KING&WOOD MALLESONS
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Contract Law Review 2020

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With thanks to Matthew Caldow for his editorial role and to Andrew Longo, Brittany Mashado, Georgia MacKenzie, Jonathan Beh, Madeline Close, Monica Stanisis and Nico Kunz for their contributions to this publication.

Welcome to the 2020 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.

An interesting theme this year is the ongoing relevance and application (though not always without controversy) of some of the classic and longstanding common law rules that most of us will remember well from contract law lectures at university. For example, we've seen cases this year that revisit well-worn ground relating to amongst other things:

- the principles from Masters v Cameron about the legal status of agreements that are "subject to contract";
- Justice Mason's classic "true rule" from Codelfa as to whether or not there must be ambiguity on the face of a contract before evidence as to surrounding circumstances can be used to assist in interpreting the contract (a controversy that has been the subject of extensive judicial and academic commentary in recent years, yet frustratingly is still somewhat uncertain under Australian law); and
- common law rules on privity of contract that in Australia still prevent an outsider from enforcing the terms of a contract (subject to a narrow range of exceptions established by a combination of case law and statute).

This demonstrates the value in having a good understanding of the cases that form the bedrock of contract law in Australia. Classic cases and the rules they establish are not merely of historical interest, and should not only be known by professors in universities. They set the framework within which all contract lawyers practice. Familiarity with this framework, along with an understanding of how it continues to be applied and incrementally developed by the Courts, is essential if you wish to provide sound advice to your clients.

We hope that you find this year's edition of the Contract Law Review useful reading, and that it sparks fond memories of long afternoons spent listening to contract law lectures in warm lecture theatres (or not, as the case may be!).

FORMATION

TERMS AND INTERPRETATION

TERMINATION

OTHER

Formation

Bacchus Resources Pty Ltd v Talisman Mining Limited [2019] NSWSC 1044 (Hammerschlag J)

What was this case about?

This case considered whether or not an agreement between parties that contemplates that the subject matter of their negotiation will be dealt with by a further formal contract may be immediately legally binding even if there is no further contract. The case offers guidance on when short form agreements to negotiate future long form agreements will themselves be considered legally binding.

Summary

Bacchus Resources Pty Ltd (**Bacchus**) and Talisman Mining Limited (**Talisman**) entered into a joint venture (**JV**) agreement for a particular undertaking. At the same time, Bacchus and Talisman entered into an "Alliance Deed" under which they agreed to consider other projects. Under the Alliance Deed, a party could identify an opportunity that met certain criteria and issue an opportunity notice to the other party offering to join in the exploitation of the opportunity.

Pursuant to the Alliance Deed, Talisman gave Bacchus an opportunity notice for a prospective JV for a new undertaking, which was accepted by Bacchus. The parties then negotiated and executed high level terms for the opportunity notice proposal (**Proposal**), which:

- required Talisman to draft a formal JV agreement which would subsequently be negotiated in good faith;
- required Bacchus to pay a non-refundable initial deposit to Talisman; and
- allowed either party to withdraw from the JV by giving 30 days' notice.

After some months had passed, Bacchus' solicitors wrote to Talisman alleging a failure to draft a JV agreement as required by the Proposal. Talisman took the position in a subsequent letter that the Proposal did not constitute a binding JV agreement. In response, Bacchus argued that the Proposal became binding upon payment of the non-refundable deposit. Bacchus also considered that the failure to execute and exchange a formal JV agreement meant that the parties were bound by the terms of the Proposal. Against that, Talisman argued that the Proposal was exhausted when the parties had negotiated in good faith (exchanging at least five drafts), but the negotiations failed to produce an executed formal JV agreement.

Eventually, Bacchus commenced proceedings against Talisman seeking orders to the effect that the execution of the Proposal created a binding JV between the parties.

His Honour, Hammerschlag J, found that a binding JV had come into effect and stayed on foot despite the failure of the parties to agree and execute a formal JV agreement. The key issue in this case was whether the language used by the parties in the Proposal revealed an intention to be immediately bound by the Proposal, or whether the language disclosed an intention to be bound to do nothing more than negotiate in good faith.

Ultimately, Hammerschlag J determined that the parties intended that there be a JV on the terms of the Proposal, and that they undertook to negotiate a fuller formal JV agreement on the footing that if they did not agree one, they would revert to the terms in the Proposal. His Honour considered the following factors in reaching this conclusion:

- the recitals of the Proposal recorded that the parties had negotiated the terms of the opportunity and noted that they would deal with it on the terms set out in the Proposal. This disclosed an intention that no further agreement was necessary to establish how the parties would deal with the opportunity;
- the Alliance Deed contemplated the parties negotiating and reaching agreement and entering into any necessary agreements to give effect to the acquisition, and the only agreement necessary to give effect to the acquisition was the Proposal;
- the structure of the JV was provided for in the Proposal, and it was not suggested that more terms were needed to make the arrangement workable; and
- Bacchus paid a non refundable deposit.

Justice Hammerschlag also considered that Talisman's letters did not effectively bring the Proposal to an end, as they did not purport to give 30 days' notice to Bacchus as required by the terms of the Proposal.

Key takeaways and practice points

This case illustrates the importance of carefully considering whether the language of a short form term sheet, memorandum of understanding or heads of agreement shows an intention to create immediately binding legal relations. Whether a short form agreement is binding will depend on, amongst other things, the language used in the document, and the context in which the document was negotiated.

In particular, this case highlights the following key takeaways:

- where the subsequent execution of a further formal document is expressed to be a condition, then it is less likely that the parties intend to be immediately bound;
- where the terms of the original document are capable of immediate enforcement without further agreement, there is more likely to be an intention to be immediately bound;
- non-refundable payments may be indicative of an intention to be immediately bound;
- if the totality of the initial agreement is workable without further terms, then the parties are more likely to have intended to create legal relations that are immediately binding; and
- where any contractual arrangement prescribes a process for termination (e.g. by specifying a notice period), a party seeking to terminate should ensure that the process is followed carefully (e.g. by ensuring that the appropriate period of notice is given).

Angelis (as trustee for the Angelis Family Trust) v Pemba Capital Partners Fund I Partnership, LP (No 3) [2019] NSWSC 1759 (Stevenson J)

What was this case about?

This case considered whether a term sheet was effective to bind the parties to execute a corporate acquisition and reiterates that even if a term sheet is expressed to be "binding", its effect will depend on the nature and content of the obligations set out in the term sheet.

Summary

Coverforce Holdings Pty Ltd (**Coverforce**), an insurance broker, sought to acquire Resilium Pty Ltd (**Resilium**). The proposed transaction involved Coverforce financing a management buyout of Resilium, with Resilium's management subsequently selling the business to Coverforce in exchange for a shareholding in Coverforce.

During negotiations between Coverforce and Resilium, the managing director of Resilium stated that he would only agree to the proposed acquisition if a drag right conferred on Pemba Capital Partners Pty Ltd's (**Pemba**), Coverforce's major shareholder, was removed from Coverforce's shareholders agreement (**Shareholders Agreement**). This drag right allowed Pemba to compel other Coverforce shareholders to sell their shares at the same price and on the same terms as Pemba was selling. However, Pemba insisted that it would not support the transaction unless it retained a clear pathway to exit, either through the drag right or an alternative exit mechanism (i.e. a put option).

In order to progress negotiations and demonstrate Coverforce's interest in Resilium, Pemba agreed to Coverforce's managing director, Mr Angelis, executing a term sheet with Resilium setting out the proposed terms and conditions of the acquisition. The term sheet included a draft updated Shareholders Agreement which omitted Pemba's drag right but did not mention that Pemba was seeking a put option as an alternative, as Pemba and the other Coverforce shareholders had not yet agreed on the valuation of the option. Coverforce and Resilium subsequently executed formal transaction documents without Pemba's agreement.

At trial, Mr Angelis claimed that Pemba's agreement to the execution of the term sheet constituted its agreement to proceed with the transaction and amend the Shareholders Agreement (i.e. that the term sheet was binding). Justice Stevenson held that there were some elements of the term sheet which were intended to be binding, including clauses which related to due diligence, confidentiality and public announcements about the proposed transaction. However, the term sheet did not oblige Coverforce to proceed with the transaction for the following reasons:

- although clause 2 of the term sheet was headed "Term Sheet Binding", the body of the clause stated that the term sheet set out the "proposed terms" of the transaction, which suggested those terms were not yet final;
- the term sheet envisaged a "Phase 2 Term Sheet", which would include key details about the transaction including additional financing, operational and transaction considerations and a proposed timetable for the execution of definitive transaction documentation. The need for a further term sheet indicated that the parties did not intend for the initial term sheet to bind either party to the proposed transaction;
- the term sheet provided that after its execution, Coverforce and Resilium would continue to negotiate the terms of the "formal and binding documents in relation to the transaction", and listed out the formal documents to be negotiated. The requirement to negotiate again indicated that the parties did not regard the term sheet itself to be a formal and binding document in relation to the transaction; and
- the term sheet provided that the managing director of Resilium would become a party to the Coverforce Shareholders Agreement, but stated that the issue of shares was subject to shareholder approval. Furthermore, an updated Shareholders Agreement was one of the "formal documents" that had to be negotiated after execution of the term sheet. The term sheet therefore could not bind Pemba to a variation of the Shareholders Agreement.

Key takeaways and practice points

It is possble that a "binding" term sheet may not always be effective in legally binding the parties. Depending on the particular facts of the case, further negotiation and agreement may be required before all aspects of the term sheet become binding. Factors that influence whether a term sheet is binding on its own include the language used in the document, whether the document envisages further steps to be taken, including preparation and negotiation of formal documents, and whether any obligations are subject to the approval of other parties.

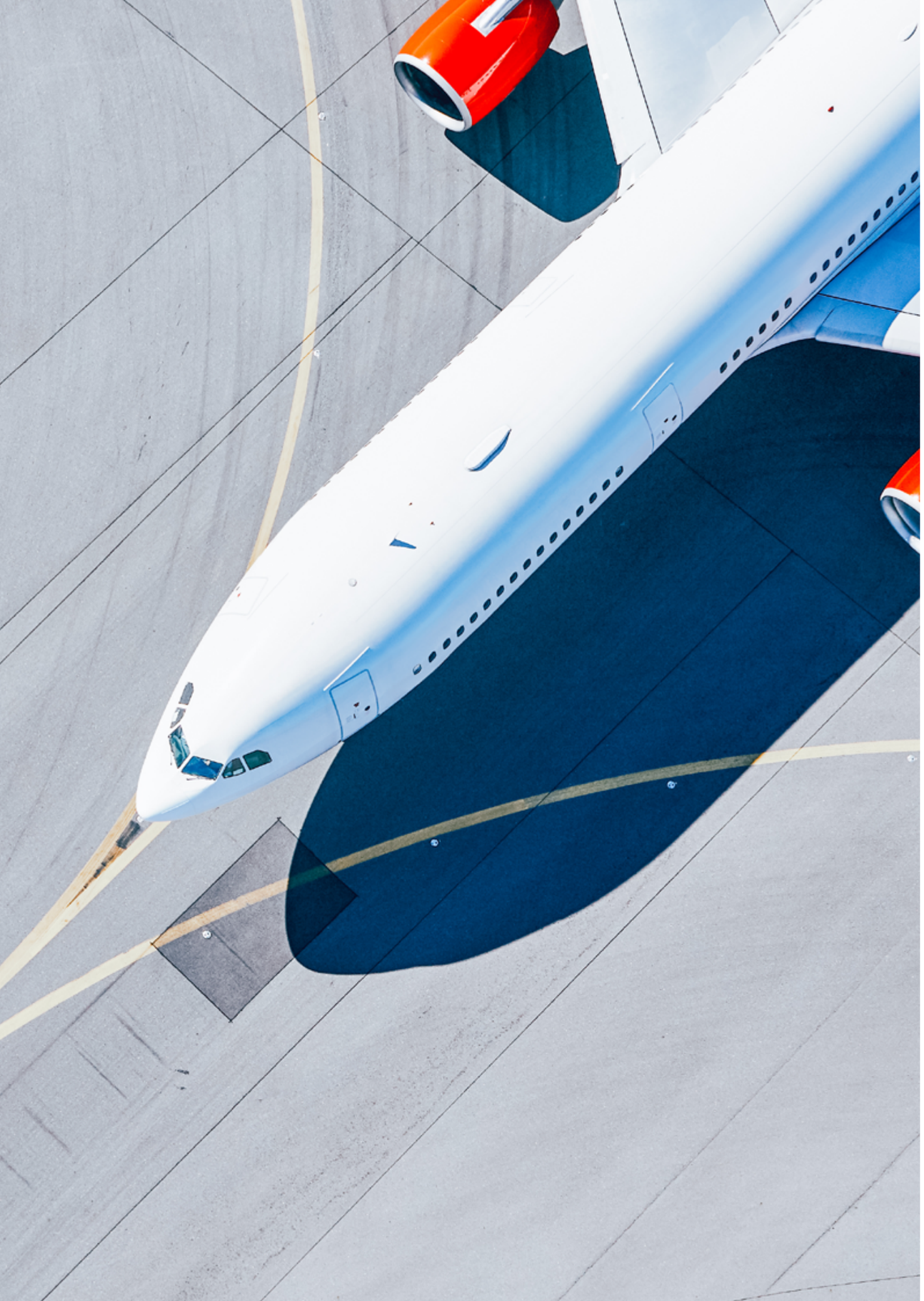
This case serves as an interesting factual counterpoint to the *Bacchus v Talisman* case discussed above, since the binding status of the early-stage document was different in the two cases. Each of these cases is, naturally, fact specific. However, together they demonstrate the risks of leaving the effect of a term sheet or other early-stage document in an indeterminate state. If it is intended for a term sheet to be binding, it should be drafted using clear language that expresses this intention. In addition, each party should seek express confirmation that the other has appropriate authority to enter into the agreement and fulfil its obligations without obtaining further approvals or other steps being required.

"Subject to Contract" – Masters v Cameron (1954) 91 CLR 353 (Dixon CJ, McTiernan and Kitto JJ)

The case of *Masters v Cameron* (1954) 91 CLR 353 provides a useful starting point from which to analyse the status of documents which are subject to the subsequent execution of a formal contract. The High Court categorised these "subject to contract" documents into three main classes. Which class a document falls into will depend on the intention of the parties, and therefore, the construction of the documents in question:

1. **execution of the formal contract is a mere formality:** the terms of the contract have been finalised but the parties wish to restate those terms in a fuller or more precise form which is no different in effect. The parties intend to be immediately bound to the performance of the agreement, regardless of whether the formal contract is executed;
2. **execution of the formal contract is a condition precedent to the obligation to perform:** the terms of the contract have been finalised and the parties do not intend to vary any of those terms. The parties are bound to execute the formal contract and then perform the agreed terms; however, performance of one or more of the parties' obligations is conditional on the execution of a formal contract; and
3. **execution of the formal contract is a condition precedent to formation of the contract:** there is no binding contract unless and until the formal contract is executed. For example, the parties may have only finalised the major terms of the contract and have not negotiated other matters yet, or even if all terms have been finalised, the parties may intend that those terms not become binding until the execution of the formal contract. Documents in this class have no binding effect and the parties may withdraw from the arrangement at any time without being in breach of contract.

When drafting any preliminary document for a contractual arrangement that contemplates that further formal documentation will follow, it is useful to consider which of the three classes you are intending to fall into. If you are not sure, or if it is not immediately apparent from the terms you have drafted, then further work is required!



Bombardier Inc v AVWest Aircraft Pty Ltd [2020] WASCA 2 (Buss P, Beech JA and Pritchard JA)

What was this case about?

This case considered the fundamental common law principle that acceptance of an offer for the purposes of forming a contract requires communication of that acceptance to the offeror and demonstrates that only clear and unambiguous drafting will modify or dispense with this principle.

Summary

Between 2009 and 2015, AVWest Aircraft Pty Ltd (**AVWest**) and Bombardier Inc (**Bombardier**) engaged in an extensive commercial relationship whereby Bombardier would sell aircraft to AVWest and repurchase them if a third party purchaser was found. AVWest's registered office was located in Perth and its principal place of business was Western Australia, while Bombardier was headquartered in Quebec and conducted all of its operations in Canada.

AVWest commenced proceedings in the Supreme Court of Western Australia against Bombardier for failing to perform its contractual obligations under 12 agreements. In order to issue and serve a writ on Bombardier in Canada, AVWest sought and obtained leave under Order 10 of the *Rules of the Supreme Court 1971* (WA) (**Order 10**). Bombardier disputed the jurisdiction of the Supreme Court and applied for orders setting aside the grant of leave to issue and serve the writ. The key issue in dispute was whether there was an arguable case that the agreements were made in Western Australia and therefore satisfied the jurisdictional conditions in Order 10.

Each agreement was made in the same way, whereby Bombardier would sign a copy of the agreement sent to it by AVWest and email the signed copy back to AVWest. AVWest submitted that because it received communication of Bombardier's acceptance in Western Australia, communication being the last step in the formation of the contract, the contract was made in Western Australia. However, Bombardier relied on a clause in each agreement stating that the agreement "shall be effective as of the date of its acceptance and execution by the Seller [Bombardier]" (acceptance clause). Bombardier argued that this clause had the effect of displacing the common law principle requiring communication of acceptance and as a result, the agreement was made when executed by Bombardier in Canada.

As this case was an interlocutory proceeding concerning the validity of an application for leave for overseas service, the Court of Appeal only had to decide whether there was an arguable case that the contract was made in Western Australia and did not make a final determination. In any event, the Court of Appeal rejected Bombardier's interpretation and dismissed its application for leave to appeal. The Court reaffirmed that a commercial contract is to be interpreted objectively based on what a reasonable businessperson would understand the terms of the contract to mean. Furthermore, construction of a contract should produce a result which is consistent with the commercial purpose of the agreement. The Court held that there was an arguable case that the communication of acceptance was still required for the following reasons:

- the acceptance clause was not concerned with when the contract was made but rather when the terms of the contract were to become "effective" or operative. It did not waive the ordinary requirement that acceptance of the agreement must be communicated;
- the fact that the agreements could be executed in counterparts and subsequently delivered to each party was inconsistent with the argument that communication of acceptance was not required; and
- as a matter of commercial practicality, communication of acceptance is necessary to give the parties clarity as to when their contractual obligations become operative. Without any communication of acceptance, AVWest would have no means of determining whether Bombardier had actually accepted the terms of the agreement and, therefore, whether the agreement was in effect. The commercial certainty would also benefit Bombardier, as it had to ensure that it was not legally obligated to sell an aircraft to AVWest at the same time as it had contracted to sell the same aircraft to a third party.

Key takeaways and practice points

While this was only an interlocutory proceeding, there are still useful lessons that can be taken away from this case. In particular, a contract is made at the place where the last step of the formation of the contract occurs. Under common law principles, this will be the jurisdiction in which communication of the acceptance is received, because communication is required to give both parties certainty as to the existence of a valid contractual relationship and the time from which their legal obligations begin. Express and unambiguous drafting, or a clear inference from the circumstances, will be required to waive the requirement to communicate a party's acceptance, because Courts will generally seek to prioritise commercial certainty when interpreting contracts. Companies should carefully consider whether to give any such waiver, as it may lead to uncertainty and unexpected outcomes.

Terms and Interpretation

Galileo Miranda Nominee Pty Ltd v Duffy Kennedy Pty Ltd [2019] NSWSC 1157 (Parker J)

What was this case about?

This case involved an assessment as to whether or not a party had a "reasonable cause" to exercise a contractual right of suspension. The Court found that this was a question to be determined objectively, including by considering whether the suspension was a proportionate response to the underlying cause.

Summary

Galileo Miranda Nominee Pty Ltd (**Galileo**) engaged Duffy Kennedy Pty Ltd (**DK**) as contractor to design and construct two residential tower buildings and other facilities as part of a major development. The contract price was $65,758,576 exclusive of GST.

Galileo failed to make a progress payment before the contractually required date. Subsequently, DK gave Galileo notice of its intention to suspend construction work under section 16(2)(b) of the *Building and Construction Industry Security of Payment Act 1999* (NSW) (the **Act**), which entitled DK to suspend works until the end of the third business day after payment had been received.

Despite eventually receiving payment of the progress amount, DK continued to suspend the works. Galileo issued a show cause notice alleging that, among other things, DK had suspended the works without reasonable cause. In response, DK asserted that Galileo had failed to pay $177.20 in interest that had accrued on late payment of the progress amount and, as interest formed part of the payment amount under the Act, DK was entitled to suspend the works.

At trial, Parker J held that section 16 of the Act only entitled DK to suspend construction works while the principal amount of the progress payment remained unpaid and did not include any interest. Therefore, DK's entitlement to suspend works expired three business days after it had received payment of the progress amount. However, the contract only allowed Galileo to serve a show cause notice if DK had suspended works "without reasonable cause". DK argued that even if it had no statutory right to suspend works, the notice was invalid because Galileo's failure to pay interest constituted a "reasonable cause" for suspension, especially in circumstances where DK had acted in good faith in accordance with a reasonable interpretation of the Act.

Justice Parker held that whether a party has reasonable cause under a contract should be determined objectively. A business-like construction of the contract should allow the parties to determine their respective positions objectively; a subjective determination of "reasonable cause" would create uncertainty as it would rely on the internal deliberations and thinking processes of each party. Commercial certainty is especially important in relation to the right of suspension. According to Parker J, the amount of interest owing by Galileo "was miniscule in the scheme of things" and suspension of works was a completely disproportionate response. The failure to pay interest did not constitute a "reasonable cause" for DK to suspend construction and Galileo was entitled to terminate the contract for breach by DK, effectively enabling Galileo to reallocate the work to a different contractor.

DK appealed the trial decision on the grounds that Parker J erred in his interpretation of section 16 of the Act and that the show cause and take-out notices were invalid (*Duffy Kennedy Pty Ltd v Galileo Miranda Nominee Pty Ltd* [2020] NSWCA 25). The appeal was unanimously dismissed. The interpretation of "reasonable cause" in the contract was not a ground of appeal.

Key takeaways and practice points

Courts will interpret commercial contracts in a business-like manner and seek to give the parties as much certainty as to their rights and obligations as possible. If a party has the right to suspend works or take other specified action if there is "reasonable cause", then in the absence of clear contractual terms indicating an intention to grant a broader discretion, the existence of the "reasonable cause" should be determined objectively and will not be left to the subjective whims of the party to whom that right is granted. An objective assessment should include a consideration of proportionality.

When exercising any qualified contractual right of suspension, companies should be especially careful to consider whether the suspension is a proportionate response to the underlying concern. Factors to be considered include the nature and severity of any alleged default and its materiality when assessed against the contract as a whole. Failure to undertake such an analysis may invalidate the suspension and result in exposure to damages or even termination of the contract.

Advanced National Services Pty Ltd v Daintree Contractors Pty Ltd [2019] NSWCA 270 (Gleeson JA, White JA and Barrett AJA)

What was this case about?

This case concerned the potential consequences of failing to obtain consent to subcontract the performance of a contractual obligation. As it illustrates, the impact may be significant, particularly where the contract is for services that are intended to be performed personally by the service provider.

Summary

Daintree Contractors Pty Ltd (**Daintree**) entered into contracts with Advanced National Services Pty Ltd (**Advanced**) for the cleaning of Daintree client premises. The contracts required Advanced to obtain written consent to subcontract or assign any obligations under the contracts. Upon discovering that Advanced had used unauthored subcontractors to complete 90% of the work, Daintree terminated the contract immediately for the breach as it was entitled to under the contract. Daintree also refused to pay for services rendered prior to termination.

Advanced brought proceedings against Daintree claiming a liquidated sum for performance of the cleaning services or alternatively damages for breach of contract. The parties agreed that the services had been provided and that there was no issue with quality. The primary judge held that Advanced should be paid for the services it had personally delivered but it had not "earnt" the money for performance completed by unauthorised subcontractors and so Daintree was not liable to pay for that work.

The Court of Appeal agreed with the primary judge and dismissed an appeal by Advanced. Justice of Appeal Gleeson (White JA and Barrett AJA concurring) held the contracts were not merely contracts to produce a result but rather contracts for the personal performance of cleaning services by Advanced in a particular manner, and on certain conditions. It was not a matter of indifference to the parties whether the work was performed by Advanced itself or by an unauthorised subcontractor.

Whether a contract required personal performance could not be determined solely by looking at the subject matter but depended on inferences to be drawn from the contract, the subject matter and other material surrounding circumstances. The Court preferred Daintree's construction of the contracts in question, requiring personal performance except where permission had been given for subcontracting, because:

- the contracts prohibited the assigning or subcontracting of performance without written approval by Daintree;
- the contracts used the verb "perform" rather than a more general expression such as "provide" or "supply" cleaning services;
- the contracts distinguished between two modes of performance, either by Advanced itself or by Advanced using authorised assignees or subcontractors. This suggested that there was no third mode of performance by unauthorised subcontractors;
- the contracts imposed extensive conditions on Advanced in the performance of the work, including among other things the level of insurance, OH&S training and compliance reporting. The contracts also provided Daintree with mechanisms to ensure compliance with those conditions and the right to terminate immediately without notice or opportunity to remedy breach if these conditions were not met;
- if unauthorised subcontractors had been permitted, it would cause many of the contractual protections for Daintree, such as requirements to take out workers insurance that would only cover authorised subcontractors, to be set to naught; and
- Daintree's construction would not lead to a non-commercial result.

Issues of quantum merit, unjust enrichment or penalty clauses were not raised by the parties and therefore not considered by the Court even though the judges acknowledged that those issues may have been relevant.

Key takeaways and practice points

Ignoring a requirement to obtain consent before subcontracting the performance of a contractual obligation may not only result in the termination of the contract for breach but may also entitle the innocent party to refuse to pay for services performed by the unauthorised subcontractors.

Accordingly, it is essential for service providers to be aware of what rules and restrictions apply to subcontracting or assignment of their service obligations and to strictly comply with those rules and restrictions. In order to avoid uncertainty, contracts should expressly deal with subcontracting rights, and should be clear about the consequences if unauthorised subcontractors are used.

DiCOM AWT Operations Pty Ltd v City of Stirling [2019] WASCA 117 (Quinlan CJ, Mitchell JA and Beech JA)

What was this case about?

This case dealt with the interpretation of conflicting definitions and uncertain completion criteria used in a contract. It illustrates the importance of ensuring that key concepts used in a contract are clearly and consistently defined.

Summary

This appeal concerned the proper construction of two waste supply contracts between DiCOM AWT Operations Pty Ltd (**DiCOM**) and the Western Metropolitan Regional Council (**Council**) and the City of Stirling (**City**) respectively.

Under the contracts, DiCOM provided processing services at the DiCOM Waste Processing Plant (the **Facility**) in order to remove recyclable material and thereby reduce the amount of waste the Council and the City were required to send to landfill.

A dispute arose under each contract about whether obligations of the Council and the City to start making (and paying for) regular delivery of waste to the Facility had been triggered. The trigger terms were "on achievement of Practical Completion in respect of Stage 2 (as notified by [DiCOM])" for the contract with the Council where "Practical Completion" was not defined, and "Final Completion" for the contract with the City where "Final Completion" was inconsistently defined in the body of the contract and an attached schedule.

The trial judge held that both these conditions would be met when practical completion of the Facility was certified under a contract for the construction of the Facility (**Construction Contract**) rather than when DiCOM notified a party that the facility was complete. The Appeal Court dismissed an appeal from that ruling for the reasons below.

Council Contract

The contract with the Council consisted of a number of trial periods where the Council was delivering test quantities of waste before the full delivery obligations began "[o]n achievement of Practical Completion." DiCOM argued that this occurred at the end of the trial periods. Even though "Practical Completion" was not defined, the Court held that the language used was not apt to denote the conclusion of a period, such as a trial period. Additionally, the contract did not provide criteria by which the trial periods could be judged to determine successful completion. Construction of a contract is to be determined by what a reasonable business person would have understood the terms to mean. The Court held that a reference to "achievement" indicates that something must be achieved rather than something automatically following from the giving of notice. In this case, the Court found that "Practical Completion" was achieved when completion of the Facility was certified under the Construction Contract. In support of this conclusion, the Court considered that the commercial purpose of the agreement as a whole was to process waste and a construction which would require the Council to pay fees when the Facility was not capable of processing waste was uncommercial.

City Contract

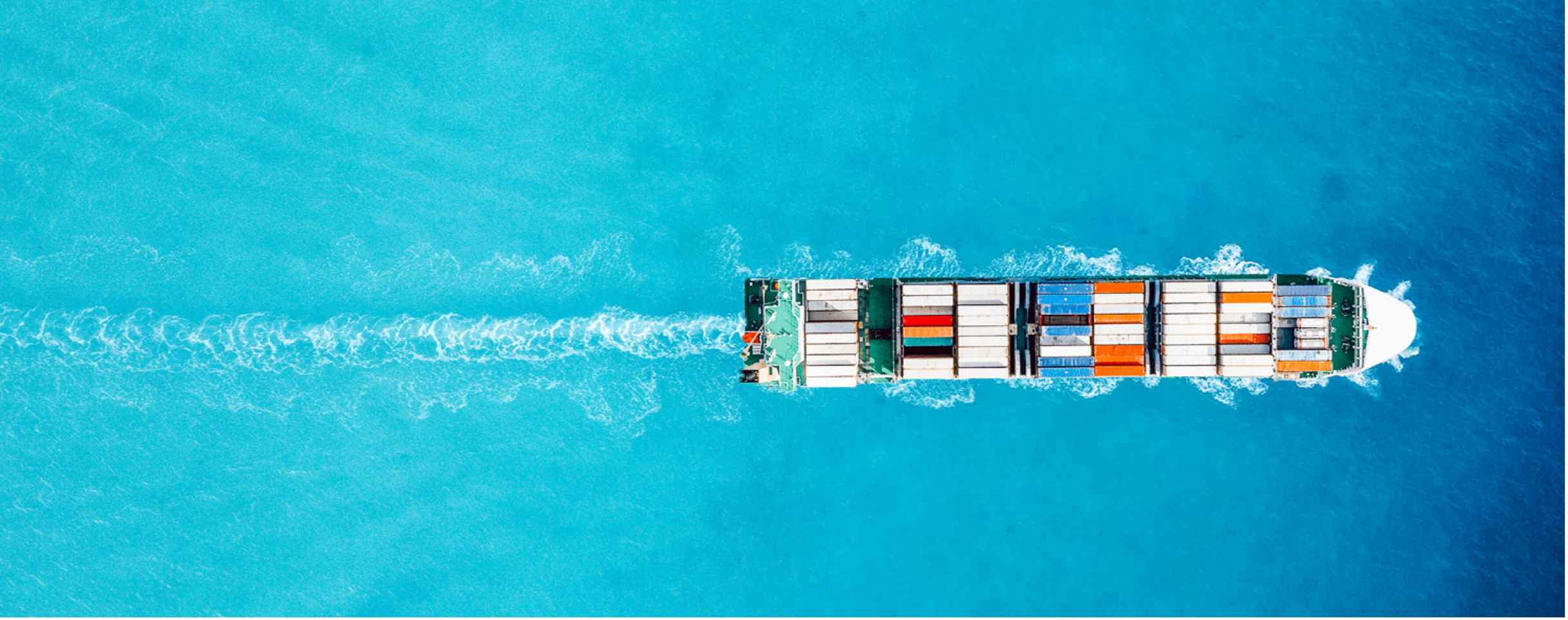
The term "Final Completion" was defined in the body of the City contract to "occur when the Facility is able to process Waste at a rate of 55,000 tonnes per annum as certified in accordance with the… agreement under which the Facility was constructed" but Schedule 1 defined "Final Completion" as when the Facility was able to "process waste at a rate of 55,000 tonnes per annum to satisfaction of DiCOM". The dispute concerned whether or not DiCOM, rather than a third party, was entitled to determine when the Facility could process the required volume of waste, such as to achieve Final Completion. The trial judge held that a reasonable person would have understood the clauses to operate so that certification would be issued by an entity that would not benefit from making the certification.

On appeal DiCOM argued that the definition in the body of the City contract only applied if the Construction Contract specified a certification process at exactly 55,000 tonnes operating capacity, and since the Construction Contract specified a higher standard, the Schedule 1 definition should apply instead. While the Court agreed that this interpretation gave all the clauses work to do, it did not fit the commercial purpose of the contract. The Court held that the two definitions worked together better when, once the Facility had been certified by the Construction Contract to operate at 55,000 tonnes, or higher, DiCOM could choose whether to notify the City or not so that DiCOM was not forced to begin accepting waste before it believed that it was ready.

Key takeaways and practice points

This case illustrates the importance of ensuring key terms are defined and used consistently throughout your contract. Inconsistent or duelling definitions will inevitably lead to ambiguity and result in difficulty in applying the contract in practice. In this case, the Courts will search for a construction they consider best fits the commercial purpose of the contract, though there is no guarantee that it will be the interpretation that best matches your own intention.

The case also illustrates the importance on clearly specifying contract triggers, ideally by reference to some objective criteria. Where a contract uses imprecise or uncertain language, Courts are unlikely to prefer an interpretation that leaves one of the parties a discretion to unilaterally alter the contractual position, as that is inherently an unlikely commercial outcome. As such, if you intend to reserve a discretion to yourself within a contract, it will be critical to ensure that is unambiguously reflected in the terms of the contract.



Royal and Sun Alliance Insurance Plc v DMS Maritime Pty Limited [2019] QCA 264 (Fraser and McMurdo JJA and Boddice J)

What was this case about?

This case concerned the application of remedies specifically conferred under a contract that may confer a greater benefit than an award of damages for breach.

Summary

The Commonwealth engaged DMS Maritime Pty Limited (**DMS**) to design, manufacture, supply and maintain Armidale Class Patrol Boats for the Royal Australian Navy. One of those patrol boats, HMAS Bundaberg, was destroyed by fire while in DMS's possession for routine scheduled repairs and maintenance.

The Commonwealth and DMS settled the Commonwealth's claimed losses under the contract for $31.5 million. This figure was reached on the basis that the Commonwealth needed to purchase a new patrol boat from another manufacturer to replace HMAS Bundaberg.

However, DMS's insurer, Royal and Sun Alliance Insurance Plc (**RSA**) refused to indemnify DMS for the $31.5 million settlement sum between the Commonwealth and DMS on the basis that it was not a reasonable settlement of the contractual liability of DMS to the Commonwealth.

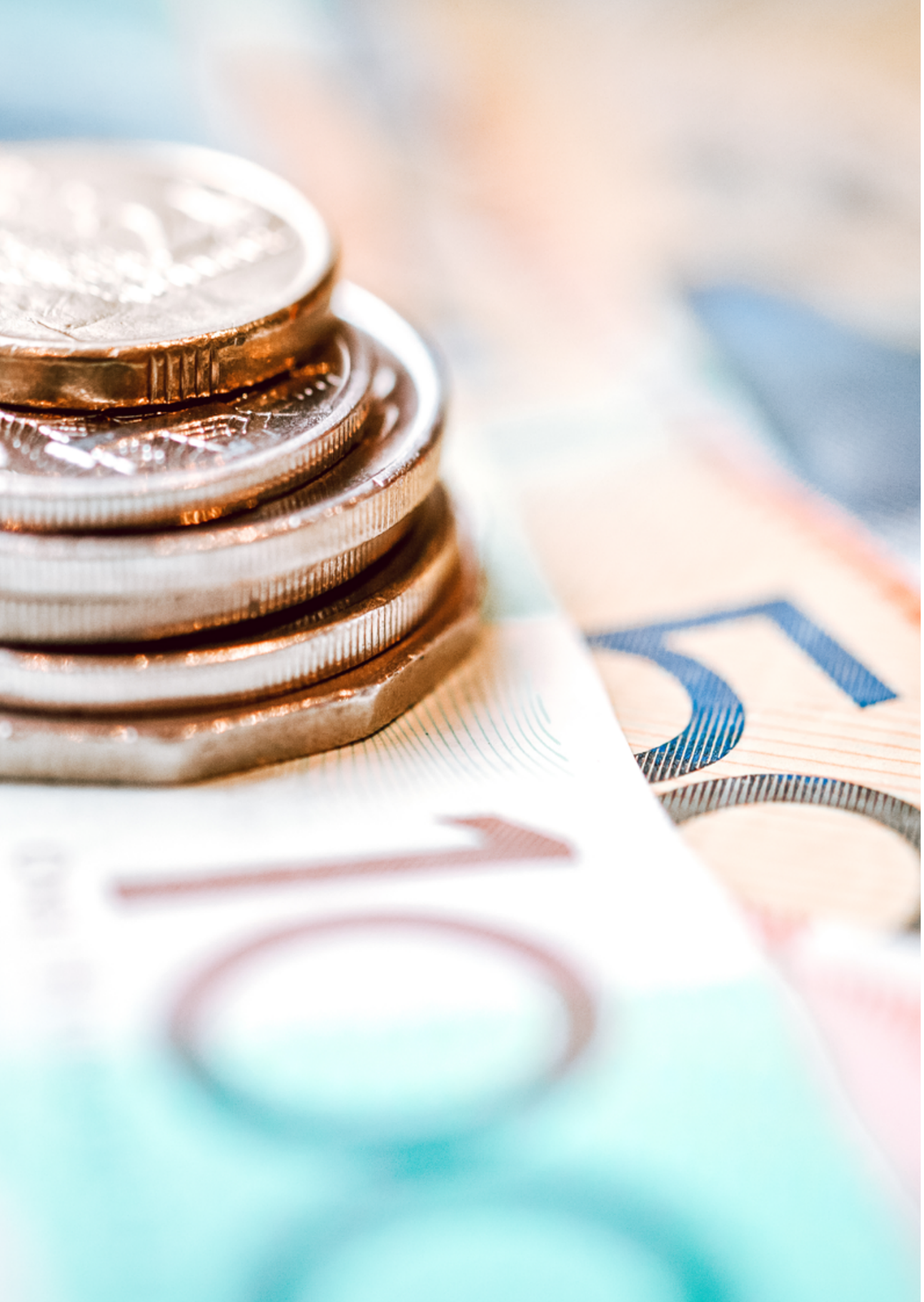
A key issue was the proper construction of clause 8.3.1 of the contract between the Commonwealth and DMS, which required DMS to "replace or otherwise make good any loss of, or repair the damage to, [HMAS Bundaberg] at its cost". Expert evidence suggested that HMAS Bundaberg had no market value at the date of its loss. Furthermore, the Commonwealth had managed the loss of HMAS Bundaberg by replacing it with an Australian Border Force patrol boat and renting two new patrol boats for a three-year period, with the option to extend for a further two years. RSA argued that under clause 8.3.1, DMS was only required to indemnify the Commonwealth for the actual monetary loss suffered by taking these steps. In the alternative, DMS's liability was limited to obtaining a lease of an equivalent or better vessel as a functional replacement for the service life of HMAS Bundaberg. The phrase "otherwise make good" suggested that there were other ways to make good a loss than to purchase a replacement vessel.

The Court of Appeal held that the alternative constructions of clause 8.3.1 offered by RSA did not have the effect of replacing or otherwise making good the loss of HMAS Bundaberg. The word "otherwise" suggested an equivalence between the concepts of "replace" and "make good". DMS was therefore required to provide a substitute equivalent vessel, or compensate the Commonwealth for its loss in some other equivalent way. A lease for the service life of HMAS Bundaberg would not "make good" the full loss that the Commonwealth had suffered, given the Commonwealth would have continued to own HMAS Bundaberg after the end of its service life.

While RMS argued that this interpretation of clause 8.3.1 would likely result in the Commonwealth obtaining a benefit (in the form of betterment) when compared to the award of damages that it may have been entitled to under common law, it was clear to both DMS and the Commonwealth at the time of making the contract that the only Armidale Class Patrol Boats in existence were those manufactured by DMS under the contract. If a boat was destroyed it would have been impossible for DMS to find another Armidale Class Patrol Boat of an equivalent age and usage. DMS would either have to build a new patrol boat or obtain an equivalent boat. Therefore, the fact that the Commonwealth may obtain a benefit was contemplated from the beginning.

Key takeaways and practice points

Although remedies expressly conferred under a contract can give the parties more certainty than relying upon a common law award of damages, companies should approach the drafting of these provisions carefully and with a full appreciation of what they may mean in practice. In particular, they should be aware that contractual remedies that require particular steps to be taken to make up for a performance failure (regardless of the loss that has actually been suffered) may end up being more costly than an award of damages (which will generally be calculated to compensate for loss actually suffered).



Cardtronics Australasia Pty Ltd v FX Investments Australia Pty Ltd [2020] FCA 218 (Lee J)

What was this case about?

This case considered the use of post-contractual conduct to determine the nature of an agreement where the parties had failed to document their agreement wholly and the available written communications were contradictory.

Summary

Cardtronics Australasia Pty Ltd (**Cardtronics**) supplied ATMs and associated equipment to FX Investments Australia Pty Ltd (**FX**) from mid-2016 onwards. In June 2019 Cardtronics brought proceedings because FX had stopped making payments to Cardtronics and the ATMs were disconnected from the Cardtronics network. The dispute between the parties was about the existence and the terms of the agreement or agreements under which Cardtronics leased or sold ATMs to FX. The key question was whether the ATMs had been sold in exchange for monthly instalments or leased for a period after which title would pass to FX. Before the ATMs were supplied, the parties engaged in extensive negotiation by email and phone before appearing to agree on a set of terms which they expected would be formalised in a written contract. No formal written contract ever eventuated even though Cardtronics began supplying ATMs. The order sheets, monthly invoices and other documentation described the payments as rental, but FX alleged numerous oral conversations asking for these to be amended to reflect the bargain FX thought was reached, which was for sale.

Months later, for the first time in writing, FX requested that invoices be issued for the sale of the ATMs because their accountant required it for tax reasons. This communication was not immediately addressed by Cardtronics, though when they finally replied in mid-2017 Cardtronics did not contradict FX's representation regarding the nature of the bargain as a sale.

There was repeated written and oral communication between the parties before Cardtronics issued a sales invoice for the 66 ATMs supplied so far. Internal Cardtronics emails at the time of these conversations represented the original transaction as a sale, which contradicted Cardtronics' claim that the original agreement was for rental. New ATMs supplied to FX by Cardtronics continued to be characterised as rentals on the statement of account. When in late-2018 Cardtronics finally sent a written Term of Sale agreement for the 66 ATMs, FX disagreed with the terms insisting that the details were not what had been initially agreed. Cardtronics then did not supply any further ATMs.

The dispute as to whether the arrangement between Cardtronics and FX for the supply of the ATMs was a sale or a lease was a factual dispute, which can be largely attributed to the failure of the parties to document promptly and with precision the full terms of the agreement. This failure left the Court to determine the substance of the arrangement from a series of contemporaneous written and oral communications. Ordinarily, in a commercial dispute the contemporaneous written evidence will be the most powerful. In this case the written evidence was contradictory leading the Court to have to rely on the oral evidence.

The Court found against FX and held that the arrangement should be characterised as a lease rather than a sale. The Court reached this view for two reasons. Firstly, it would be unusual for the representatives of FX who were assiduous in negotiating and documenting terms to leave something so vital as the nature of ownership to oral agreement. Secondly, the contradictory written evidence in Cardtronics internal correspondence could be explained by the fact that Cardtronics was trying to appease an important customer. The sales staff of Cardtronics were trying to create a paper trail so they could provide sales invoices to FX against standard practice. However, this could not contradict the fact that the transaction was, in substance, a lease rather than a sale of the ATMs.

Key takeaways and practice points

Parties to a contract created through partly written and partly oral agreement should formalise the agreement in a complete written form as soon as possible to prevent disagreement about terms and to prevent a Court having to reconstruct the agreement from oral accounts.

When a Court is considering the existence of an agreement or what terms are incorporated into the agreement, rather than answering a question of construction, the Court may consider post-contractual communication as relevant and admissible. For this reason, it is important to ensure that all communications, including internal communications, are consistent with the intended characterisation of the agreement and its terms. Any inconsistent representations will cast doubt on the arrangement and lead to uncertainty as to the commercial bargain that the parties have struck.

Siemens Gamesa Renewable Energy Pty Limited v Bulgana Wind Farm Pty Ltd [2020] VSC 126 (Riordan J)

What was this case about?

This case considered the admissibility of extrinsic evidence of the surrounding circumstances to assist with contractual interpretation. This is a vexed issue in Australia that has been the subject of a number of superior court decisions in recent years.

Summary

Bulgana Wind Farm Pty Ltd (**BWF**) entered into an Engineering, Procurement and Construction Contract (**EPC Contract**) with Siemens Gamesa Renewable Energy Pty Limited (**SGRE**) to build a wind farm and energy storage facility. SGRE also provided two unconditional bank guarantees (the **Performance Securities**).

SGRE failed to achieve practical completion by the due date. BWF claimed it was entitled to liquidated damages for delay under the EPC Contract. SGRE claimed it was entitled to an extension and denied liability for the liquidated damages.

After some negotiation, BWF advised SGRE that it intended to call on the Performance Securities to satisfy the liquidated damages payable during a specific period. SGRE denied liability, but the parties nevertheless negotiated a written agreement which included clauses to the effect that BWF would continue to offset the liquidated damages against progress payments due to SGRE, SGRE would not object to any such offsetting, and BWF would not exercise its rights to draw on the Performance Securities "in relation to this matter" without giving a minimum amount of notice to SGRE.

SGRE later applied for a permanent injunction to prevent BWF calling on the Performance Securities. The central issue was whether the agreement reached between the parties prevented BWF calling on the Performance Securities. SGRE submitted that the references to "this matter" in the agreement referred to the disputed liquidated damages generally, meaning BWF could only recover liquidated damages by offsetting against progress payments. BWF submitted that the reference to "this matter" referred solely to the liquidated damages in the relevant period and so should not affect its rights to claim liquidated damages in respect of other periods. BWF sought to rely on evidence of the surrounding circumstances to support this interpretation. BWF argued that ambiguity is not a requirement for the admission of evidence of surrounding circumstances, but also that there was in any case ambiguity about the identity of the "matter".

Justice Riordan set out the established rules of constructing commercial contracts including Justice Mason's "true rule" from *Codelfa*:

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

Whether ambiguity acts as a precondition for admitting extrinsic evidence of the surrounding circumstances has been extensively considered in academic and judicial writing. Justice Riordan explains that some have argued the "true rule" from *Codelfa* does not incorporate ambiguity as a precondition for admitting evidence of the surrounding circumstances. These views are generally based on the proposition that the true rule does not prevent reference to surrounding circumstances in order to determine whether an ambiguity exists in the contract to begin with, or else that subsequent High Court decisions have overruled the requirement to identify an ambiguity before reference can be made to surrounding circumstances.

Justice Riordan firmly rejected these views. His Honour held *Codelfa* has not been impliedly overruled because the High Court decisions cited in support of the proposition did not deal directly with the ambiguity requirement. In regard to admitting extrinsic evidence to identify ambiguity, Riordan J clarified that ambiguity indeed acts as a "gateway". His Honour pointed out that Justice Mason explicitly considered the competing positions and endorsed the view that evidence was not admissible to raise an ambiguity because that would be to contradict or vary the words of the written document. Further, his Honour reasoned that admitting extrinsic evidence to identify ambiguity would undermine the parol evidence rule, which seeks to preserve the finality of written documents and make it simpler to resolve disputes by avoiding the need to consider extraneous materials. If the words are unambiguous, extrinsic evidence can only serve to impermissibly contradict plain meaning.

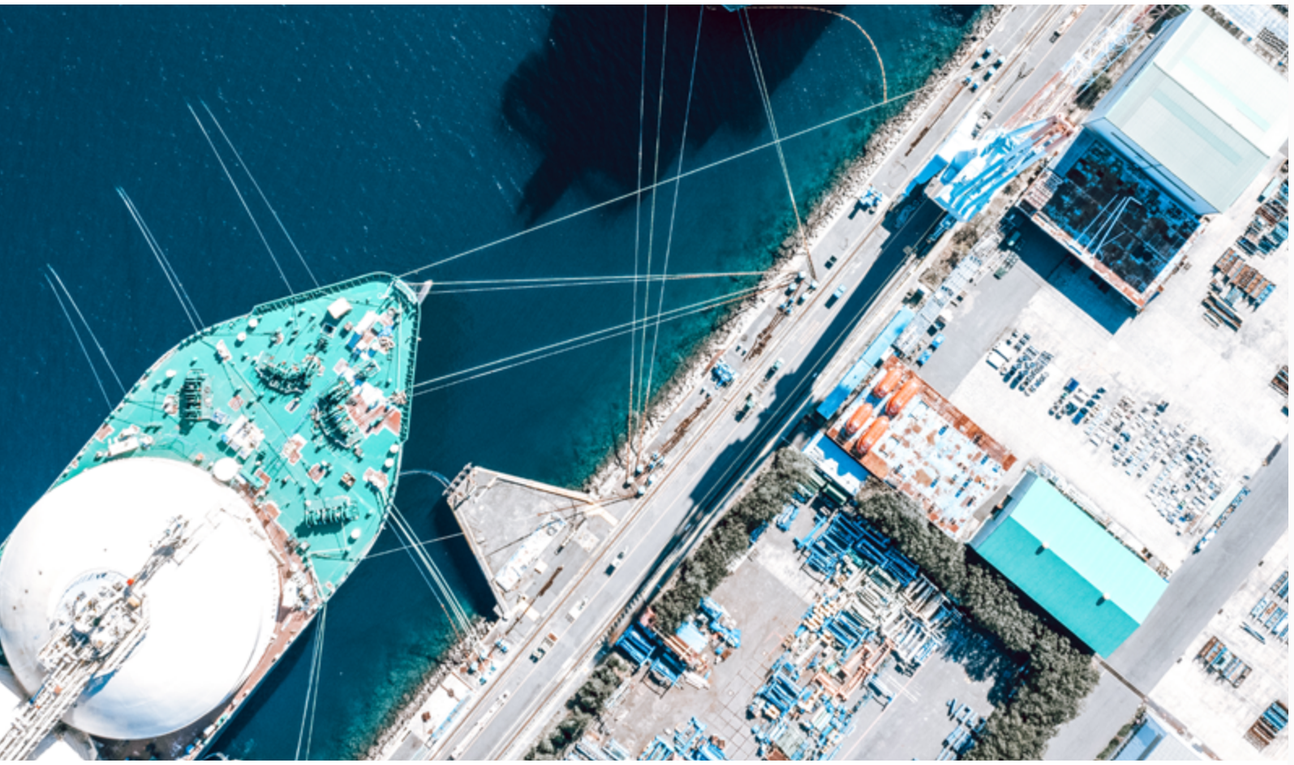
However, Riordan J accepted that the reference to "this matter" in the agreement between the parties was ambiguous, meaning that extrinsic evidence was admissible. Justice Riordan considered the evidence of the negotiations and found that the parties referred to *both* BWF's entitlement to enforce disputed liquidated damages on a continuous basis as well as during the specific period that had previously been identified. Justice Riordan held that the agreement referred to the general entitlements to enforce disputed liquidated damages because nothing in the agreement purported to limit the scope to liquidated damages in respect of a particular period. Further, the agreement contemplated continuing offsets against progress payments, which in turn suggested that the agreement apply to future liabilities.

Key takeaways and practice points

This case emphasises the primacy of the written words of the contract. The Courts will only consider extrinsic evidence of the surrounding circumstances in limited circumstances, such as to resolve an ambiguity apparent on the face of the text. Surrounding circumstances cannot be admitted to establish ambiguity.

Parties should ensure that the written contract reflects what they intend to agree using clear and precise language that is not susceptible to multiple meanings. If they fail to perfectly capture their attention in the written contract, they may face difficulty in relying on evidence of negotiations or correspondence in order to fix the issue.

Termination



Donau Pty Ltd v ASC AWD Shipbuilder Pty Ltd [2019] NSWCA 185 (Bell P, Basten JA and Emmett AJA)

What was this case about?

This case required the Court to decide whether a contract had been effectively terminated by a party who did not exercise their termination right for over 3 months, and who had continued to act in accordance with the contract's procedures in the meantime. This was an appeal from a first instance decision covered in our 2019 Contract Law Review.

Summary

The Federal Government entered into a contract with ASC AWD Shipbuilder Pty Ltd (**ASC**) for the procurement of air warfare destroyers. ASC in turn subcontracted the construction of certain parts of each ship to Donau Pty Ltd, which was then known as Forgacs Engineering Pty Ltd (**Forgacs**). Over time there were a number of design changes to the ships, which caused many difficulties for ASC and Forgacs when attempting to implement the payment mechanism in their subcontract. The parties therefore entered into a Second Heads of Agreement (**2HA**) to vary the original subcontract, including by introducing a new method to calculate Forgacs' fees.

The 2HA required the parties to use reasonable endeavours to agree on new "baseline" performance metrics for the project by 14 December 2012. However, if these new baseline metrics were not agreed by 28 February 2013, ASC had an express right to terminate the 2HA (in which case parties would revert back to the original contract's payment regime). The parties failed to reach agreement on the new baseline metrics by 28 February 2013. Nevertheless, they continued their negotiations until June 2013, when ASC purported to exercise its right to terminate the 2HA by serving written notice on Forgacs.

After the project was completed, the parties commenced proceedings over the amount of fees owed to Forgacs. One of the key issues for the Court to decide was whether ASC had validly terminated the 2HA in June 2013. Forgacs contended that ASC's purported termination was ineffective because either: (1) ASC, by continuing to act in accordance with the 2HA procedures even after 28 February 2013, had elected to affirm the 2HA; or (2) ASC had failed to exercise its termination right within a reasonable time, which was a limitation to be implied into the 2HA.

On the first issue, the Court of Appeal upheld the primary judge's decision that ASC had not by its conduct elected to affirm the contract. Bell P reiterated that, to constitute an election, a party's conduct must be unequivocal in the sense that "it is consistent only with the exercise of one of the two sets of rights and inconsistent with the exercise of the other". Here, ASC's conduct was not sufficiently unequivocal to amount to an election to affirm the 2HA. Rather, ASC's conduct was consistent with a decision to reserve its position on whether or not to terminate.

On the second issue, the Court of Appeal overturned the primary judge's decision and found that, by not exercising its termination right for over 3 months, ASC had failed to exercise that right within a reasonable time. Bell P (with Emmett AJA agreeing) explained that the legal meaning of "reasonable time" must be ascertained at the date of the contract, but that the question of what period amounts to a "reasonable time" as a matter of fact must be assessed as at the date on which the right to terminate is first capable of being exercised.

The Court of Appeal found that ASC was only entitled to a "very short period of time" to exercise its termination right for the following reasons:

- the 2HA made significant changes to the parties' rights and obligations going forward, which meant that the longer the parties operated under the new regime the more difficult it would be to revert to the former regime;
- the 2HA required the parties to use reasonable endeavours to agree the new baseline metrics by 14 December 2012. When this did not happen, ASC effectively had 10 weeks' notice to decide whether or not it would terminate on 28 February 2013 (or to negotiate an agreement to preserve its rights if it anticipated needing more time). After this point, ASC should only have been entitled to a very small timeframe to exercise the right;
- ASC's decision about whether to terminate was not dependent on ASC receiving any further information nor on any other factors outside its control; and
- it was inappropriate for the primary judge to determine what would constitute a "reasonable time" by reference to ASC's conduct after its termination right had already arisen. The continuance of the baseline negotiations could not by itself dictate what was a "reasonable time" for ASC to exercise its unilateral termination right (otherwise the negotiations could carry on indefinitely at ASC's choice without ASC ever having to give up its termination right).

Bell P (with Emmett AJA agreeing) therefore found that a reasonable time had "long since passed" by the time ASC purported to terminate the 2HA. Basten JA found that ASC should have exercised its termination right by no later than the end of April 2013, a time period which would have allowed ASC to make its decision and obtain board approval. This outcome meant that the fees payable to Forgacs were to be calculated under the terms of the 2HA instead of the original contract.

Key takeaways and practice points

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 is better for the party in question to expressly reserve its rights in writing (especially where the parties have a prior history of operating outside the terms of their contract).

Where a contract does not expressly stipulate the date by which a termination right must be exercised, that right normally needs to be exercised within a "reasonable time". What constitutes a "reasonable time" will depend on the relevant context of the contract and the circumstances in which the termination right arises. However, the terminating party's conduct *after* the right has arisen should not be taken into account. If an extended period for consideration is necessary before exercising a particular right, to reduce any uncertainty, the party in question should ideally seek to negotiate a standstill agreement (i.e. an agreement to suspend or extend the time period in which a party can exercise one of their rights in another contract) with the counterparty to clearly preserve their rights.

University of Sydney v ObjectiVision Pty Ltd [2019] FCA 1625 (Burley J)

What was this case about?

This case concerned various issues with regard to termination of a licensing arrangement, including whether licences had been automatically terminated because the licensee failed to comply with certain conditions precedent under an assignment regime.[1]

Summary

The University of Sydney (**USYD**) entered into two licensing agreements with ObjectiVision Pty Ltd (**ObjectiVision**) to commercialise a product for detecting glaucoma that used patented technology developed by USYD. The commercialisation failed, resulting in a protracted dispute.

ObjectiVision did not meet its minimum sales obligations under the licensing agreements, resulting in USYD terminating the exclusivity of ObjectiVision's licences. The parties negotiated and executed new Heads of Agreement (**HOA**), which reinstated ObjectiVision's exclusivity but required ObjectiVision to find a third party to acquire a majority of shares in ObjectiVision within a defined "exclusivity period". If ObjectiVision failed to enter into an agreement in accordance with the terms of the HOA by this deadline, the licensing agreements would automatically terminate.

The HOA set out a process by which any acquisition of ObjectiVision could take place. This included a requirement for ObjectiVision to consult with USYD and to obtain USYD's consent, as well as to "first assign" certain patents to USYD as a condition to USYD consenting. ObjectiVision entered into an arrangement whereby a third party would acquire a majority shareholding in ObjectiVision, but without following the process set out in the HOA. As a result, USYD advised that the licencing agreements had automatically terminated by operation of the HOA and further that ObjectiVision's non-payment of invoices also independently gave rise to a termination right. USYD later commenced proceedings in 2014 claiming the agreements had been terminated, seeking damages and alleging patent infringement. ObjectiVision brought various cross claims.

Justice Burley held the licencing agreements terminated automatically because ObjectiVision failed to enter into an agreement for a third party to acquire a majority shareholding in ObjectiVision in accordance with the terms before the exclusivity period ended. It failed to do so because:

- first, ObjectiVision failed to fulfil a relevant condition precedent by assigning relevant patents to USYD before seeking USYD's consent. His Honour considered that the language of "first assign" made clear that the patents had to be assigned before consent would be given. ObjectiVision pointed to statements in correspondence that it was "ready, able and willing" to assign when USYD provided consent, but this was not sufficient; and
- second, ObjectiVision did not seek or obtain USYD's prior consent. It was an undisputed fact that ObjectiVision did not seek consent prior to entering the agreement with the relevant third party acquirer, and Burley J considered the HOA was unequivocal that consent was required in advance. The question was not whether consent would be refused if it was sought, it was whether consent had been obtained prior to entering the transaction.

Had the licensing agreements not terminated automatically, they would in any case have been validly terminated by USYD's correspondence because the unpaid invoices gave rise to a valid termination right. Commencing proceedings would also have terminated the licensing agreements. ObjectiVision's various cross claims all failed.

Key takeaways and practice points

In an agreement to commercialise intellectual property, careful consideration should be given to what rights the licensee has to assign the agreement to a third party or, as in this case, to assign the majority of its shares so as to effectively give a third party control over the licensed rights. Ideally, from the licensor's perspective, the licensor should have a mechanism to withhold consent when not satisfied the proposed third party has the required resources to successfully commercialise the licensed intellectual property. As in this case, the mechanism should be clear that the licensor's consent is a pre-condition to the assignment or transfer taking effect, and that the licence will terminate if the licensee purports to proceed without having first obtained the consent.

[1] A discussion of other issues in the case can be found in the article "Licensing Lessons – Takeaways from *ObjectiVision* and Other Recent Cases" by Scott Bouvier, published in Issue 120 (June 2020) of the Intellectual Property Forum.

Visual Building Construction Pty Ltd v Armitstead (No 2) [2019] NSWCA 280 (Bell ACJ, Macfarlan JA and White JA)

What was this case about?

This case clarified that if a contract stipulates a minimum notice period before a party can terminate for the counterparty's remediable default, termination without a notice period will still be valid if the default cannot be remedied within the notice period.

Summary

David Armitstead and Maria-Luisa Patisso (the **respondents**) engaged Visual Building Construction Pty Ltd (**VBC**) to construct two duplex buildings on a block of land. Under the construction contract, VBC was required to apply for and obtain at its expense all approvals required from any public authority to occupy and use the completed work. The local council approved the development but advised that construction could not begin until VBC applied for a Construction Certificate. VBC did not apply for a Construction Certificate.

When the council discovered that construction had commenced without a Construction Certificate, it issued a notice ordering VBC to cease all building work, obtain a Building Certificate for the unauthorised work and obtain a Construction Certificate to complete the development. VBC failed to comply with the order.

The respondents subsequently issued a notice immediately terminating the contract and commenced proceedings against VBC for damages for breach of contract. The respondents claimed that VBC had defaulted on its obligations under the contract because, among other things, it had failed to obtain the necessary approvals from the council for a Construction Certificate.

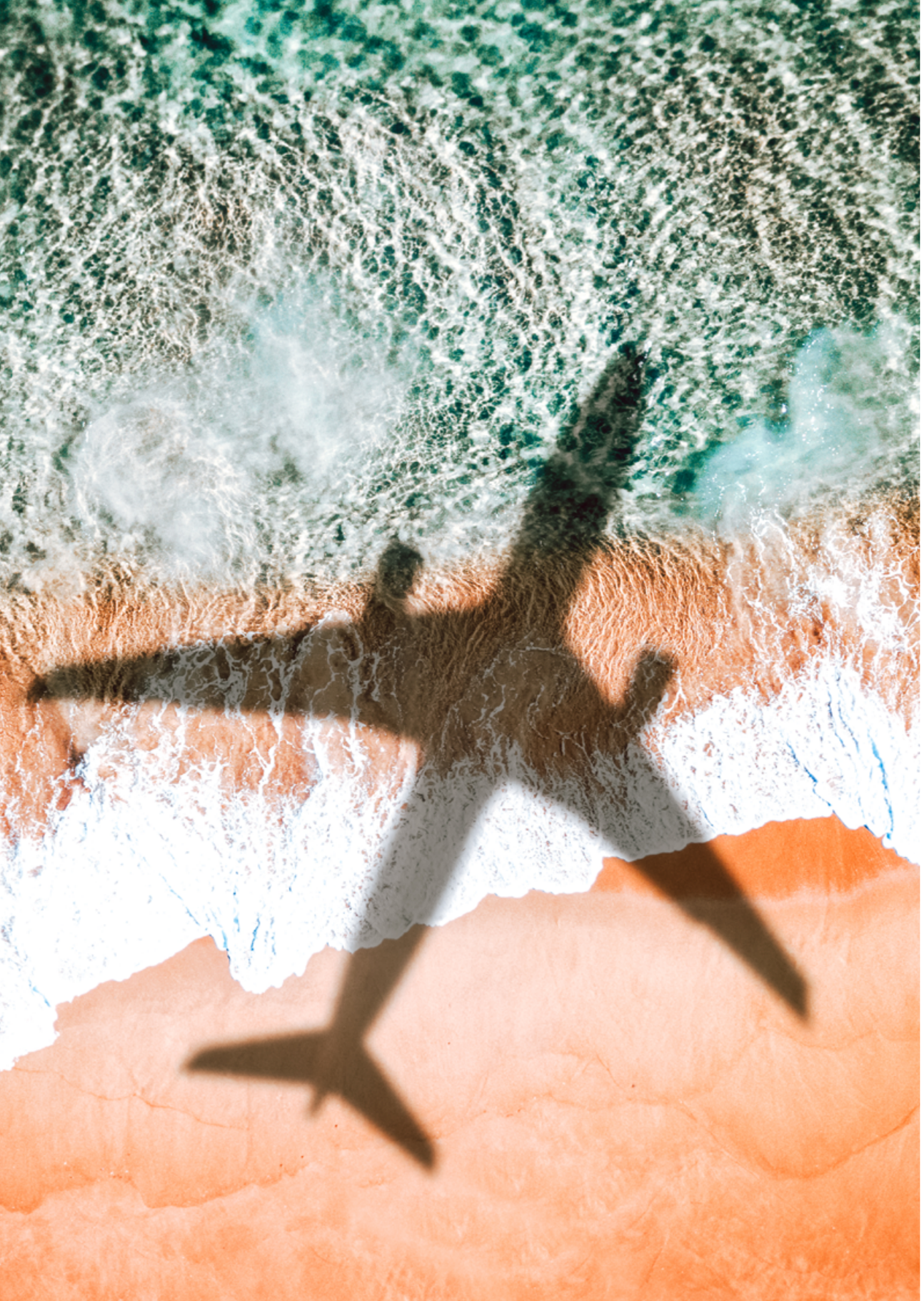
At trial, VBC argued that termination of the contract was defective. Under the contract, the respondents were entitled to immediate termination if a default could not be remedied, but were required to give 10 business days' notice if the default could be remedied. VBC argued that as the defaults, in particular the failure to obtain a Building Certificate and Construction Certificate, were remediable, it should have been given 10 days' notice of the respondents' intention to terminate.

The Court of Appeal held that the contractual requirement to give 10 business days' notice only applied if the default was capable of being remedied within 10 business days. The contract did not require the respondents to delay termination where it was not possible to remedy the defaults within the relevant notice period. The Court held that it would not have been possible, as a matter of fact, for VBC to obtain a Building Certificate and Construction Certificate within 10 business days. This conclusion was based on the fact that the council had refused the respondents' subsequent application for a Building Certificate, because an engineering report found that the construction to date was non-compliant with the design drawings and recommended that the partially constructed building be demolished. Furthermore, VBC never attempted to apply for a Building Certificate or Construction Certificate in the weeks between the council's order and termination of the contract, suggesting that VBC itself did not think it could be done.

Because the defaults were not capable of being remedied within the relevant notice period, no notice was required to terminate the contract and termination was therefore valid.

Key takeaways and practice points

It is common in a contractual termination regime to distinguish between remediable and non-remediable defaults. While a notice period may apply in relation to remediable defaults, in order to provide an opportunity for the defaulting party to address the matter and ward off termination, termination may be permitted without notice where the default cannot be remedied. Even with such a regime, a defaulting party should be aware, based on this decision, that the notice period may not apply to defaults that, as a matter of fact, cannot be remedied within the stipulated period. In effect, such defaults may be treated as non-remediable. One way to add flexibility, where a default may take longer to remediate, is to provide that either (1) the parties may agree on a longer notice period in the circumstances; or (2) that the termination right will effectively be suspended provided that the defaulting party is actively implementing a remediation plan that has been agreed with the other party. While there may be temptation to replace a fixed notice period with something indeterminate such as a "reasonable period", that may be a risky strategy as it will inevitably introduce uncertainty as to precisely when the termination right will crystallise.



Other

Clarence City Council v Commonwealth of Australia [2020] FCAFC 134 (Jagot, Kerr and Anderson JJ)

What was this case about?

This case explores the boundaries of the doctrine of privity in the Australian common law and demonstrates that the doctrine may not prohibit third parties to a contract from seeking and obtaining declaratory relief in respect of the interpretation or application of the contract.

Summary

The operators of the Hobart Airport and the Launceston Airport (**Operators**) each had long term leases with the Commonwealth. Clause 26.2(a) of the leases required the Operators to make "ex gratia payments in lieu of rates" to the Clarence City Council and the Northern Midlands Council respectively (**Councils**) for the parts of the airports on which "trading or financial operations" were undertaken. This was included in the leases because the Commonwealth sought to maintain a "level playing field" between enterprises at the airports, which were not subject to rates because they were on Commonwealth land, and their off-airport rate-paying competitors.

There was no dispute between the Operators and the Commonwealth, as the Operators had been making the ex gratia payments to the Councils for the duration of the leases in accordance with annual independent valuations. However, the Councils sought declaratory relief in the Federal Court about the meaning of clause 26.2(a). They argued that "trading or financial operations" extended to parts of the airports used for things such as departure and arrival lounges, baggage claims, security facilities, bathrooms and circulation areas. Moreover, they disagreed with the way in which the ex gratia payments were being calculated by the independent valuer, which were significantly lower than they would have been had the *Valuation of Land Act* 2001 (Tas) been applied.

The hurdle issue was whether the Councils had standing to seek declaratory relief. The Operators and the Commonwealth argued they did not, because:

- the Councils were not parties to the leases;
- the Councils had no legal rights under the leases; and
- the Operators and the Commonwealth were not in dispute about the operation of clause 26.2(a).

At trial, the judge held that the Councils did not have standing to seek declaratory relief, on the basis that the Councils were not privy to the contracts between the Commonwealth and the Operators.

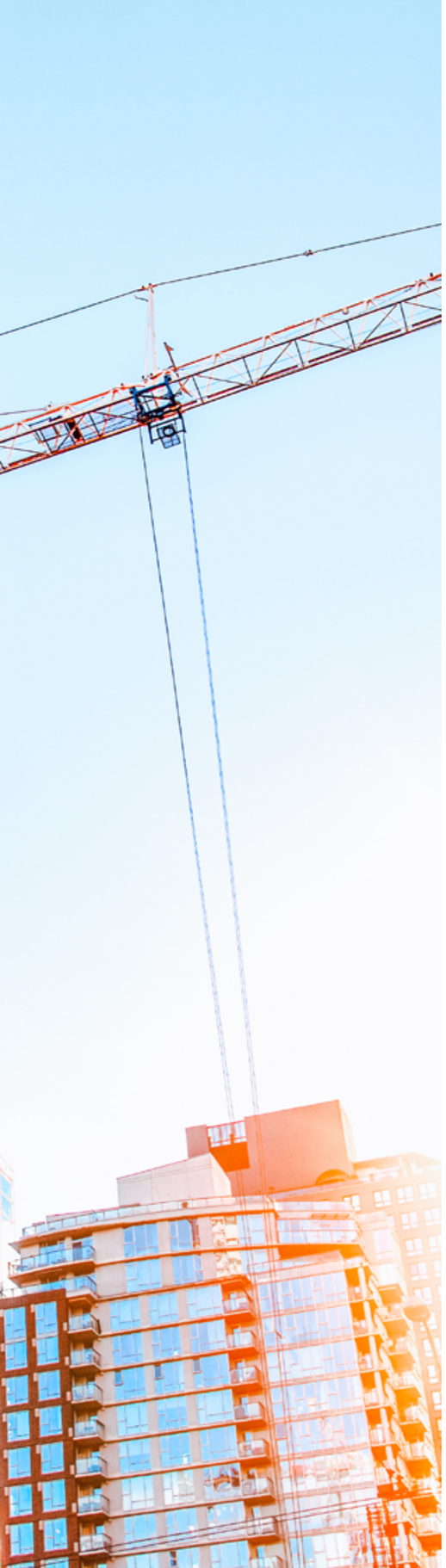
However, the Full Court of the Federal Court overturned the trial judgment on appeal and held that the doctrine of privity of contract was irrelevant to the question of the Councils' standing for declaratory relief. While the general rule is that "a person who is not party to a contract can neither enforce that contract nor incur any obligations to that contract", the doctrine of privity only prevents a contractual third party from directly suing (or being sued) on a contract. That is, a third party is prohibited from directly enforcing obligations arising under the contract pursuant to a right of action derived from the contractual relationship. However, a declaratory judgment is a formal statement of the court deciding on the existence or non-existence of a legal state of affairs. When a third party seeks a declaratory judgment the third party is neither suing on the contract, nor seeking to enforce any obligations under the contract. Furthermore, the entitlement to seek and obtain declaratory relief does not arise from the contract but from the Federal Court's statutory jurisdiction. As such, lack of privity did not prevent the Councils from seeking declaratory relief.

After reviewing the Court's jurisdiction to grant declaratory relief, the Full Court held that the Councils did have standing to seek declaratory relief and remitted the matter to the trial judge for determination of their entitlement to the relief sought.

Key takeaways and practice points

The doctrine of privity of contract is well-established in Australia. However, companies should be careful not to assume that the doctrine protects them from all third-party legal action in relation to a contract. This case demonstrates that the courts may apply the doctrine of privity narrowly, to prevent the direct enforcement of obligations under the contract through a right of action that is derived from the contract.

Particular attention should therefore be paid to the nature of the rights being relied upon if and when a third party commences legal proceedings. For example, the right to seek declaratory relief, as well as many common exceptions to the doctrine of privity such as trust, agency, assignment or statute, are not true "exceptions" because they rely on legal principles or institutions other than the contract itself to create and enforce rights or obligations. Failure to fully understand the scope of the doctrine of privity may lead to inadequate preparation against otherwise meritorious claims by third parties.



Mann v Paterson Constructions Pty Ltd [2019] HCA 32 (Kiefel CJ, Bell, Gageler, Keane, Nettle, Gordon and Edelman JJ)

What was this case about?

This case was about whether a builder was entitled to a sue on a *quantum meruit*, and if so whether the claim was limited by the contract price.

Summary

Peter and Angela Mann (**Owners**) entered into a domestic building contract with Paterson Constructions Pty Ltd (**Builder**) to build two townhouses. The work was to be completed for a fixed price paid in stages. The Owners orally requested 42 variations. The Builder issued an invoice for the variations after the handover of the first townhouse, but the Owners refused to pay. The Owners claimed the Builder repudiated the contract by indicating the works would not continue until the invoice was paid and purported to accept the repudiation. The Builder denied the Owners' right to terminate but alleged the Owners' claim of repudiation was itself a repudiation by the Owners, which the Builder accepted. The Builder's claim related to three categories of work:

- variations;
- work for which the Builder had an accrued contractual right to payment at the time of termination (complete stages); and
- work for which the Builder had not yet accrued a contractual right to payment at the time of termination (incomplete stages).

The Builder commenced proceedings in VCAT, including a quantum meruit claim. Quantum meruit is a remedy in restitution for the reasonable value of work performed or services rendered. VCAT found in favour of the Builder which was upheld by the Victorian Supreme Court and the Court of Appeal. The Owners appealed to the High Court on the following grounds:

- that the Builder was not entitled to sue on a *quantum meruit*;
- if the Builder was entitled to sue on a *quantum meruit*, the contract price operates as a ceiling; and
- section 38 of the *Domestic Building Contracts Act 1995* (Vic) (**Domestic Building Act**) prevents a *quantum meruit* claim for variations.

The High Court unanimously held that remuneration for the variations work was precluded by section 38 the Domestic Building Act. Section 38 sets out a procedure for variation requests for domestic building acts, which if not followed precludes recovery.

The High Court also held unanimously that a quantum meruit was not available in respect of the completed stages of work where the Builder had an accrued contractual right to payment. This is a departure from earlier authorities such as *Lodder v Slowley* [1904] AC 442 (**Lodder**) where the Privy Council held that an innocent party may elect between a *quantum meruit* and contractual damages when a contract was terminated for breach or repudiation. *Lodder* has been applied by intermediate appellate courts in decisions such as *Sopov v Kane Constructions Pty Ltd* [No 2] (2009) 24 VR 510. However, Nettle, Gordon and Edelman JJ, and separately Gageler J, held that the Builder was still entitled to sue on a *quantum meruit* with respect to the incomplete stages where there was no accrued right to payment. Chief Justice Kiefel and Justices Bell and Keane dissented on this point.

Chief Justice Kiefel and Justices Bell and Keane held that no *quantum meruit* was available for any of the work because it would subvert the contractual allocation of risk. Further authorities such as *Lodder* were wrongly decided because they relied on the "rescission fallacy", being the fallacious notion that a contract is void *ab initio* when terminated for repudiation. Since *McDonald v Dennys Lascelles Ltd* (1933) 48 CLR 457, it is clear that in the case of a repudiation parties are released from performance, but accrued rights remain enforceable.

Justices Nettle, Gordon and Edelman acknowledged the issues with some of the historic case law but held that the modern claim does not rely on the "rescission fallacy". Instead their Honours relied on the concept of "total failure of consideration". Their Honours explained that a party who has been enriched has a prima facie obligation "to make restitution" where there has been "a total failure of consideration" or "a total failure of a severable part of the consideration". This means that if a plaintiff has no contractual right to payment under a contract until all the work is complete (an "*entire*" obligation), the plaintiff may be entitled to restitution when part of the work has been completed. Conversely, if a plaintiff has a contractual right to payment upon completion of any part of the work (an "*infinitely divisible*" obligation), restitution will not be available because the contract fixes what the parties agreed would be payable for the work that has been completed. In this particular case, their Honours considered that the Builder had a contractual right to payment for completed stages of construction, but no right to payment at all for incomplete stages. Their Honours held that the Builder's obligations were severable into "*entire stages*" which could each be treated as an *entire obligation*. This meant that a *quantum meruit* was available with respect to the incomplete stages of work because there had been a total failure of a *severable part* of the consideration. With respect to the completed stages, the claim would be determined under the contract.

Justice Gageler arrived at the same outcome as Nettle, Gordon and Edelman JJ by a "narrower path of reasoning". His Honour stressed that total failure of consideration should not be given "hegemonic status", but acknowledged it had "some explanatory power" in this case.

Justices Nettle, Gordon and Edelman further held that a *quantum meruit* should prima facie be restricted to the contract price (or relevant stage price, as in this case). However, their Honours left open the possibility of a case where it would unconscionable for the plaintiff to be restricted to the contract price. Justice Gageler held the contract price imposed a ceiling but made no such qualification. The minority did not consider the question.

The matter was remitted to VCAT for further determination in accordance with law.

Key takeaways and practice points

A *quantum meruit* will only be available with respect to work for which no right to payment has accrued at the time of termination. Where the contract provides for payment for work pursuant to "stages", the obligations to complete work in each stage will be treated separately.

The contract price prima facie sets a ceiling for recovery, although the possibility of this being displaced (on the basis of unconscionability) in a particular case is still open. Limiting recovery to the contract price creates certainty and efficiency. This is a welcome development because, as Gageler J observed, the possibility of recovering well in excess of the contract price could otherwise create perverse incentives to terminate and search for repudiatory conduct. Conversely, the other party may be motivated to avoid termination at all costs and therefore be incentivised to "overperform" or be excessively cautious, which may produce an inefficient outcome.

When entering into an agreement for the provision of services, consider whether the parties should make express provision for how incomplete services should be dealt with in the event of termination. Where a contract makes express provision for incomplete "stages", a *quantum meruit* claim would not be available, because there would be an accrued contractual right. This approach helps to avoid any residual uncertainty surrounding the application of claims based on *quantum meruit*.

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