

IT BYTES

ANSWERING YOUR COMMON IT CONTRACT LAW QUESTIONS

IS A SERVICE PROVIDER ENTITLED TO BE PAID IF THEY START WORK BEFORE A CONTRACT IS FINALISED?



WHEN DOES THIS QUESTION TEND TO ARISE?

In a highly competitive market, IT service providers are often very motivated to secure new customer mandates even if it means working to exceedingly ambitious deadlines set by the customer. In such instances, it is not uncommon for a service provider to commence work while negotiations are ongoing and before a binding contract is signed. If the deal does eventually fall over, this may raise difficult questions about whether the service provider is entitled to payment for work performed in anticipation of a contract that, for one reason or another, fails to eventuate.

WHAT DOES THE LAW SAY?

Whether a service provider is entitled to payment for services rendered in anticipation of a contract that is never entered into will depend on the circumstances under which the work was carried out and in particular whether it was carried out at the request, or with the approval, of the customer.

If a customer requests work be done in circumstances where there is an implied promise of remuneration, or where the customer derives a benefit from the services performed, and it would otherwise be unjust for the service provider not to receive some compensation, the service provider will be entitled to reasonable payment under the legal doctrine of ‘quantum meruit’ (meaning “the amount that one deserves”). Importantly, quantum meruit does not rely on the existence of an implied contract; rather, it seeks restitution based on the principle of unjust enrichment.

In a quantum meruit claim, the claimant must typically demonstrate that the defendant either expressly or impliedly requested or freely accepted the goods or services in question (see *Pavey & Matthews Pty Ltd (1987) 162 CLR 221*). Such claims often arise when there is no contract between the parties. However, quantum meruit may also apply in situations where a contract exists (i.e., an agreement has been reached on key terms) but there is no fixed contractual price.

Nevertheless, it is important to recognise that a remedy under the law of restitution, such as quantum meruit, may offer more limited relief when compared to a remedy for breach of contract. Restitution generally results in the vendor receiving reasonable payment for the goods or services, which is calculated adopting general market rates. By contrast, where there is a breach of a payment obligation under a contract, the aggrieved party could seek specific performance or damages, in order to recover the contracted sum (which may exceed market rates) along with compensation for any other loss or damage suffered (subject, of course, to the liability framework in the contract, which may amongst other things exclude recovery of consequential losses).

While quantum meruit is the most attractive and commonly pursued action to seek compensation for work performed in anticipation of a failed contract, there is an alternative avenue through the equitable doctrine of promissory estoppel. If a customer, through active encouragement or culpable acquiescence, leads a service provider to rely to their detriment on certain actions or promises (e.g., as to payment), the customer may be legally barred (or “estopped”) from acting in an inconsistent manner. In that case, the principal could theoretically be required to follow through on promises relating to payment, even if no binding contract exists. However, it is worth noting that such claims based on estoppel can be challenging and are not commonly pursued in practice.



WHAT ARE THE PRACTICAL IMPLICATIONS FOR YOUR CONTRACT?

Seeking compensation for work performed in anticipation of a failed contract can be an arduous process. Even with straight-forward claims, legal proceedings are often protracted and require significant allocation of financial and personnel resources. These issues can be exacerbated with legally complex claims. And even if a quantum meruit claim is successfully established, the compensation awarded, based on a court’s determination of the fair value of the work performed, may not align with the service provider’s expectations.

To mitigate the risk of becoming embroiled in complex disputes of this nature:

- service providers should exercise caution when commencing work before a contract has been signed. If an early start is essential to meet relevant customer deadlines, the service provider should make this clear and ideally secure some written endorsement from the customer (with a commitment to pay for the work even if the contract does not proceed) before starting work; and
- conversely, customers should be clear as to when service providers will be starting work early at their own risk. If a service provider does insist on beginning preparatory works before a contract is signed, the customer should consider writing to the service provider to expressly state that the customer has not committed to proceed with the contract and has not agreed to make any payment for work that may be carried out in advance of the contract being signed.

In this way, the parties will be clear where they stand in relation to any work carried out, delivering commercial certainty, and minimising the scope for future legal claims

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