by Mackay. The choice of the preposition "in", as opposed to "after", suggested a temporal connection between the consultation and the exercise of alteration power. It implied a state of affairs during which the alteration is made. In other words, a change could only be made by the parties acting together, in consultation with one another, rather than by Mackay on its own.
- **Contractual context** – other parts of the Agreement were found to shed light on the interpretation of the provision requiring consultation. Chief Justice Holmes noted that the Agreement in numerous respects assigned a consultative or joint decision-making role to the bargaining representatives of the growers. This context suggested a requirement for decisions to be made collectively rather than by unilateral action.
- **Commerciality and background** – Chief Justice Holmes noted that the other parties might reasonably expect to have a greater role in decision-making about operational matters given the historical role played by Mackay as a co-operative for cane growers. The parties were also expressly obliged to act reasonably and in good faith. Having regard to all these considerations, Holmes CJ found that a reasonable business person would regard it as commercially rational that pricing amendments require a joint decision.

Key takeaways and practice points

The case highlights the importance of using clear and unambiguous language when drafting key contractual provisions. If there is an intention to confer specific rights upon one party that may be exercised unilaterally, or with complete discretion, then this should be stated explicitly. Obligations to consult or take into account the views of other parties may, in practice, have the effect of constraining a discretion that may have been intended.

As highlighted in the ACCC v Servcorp case discussed above, when contracting on standard terms with a small business it is also important to consider the impact of the ACL and the potential for terms that confer a unilateral discretion on one party to be considered unfair and, therefore, void.

Contract and Competition

Rehau Pte Ltd v AAP Industries Pty Ltd [2018] NSWCA 96 (Macfarlan JA, Sackville AJA, Emmett AJA)

What was this case about?

This case considered whether an exclusivity clause could be implied into an agreement. It illustrates how a term may be implied in a contract with reference to the proper construction of the express terms.

Summary

In September 1999, AAP Industries Pty Ltd (**AAP**) and Rehau Pte Ltd (**Rehau**) entered into an agreement (**Supply Agreement**) under which AAP was to supply plumbing products to Rehau.

On 6 July 2012, Rehau sent an email to AAP seeking possible price reductions of the products, and an 'understanding' that AAP should cease production until discussions about the possible price reductions were concluded. Despite this, Rehau continued to place orders for the plumbing supplies with AAP until 11 July 2013, after which no further orders were placed.

On 2 June 2014, AAP's solicitor sent Rehau a letter stating Rehau's failure to place an order for plumbing products after 11 July 2013 amounted to a repudiation of the Supply Agreement, which AAP had accepted, and that AAP intended to seek a substantial amount of damages. AAP subsequently commenced proceedings, submitting an implied term of the contract required Rehau to order certain plumbing products exclusively from AAP.

The primary judge, Davies J, indicated that terms could be implied where necessary to make commercial sense of the express words of the contract, or else could be implied as a matter of business efficacy on the principles stated in *Codelfa Construction Pty Ltd v State Rail Authority (NSW)* [1982] HCA 24, *BP Refinery (Westernport) Pty Ltd v Hastings Shire Council* [1977] HCA 40 and other long-standing authorities (namely that a term may be implied where it is necessary to give business efficacy to the contract and is also reasonable, obvious, capable of clear expression, and consistent with the express terms of the contract).

Justice Davies found that in this case an exclusivity term could be implied from the express language used in the Supply Agreement. His Honour gave particular reference to:

- a provision in the Supply Agreement that Rehau "shall purchase" the relevant plumbing products from AAP, with the word "shall" indicating a compulsion for Rehau to do so;
- clauses in the Supply Agreement requiring AAP to reserve sufficient production capacity to meet Rehau's requirements and to plan the raw materials necessary to ensure deadlines were met, as well as maintaining two months minimum buffer stock of the plumbing products. His Honour thought such clauses would be unnecessary if Rehau was entitled to acquire the products from other sources in the event AAP did not have the required production capacity or raw materials to meet Rehau's deadlines;
- the fact that a clause in the Supply Agreement requiring AAP to meet specified deadlines and required quantities was stated to be "absolutely binding", with a failure to meet a deadline entitling Rehau to terminate; and
- the fact that the Supply Agreement was to automatically renew on a rolling basis unless one party opted to bring it to an end. His Honour considered such a clause would be unnecessary if Rehau was under no obligation to purchase the plumbing products exclusively from AAP.

His Honour also found that an exclusivity commitment could also be implied on grounds of business efficacy, in line with other precedents on this topic.

The Court of Appeal agreed with Davies J's reasoning, finding that an exclusivity commitment should be implied from the express terms of the Supply Agreement as "the Supply Agreement read as a whole makes commercial sense only if it is construed as requiring Rehau, while the Supply Agreement remains in force, to purchase its requirements for the articles exclusively from AAP." In light of this conclusion, the Court of Appeal did not consider it necessary to determine whether the exclusivity commitment could be implied as a matter of business efficacy, such an implication requiring satisfaction of the higher threshold of necessity (i.e. the contract would not be effective without the term) rather than simply giving effect to what made commercial sense.

Key takeaways and practice points

This case illustrates that express written terms may not be the only terms that make up a contract – express written terms may be supplemented by material implied terms that are drawn from the language used in the contract itself or else are required to give business efficacy to the arrangement in question.

While the Courts will not necessarily be quick to imply terms without strong grounds to do so, in order to avoid the risk of an implication interfering with their commercial intentions, it is always better for parties to explicitly deal with important commercial issues in writing so that there is no confusion (as an implied term can never contradict an express term). For example, in a supply contract, it is always wise to expressly state whether the supply arrangement contemplated in the contract is intended to be exclusive, or whether the customer may source the same supplies from other sources.

Treasury Laws Amendment (2018 Measures No. 5) Act 2019 (Cth)

What does this Act do?

Under this Act, from 13 September 2019, intellectual property (**IP**) owners will no longer be able to rely on section 51(3) of the Competition and Consumer Act 2010 (**CCA**) to avoid the application of competition laws to their IP contracts.

Background

In 2016, the Productivity Commission published a report on *Intellectual Property Arrangements* in which it recommended the repeal of s 51(3). The key purpose for making this recommendation was to promote innovation and consumer welfare through the prohibition of anti-competitive licensing practices in IP-intensive industries such as pharmaceuticals, information technology and telecommunications. The Explanatory Memorandum for the Act also suggests that the repeal will bring Australia into line with comparable jurisdictions.

Impact of the Act

Currently, section 51(3) creates an exemption for certain types of conduct that might otherwise constitute a contravention of Part IV of the CCA. This includes, amongst other things, imposing or giving effect to a condition of a licence or assignment of IP rights, to the extent that the condition relates to the relevant IP rights. This exemption is not absolute – for example, it does not extend to misuse of market power or resale price maintenance, and does not extend to all types of IP (such as confidential information or trade secrets) – but does provide a freedom for contracts relating to IP rights that does not apply to other subject matter.

The Act will repeal the current exemption so that all existing and future licences, assignments and arrangements dealing with IP will be subject to generally applicable competition laws. This may raise concerns for IP agreements insofar as their terms can be viewed as:

- cartel conduct (e.g. where competitors agree on price, output restrictions or market sharing);
- exclusive dealing (e.g. where a supplier imposes restrictions on the other's freedom to choose with whom, in what, or where they deal); and/or
- an arrangement that has the purpose, effect or likely effect of substantially lessening competition in the relevant market.
- In the context of IP agreements, the following are at particular risk of raising competition concerns following the repeal of the s 51(3) exemption:
- licences that include quantity and/or price restrictions;
- conditions that limit the use of the IP rights with respect to certain customers;
- conditions that limit the use of the IP rights with respect to certain territories;
- patent pooling arrangements;
- 'pay for delay' arrangements, where for example, a pharmaceutical company may pay another to delay market entry;
- restrictive cross-licences entered into by parties following the resolution of a dispute; and
- licences that include 'grant-back' obligations under which a licensee must grant the licensor a licence for any improvements made by the licensee to the licensed technology.

Importantly, existing arrangements will not be grandfathered, so contracts dealing with IP rights may be exposed to the full effect of the CCA even if entered into before the change to repeal the current exemptions comes into effect on 13 September 2019.

Key takeaways and practice points

In anticipation of the amendment coming into force, businesses should identify all of their commercial contracts and arrangements concerning IP rights and conduct a review to establish whether any of agreements currently rely on the IP exemption.

Where an agreement has been identified as relying on the current exemption, a strategy should be devised to ensure that the agreement is compliant prior to the amendment coming into force. This may require the parties to negotiate and amend the terms of the agreement.

Failure to ensure that IP contracts and arrangements are compliant with the CCA may result in the parties facing criminal and civil penalties (including imprisonment for individuals), injunctions, and disqualification from the management of companies, not to mention lasting reputational harm.

The ACCC has published draft guidelines that set out further information on how the ACCC will apply the provisions of the CCA to IP agreements following the repeal of s 51(3), which should be consulted if in doubt about the potential impact of the repeal.

You can read more about this significant change to the CCA, along with our recommendations about how to ensure your business is ready for the change at:
www.kwm.com/en/au/knowledge/insights/ip-exemption-time-starts-now-20190304

Australian Competition and Consumer Commission v Servcorp Limited [2018] FCA 1044 (Markovic J)

What was this case about?

This case considered whether certain clauses in a standard form agreement breached the unfair contract terms (**UCT**) regime in Australian Consumer Law (**ACL**). The case offers guidance on how protections in the UCT regime for small businesses, enacted in November 2016, will be interpreted and applied by the ACCC and the Federal Court.

Summary

The ACCC commenced proceedings seeking declaratory and other relief against Servcorp, on the basis of the UCT regime. Servcorp is the publically listed holding company of Servcorp Parramatta Pty Ltd and Servcorp Melbourne Pty Ltd (collectively, the **Respondents**). The ACCC contended the following terms in contracts used by the Respondents were 'unfair' because they caused a 'significant imbalance' between the parties' rights within the meaning of s 24 of the ACL:

- an automatic renewal clause which, if the relevant counterparty did not give the required notice to terminate the contract, allowed the Respondents to unilaterally vary the price payable under the contract at their discretion with no obligation to notify the counterparty of the price increase;
- a limitation of liability clause which stated the Respondents (but for their own gross negligence or wilful misconduct) were not responsible for any loss, theft or damage to goods howsoever caused and that the counterparty must indemnify the Respondents for any loss;
- a clause allowing the Respondents to change, review or vary the charges for their Services;
- a clause that entitled the Respondents to determine the time at which notice has been validly served, allowing them to determine when a termination right has been exercised; and
- a clause allowing the Respondents to unilaterally terminate due to an alleged breach by the counterparty in circumstances where any asserted breach may not be material, the counterparty may not have been notified of, or aware of, the breach or given the opportunity to remedy the breach.

The Respondents did not seek to rebut the presumption that the terms were not reasonably necessary to protect their legitimate interests. The Court found that all clauses listed above, insofar as they were included in the relevant contracts, were unfair within the meaning of s 24 of the ACL, and void under s 23(1) of the ACL.

The ACCC sought an order for the Respondents to establish and implement a compliance program to ensure compliance with the UCT regime. The Respondents consented to this. The Respondents were also ordered to pay the ACCC's costs, fixed in the sum of $150,000.

Key takeaways and practice points

Companies that use standard form agreements to contract with small businesses should consider whether any clauses breach the UCT regime in the ACL, as these clauses will be void under s 23(1) of the ACL and the ACCC may seek to recover costs if it takes any enforcement action.

Companies should be especially careful when purporting to give themselves rights in standard form agreements that they can exercise unilaterally, particularly where they relate to key commercial matters such as contract price, termination, or renewal.

JPA Finance Pty Ltd v Gordon Nominees Pty Ltd [2019] VSCA 159 (Beach, McLeish and Niall JJA)

What was the case about?

This case illustrates that Courts may construe notice provisions strictly, so that a notice will not be effective if all prescribed requirements set out in a contract have not been properly followed. Even though a more commercial reading may ultimately prevail, in order to limit the risk it is important to pay close attention to all procedural requirements that may apply under a contract.

Summary

On 14 February 2017, JPA Finance Pty Ltd (**JPA**) and Gordon Nominees Pty Ltd (**GNPL**) executed a Call Option Deed (**Deed**) which entitled GNPL to purchase back 20 units in a trust it had transferred to JPA as security in consideration for a $2.1 million loan. JPA subsequently sought to exercise a right to terminate the Deed by issuing a letter by fax to GNPL's solicitors. The Deed stated that any notice issued under it must be in writing and must be "addressed to" GNPL by either fax or letter.

GNPL claimed that the notice of termination was not effective as it was addressed to GNPL's solicitors rather than GNPL itself, as was required under the Deed. At first instance, Robson J agreed with GNPL and held that JPA did not validly terminate the Deed because the notice was not effective. His Honour held that strict compliance with the notice formalities under the Deed was required given the significant effect that the notice of termination would have (i.e. it would result in the immediate loss by GNPL of a valuable right to repurchase the relevant trust units). His Honour suggested that a less strict approach may apply to notices that would not have such a significant effect, such as notices that are purely informational. In reaching his decision, Robson J considered a number of other cases that reinforce the position that Courts may strictly construe these types of provisions. For example, Gleeson CJ held in *Bond v Hongkong Bank of Australia Ltd* (1991) 25 NSWLR 286 that a notice that was served to a different address to one stated in the guarantee was not valid. While acknowledging this approach could produce "harsh results, his Honour stated that "there is no room for saying that near enough is enough."

The Court of Appeal disagreed with Robson J and upheld JPA's appeal. In doing so, it considered the critical question to be whether notice had been given in accordance with the language of the provision and gave less weight to whether or not any valuable rights were contingent upon an effective notice being issued. In this context, the Court of Appeal found that the requirement for the notice to be "addressed to" GNPL only required the notice to be directed to GNPL's attention without needing to formally address GNPL by name. The evident commercial purpose of this requirement was to ensure that notice was directed to the attention of the intended recipient. By contrast, there was no commercial purpose in requiring that the intended recipient be formally named by way of address, provided that the identity of the intended addressee was otherwise apparent on the face of the notice. To adopt the latter view would, be "highly technical and merely destructive of the parties' bargain".

Key takeaways and practice points:

While in the end a more pragmatic approach prevailed and the notice in question was ultimately held to be validly issued, the experience of the parties in this case illustrates the risk that Courts may apply a strict reading of notice provisions and allow little leniency to a party that fails to follow these provisions to the letter, particularly when important legal rights are at stake. As a consequence, when seeking to enforce contractual rights, it is always prudent to comply carefully with any notice and other procedural requirements.

Mal Owen Consulting Pty Ltd v Ashcroft [2018] NSWCA 135 (Basten JA, Macfarlan JA and Barrett AJA)

What was this case about?

This case illustrates the remedies that may be available to a party for a breach of contract that results in a lost commercial opportunity. It was held that a plaintiff can recover damages for a lost opportunity where it can establish that the opportunity had "real value" to the plaintiff (that is, of more than theoretical or negligible value).

Summary

The appellant, Mal Owen Consulting Pty Ltd (**Mal Owen Consulting**) instructed the respondent solicitor Peter Ashcroft (**Mr Ashcroft**) to recover moneys owed to Mal Owen Consulting by a third party relating to the sale of a business. On Mal Owen Consulting's instructions, Mr Ashcroft commenced proceedings against the third party in the District Court (the original proceedings). However, Mr Ashcroft failed to diligently pursue the original proceedings over the next 3 years. Mal Owen Consulting then instructed new solicitors who commenced fresh proceedings, and were successful in obtaining judgment against the third party. Unfortunately, the third party went bankrupt before the judgment debt was paid, and Mal Owen Consulting did not recover a dividend from the bankruptcy. Mal Owen Consulting then brought proceedings against Mr Ashcroft seeking damages for the loss suffered as a result of Mr Ashcroft's delay in prosecuting the original proceedings.

Mr Ashcroft admitted at trial that he had breached his contractual obligations under his retainer, and his duty of care in tort. However, the trial judge held that Mal Owen Consulting had not proved that it had suffered a loss. On appeal, Mal Owen Consulting argued that:

- it was sufficient for Mal Owen Consulting to have established the loss of a commercial opportunity having some value (and that it need not establish financial loss on the balance of probabilities); or
- in the alternative, the trial judge erred on the facts in failing to accept that the probability of financial loss had been established.

On appeal, Basten JA held that the occurrence of harm is not an essential element of a breach of contract claim and (unlike a claim in negligence) is not part of the damage that must be proved on the balance of probabilities. Justice Basten considered that where a claim exists for breach of a contract promising a commercial opportunity, the calculation of loss must be undertaken by way of an assessment of possibilities (that is, by reference to the prospects of success of that opportunity had it been pursued). In this case, there was no doubt that the proceedings were valuable to Mal Owen Consulting, but the question was whether they would have been more valuable in 2006 than when they were litigated some three years later by the second firm. His Honour undertook an assessment of damages based on the hypothesis that Mal Owen Consulting's claim would have been successful within a reasonable period from the date on which the original proceedings were first commenced. Taking into account the conflicting considerations (e.g. the possibility that even if the original proceedings had been pursued expeditiously, Mal Owen Consulting may not have been able to recover the full debt), his Honour awarded judgment in the amount of $100,000 (being approximately 50% of the debt owed by the third party).

Justice Barrett held in a separate judgment that resolution of a claim for a lost opportunity requires a two stage process:

- firstly, proof on the balance of probabilities that there is a substantial, not merely theoretical or negligible, prospect of a beneficial outcome; and
- secondly, an assessment of damages, focusing on the actual value of the lost opportunity by reference to the degree of probabilities, or possibilities, of factual hypotheses (which may involve a degree of guesswork).

The relevant lost opportunity here was the opportunity to bring the original proceedings to a favourable conclusion. The possibility of achieving a beneficial outcome was more than merely theoretical, and damages could be assessed by the possibility of a hypotheses under which this outcome would be achieved. Applying his two-step process, Barrett J also assessed damages at 50% of the debt.

Key takeaways and practice points

While the judges on the Court of Appeal followed slightly different reasoning, this case establishes that a plaintiff can recover damages for an opportunity lost as a result of a breach of contract, provided that it can prove that the opportunity had "real value". The process for quantifying the damages will require an assessment of the probabilities of different potential outcomes being realised, and so may be considered an inexact science, but nonetheless one the Corts will engage in. A party's ability to recover damages in this type of scenario may also be affected by liability caps or exclusions they have agreed, such as an express exclusion of liability for indirect losses, which may include loss of opportunity.

Semantic Software Asia Pacific Ltd v Ebbsfleet Pty Ltd [2018] NSWCA 12 (Macfarlan and White JJA, Sackville AJA)

What was this case about?

This case required the Court to consider whether a specific remedy clause in a contract may operate to exclude common law remedies for breach of contract.

Summary

Semantic Software Asia Pacific Ltd (**Semantic**) entered into a number of Share Issue Agreements with Ebbsfleet Pty Ltd and McGee Pty Ltd (together referred to as **Ebbsfleet**), who were trustees of a self-managed super fund. The Share Issue Agreements were based on communications between Ebbsfleet and Mark Bradley (who was Semantic's sole director at all material times), as well as an 'Investor Pack' provided by Semantic. The Investor Pack made representations to prospective investors as to the potential returns an investment may yield.

The Share Issue Agreements included a clause requiring Mr Bradley to personally guarantee the issued shares would triple in value within two years and, in the event this did not happen, Mr Bradley was required to personally transfer additional shares to effect the threefold increase in value. The clause also specified that Mr Bradley must personally retain at least 10,000,000 shares in his beneficial ownership to satisfy this guarantee.

The value of the shares ultimately diminished to the point that they were deemed 'practically worthless' by the Court. Further, Mr Bradley sold all of his shares following the execution of the Share Issue Agreements. The key contractual question that the Court of Appeal had to determine was whether or not the guarantee given by Mr Bradley to transfer additional shares operated as an exclusive remedy for a breach of warranty that the shares would triple in value. Because Mr Bradley had already disposed of his shares, this remedy was not available.

Ultimately, the Court held that the clause did not operate to exclude other remedies available at common law for the breach. In reaching this conclusion, Sackville and White JJ held that a clause should be construed by reference to what a reasonable businessperson would understand the clause to mean. This involves considering:

- the language used by the parties;
- the circumstances addressed by the contract; and
- the commercial purpose or objects to be secured by the contract.

Their Honours held that, when determining whether or not the clause operated to exclude other remedies for breach of contract, the question that needs to be considered is: what remedies did the parties to the contract intend to be available if the contractual promise is not fulfilled?

In this case, it was clear the commercial purpose of the Share Issue Agreements was to raise funds by issuing shares that were warranted to triple in value. The clause included a personal warranty by Mr Bradley to hold aside a substantial number of shares as security for the contractual promise. However, this warranty would be of no value to the investor in circumstances like the present where the shares were practically worthless. Their Honours thought the clause should be construed as security for performance of Mr Bradley's warranty, and could not have been intended to operate as an exclusive remedy when considering the commercial intention behind the warranty (being to ensure an increase in the value of the relevant investment within a set period of time).

Justice Macfarlan reached the same conclusion but through different means. His Honour applied the well-established presumption that neither party to a contract intends to abandon any remedies for breach of contract. Clear express words must be used in order to rebut this presumption. Furthermore, his Honour stated that the identification of one remedy is not in itself sufficient to impliedly exclude other remedies. Following this approach, since there was no express or even implied indication in the clause that the transfer of shares was to be the exclusive remedy, the clause could not operate to exclude other remedies for breach of contract.

Key takeaways and practice points

The Courts will not readily assume that parties intend to give up their legal rights, unless they have made a clear and express commitment to do so. The fact that a contract contemplates a specific remedy for a specific type of breach does not necessarily mean that other remedies may not still be available at common law for the same type of breach, unless the parties have expressly agreed otherwise. The common law has developed over many years to specify consequences that will apply if a party breaches a contractual commitment – these remedies should always be considered alongside any special remedies that the parties have expressly agreed in the terms of their contract. If the parties intend to exclude common law rights, they should do so expressly.

Midland Metals Overseas Pte Ltd v Powercor Network Services Pty Ltd [2019] VSCA 76, Supreme Court of Victoria (Tate and Whelan JJA and Almond AJA)

What was this case about?

This case concerned the recovery of a purported debt by means of a statutory demand. It illustrates when it is appropriate to seek the payment of a contractual debt pursuant to a statutory demand and when such demands will be set aside.

Summary

Powercor Network Services Pty Ltd (**Powercor**) entered into a contract with Midland Metals Overseas Pte Ltd (**Midland**) for the supply of electricity cables. After receiving a number of deliveries, Powercor refused to pay Midland, asserting that the cables were defective and did not comply with the relevant specification (**ZD056**) as set out in the contract. Shortly thereafter, Midland served on Powercor three separate statutory demands for payment relating to the orders. In response, Powercor commenced proceedings to have the statutory demands set aside under sections 459G and 459H of the *Corporations Act 2001* (Cth) on the grounds that there was a genuine dispute about the existence of the underlying debt.

Powercor succeeded at first instance. Midland then appealed on the basis that there was no genuine dispute, but the Court of Appeal rejected this argument. Citing earlier case law, the Court noted that a "genuine dispute" within the context of a challenge of a statutory demand was one that "connoted a plausible contention requiring investigation" and had a "sufficient objective existence and prima facie plausibility to distinguish it from a merely spurious claim, bluster or assertion." In the present case, there was a real difference of views as to whether or not the cables supplied by Midland complied with the technical specifications set out in the relevant contract. Midland contended that the item descriptions in Schedule 3 provided a comprehensive statement of the technical specification for the cable. Powercor contended that the specification was instead to be ascertained by reference to Schedule 2 and other documents. The Court concluded that the resolution of the question was "neither plain nor obvious" and would depend on the answers to interrelated and subsidiary questions of construction required to ascertain the purpose and effect of Schedules 2 and 3.

For these reasons, the Court refused leave to appeal. In doing so, the Court noted that the attempt to recover the purported debt by means of statutory demand was "precipitate and misconceived" and that the appropriate course would have been to issue proceedings. The Court also found that it had the power, on an application to set aside a statutory demand, to resolve the underlying dispute where that concerned a short point of law or the construction of documents or an agreed set of facts. In this case, the Court did not do so, as expert evidence would be required to resolve the difference of views about the technical specifications.

Key takeaways and practice points

A party to a contract should take care to ensure that there is no dispute over performance before seeking to recover a contractual payment by means of statutory demand. Such a demand should not be made if there are any genuine points of contention that should be resolved by legal proceedings.

As the Courts may be willing to resolve an underlying contractual dispute on an application to set aside a statutory demand, the party seeking payment should exercise caution so that it does not risk losing the opportunity to put forward its strongest case.

Other

Chinatex (Australia) Pty Ltd v Bindaree Beef Pty Ltd [2018] NSWCA 126 (Barrett, McColl and White JJA)

What was this case about?

This case considered whether or not an agreement was frustrated by the commercial failure of a separate agreement with a third party. It provides a useful illustration of how the doctrine of frustration may be applied in practice.

Summary

The appellant Chinatex (Australia) Pty Limited (**Chinatex**) entered into a contract referred to as the Service Kill Agreement (**SKA**) with the respondent Bindaree Beef Pty Limited (**Bindaree**) for a specified term. The SKA provided that Bindaree would acquire and slaughter cattle for Chinatex on a weekly basis in consideration for a service payment.

Chinatex's business objective was to on sell the slaughtered cattle it acquired under the SKA. To that end, it entered a contract with Australia Uniwell Group Pty Ltd (**Uniwell**), the Australian subsidiary of China-based meat wholesaler Shenzen Lianhua Enterprises Development Co Ltd (**SLED**). At the time the SKA was made, Bindaree was aware of the nature of Chinatex's business, but not of its specific arrangements with Uniwell.

Before the SKA was to commence, Uniwell 'decamped' from its sales agreement with Chinatex. Chinatex argued that this frustrated the SKA because the availability of SLED (or some other person arranged by SLED, such as Uniwell) as a taker of the whole of the output produced by the SKA was a shared and fundamental actuating assumption of Bindaree and Chinatex in entering into the SKA.

Justices Barrett, McColl and White rejected this argument and found the SKA had not been frustrated. Writing the principal judgement, Barrett AJA took the opportunity to discuss the doctrine of frustration, and the circumstances in which it will apply. His Honour endorsed the following summary of the law in *oOh! Media Roadside Pty Ltd v Diamond Wheels Pty Ltd* [2011] VSCA 116:

I take the law to be that a contract is not frustrated unless a supervening event:

(a) confounds a mistaken common assumption that some particular thing or state of affairs essential to the performance of the contract will continue to exist or be available, neither party undertaking responsibility in that regard; and

(b) in doing so has the effect that, without default of either party, a contractual obligation becomes incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract.

Applying this test, Barrett AJA stated that "when regard is had to the assumed condition or state of affairs that was necessary for the fulfilment of the SKA between Bindaree and Chinatex, it cannot, on the evidence, be said that the taking of the total output from Chinatex by SLED (or someone arranged by SLED) was in any sense at all a necessary element." In reaching this conclusion, Barrett AJA highlighted that the SKA did not even indirectly contemplate any on-supply arrangements between Chinatex and a third party or that the ability for Chinatex to on-supply the products supplied by Bindaree was a necessary element of the bargain that Chinatex and Bindaree had struck.

Key takeaways and practice points

For a contract to be frustrated, a contractual obligation must become incapable of being performed due to an unforeseen event that renders performance of the obligation radically different from that which was contemplated by the parties.

When determining whether or not a contractual obligation has been frustrated, the Courts will look for evidence of a common assumption that a particular state of affairs was a necessary element of their bargain. Unspoken assumptions about arrangements with a third party further down the supply chain will not provide a reliable basis for a frustration argument. To the extent that one party considers that such arrangements are critical to the performance of the upstream arrangement, this should be written into the relevant contract rather than left unsaid.

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Media enquiries

Charlotte Geddes
Head of Corporate Affairs
T +61 2 9296 3348
charlotte.geddes@au.kwm.com

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