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Allens Contract Law Update 2017

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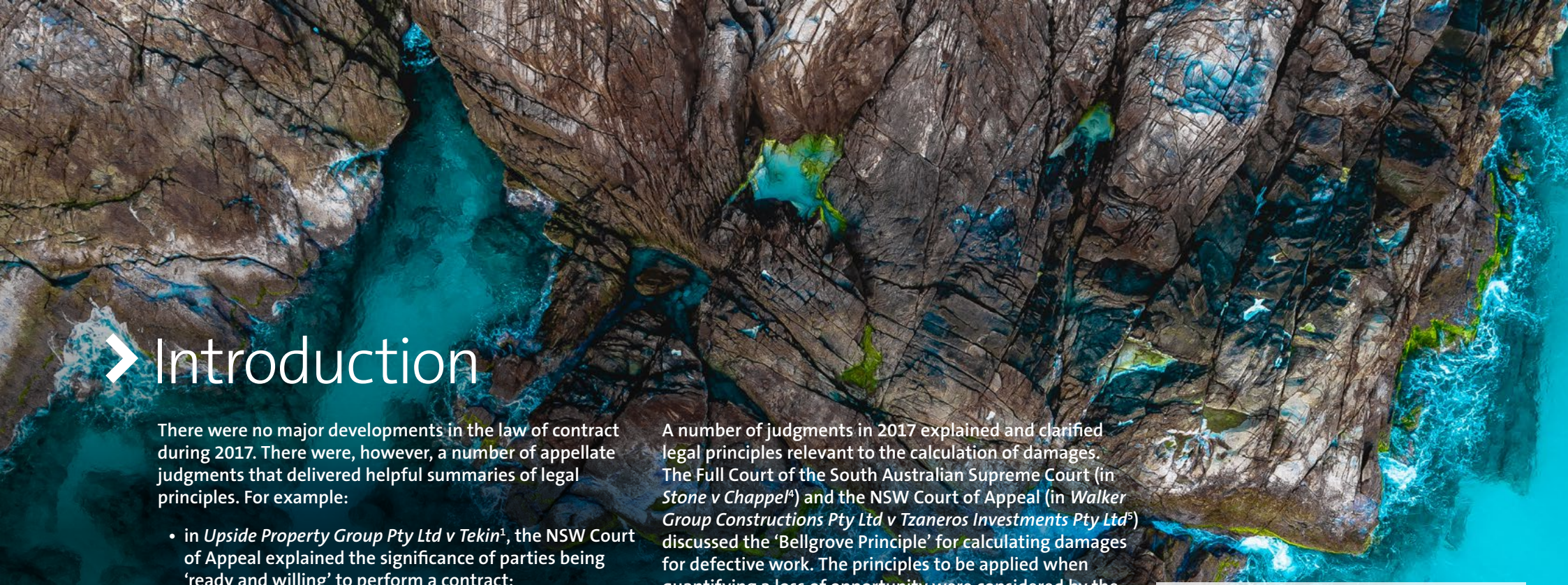

Introduction

There were no major developments in the law of contract during 2017. There were, however, a number of appellate judgments that delivered helpful summaries of legal principles. For example:

- in *Upside Property Group Pty Ltd v Tekin*[1], the NSW Court of Appeal explained the significance of parties being 'ready and willing' to perform a contract;
- in *Balanced Securities Ltd v Dumayne Property Group Pty Ltd*[2], the Victorian Court gave useful guidance on when a contract between two parties will impliedly terminate an existing contract between the same parties; and
- in *REW08 Projects Pty Ltd v PNC Lifestyle Investments Pty Ltd*[3], the NSW Court of Appeal summarised the principles to be applied in determining whether illegality will prevent a contract being enforced.

Our 2015 and 2016 *Contract Law Updates* commented on the number of appellate court judgments that considered whether parties had in fact entered into a contract. There were a number of further judgments on this issue in 2017. If there is one lesson from these cases, it is that when it comes to forming a contract, near enough is rarely good enough.

1 [2017] NSWCA 336.
2 [2017] VSCA 61.
3 [2017] NSWCA 269.

A number of judgments in 2017 explained and clarified legal principles relevant to the calculation of damages. The Full Court of the South Australian Supreme Court (in *Stone v Chappel*[4]) and the NSW Court of Appeal (in *Walker Group Constructions Pty Ltd v Tzaneros Investments Pty Ltd*[5]) discussed the 'Bellgrove Principle' for calculating damages for defective work. The principles to be applied when quantifying a loss of opportunity were considered by the Queensland Court of Appeal in *Principal Properties Pty Ltd v Brisbane Broncos Leagues Club Limited*[6] and the NSW Court of Appeal in *Port Macquarie-Hastings Council v Diveva Pty Limited*[7].

Our first *Contract Law Update* (in 2012) began by referring to the debate whether courts may, when interpreting a contract, have regard to evidence of surrounding circumstances if the contract is not, on its face, ambiguous. In each subsequent year, we have reported on the latest developments on this issue. In 2017, the High Court appeared to endorse (albeit indirectly) the position that such ambiguity was not necessary, but we are still waiting for an explicit resolution of this issue.

We hope you enjoy this update.

4 [2017] SASCFC 72.
5 [2017] NSWCA 27.
6 [2017] QCA 254.
7 [2017] NSWCA 97.

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Chapter 1: Contract formation

It is well established that post-contractual conduct:

- cannot be relied upon for the purpose of interpreting a contract; but
- can be relied upon for the purpose of deciding whether there is a contract.

In *Nurisvan Investment Ltd v Anyoption Holdings*[8] the Victorian Court of Appeal had to consider whether post-contractual conduct was admissible to determine whether a particular entity, which had not executed a contract, was nevertheless a party to that contract. The court held that post-contractual conduct was admissible for this purpose and that the relevant entity was a party to the contract.

The Court of Appeal also held that an agreement which purports to be a deed, but which is not executed according to deed requirements, may still be enforceable as a contract. Although this principle is fairly well established, the court noted this may be the first occasion where this principle has been applied to a party that had not even signed the purported deed.

The Court of Appeal further held, however, that although the heads of agreement was a binding contract, it was only a binding agreement to negotiate a share sale agreement in good faith, and was not a binding agreement for the sale of shares.

In *Nurisvan Investment*, a party was bound to an agreement despite not having signed it. There were, however, other appellate cases during 2017 that emphasised the risks of proceeding without a signed contract. In *Woolcorp Pty Ltd v Rodger Constructions Pty Ltd*[9], the Victorian Court of Appeal held that a property developer, who offered to contribute to the cost of a new road if it was relocated, was not contractually bound to make a contribution despite the fact that the road was so relocated.

8 [2013] VSCA 141.

9 [2017] VSCA 21.

In *Feldman v GNM Australia Ltd*[10], the NSW Court of Appeal considered whether parties, who had negotiated but not finalised a deed or settlement, were nevertheless bound by an earlier exchange of correspondence. The court held there was no binding agreement. One main reason was that an exchange of emails between the parties did not resolve their confidentiality obligations which, in the particular context of this case, were held by the court to be an essential or important part of the settlement agreement.

The Victorian Court of Appeal similarly concluded in *Birdsey v Vincent*[11] that an exchange of emails, which evidenced an agreed method for valuing shares, did not constitute a binding agreement to sell those shares because other key terms, such as the identity of the purchaser and the time for payment, had not been agreed.

Parties to a contract often neglect to renew the contract after its expiry, but will continue dealing with each other on the same (or a similar) basis. In those circumstances, a court will often infer a new, implied contract between the parties. A contentious issue, however, can be the extent to which this new, implied contract incorporates the terms of the expired contract. In *CSR Limited v Adecco (Australia) Pty Limited*[12], the NSW Court of Appeal had to consider whether an indemnity from a labour-hire company continued beyond the expiry of the contract. The court described the 'ultimate issue' as being:

> whether a reasonable bystander would regard the conduct of the parties, including their silence, as signalling to the other party that their relationship continued on the terms of the expired contract.

The court further held that, in applying this objective test, it was not necessary for there to be 'evidence of exactitude' in continuing to perform the expired contract. The court therefore concluded that the indemnity was a part of the new, implied contract.

10 [2017] NSWCA 107.

11 [2017] VSCA 323.

12 [2017] NSWCA 121.

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Nurisvan Investment Ltd v Anyoption Holdings [2017] VSCA 141

› Enforceability of partially executed heads of agreement

In this case, the Victorian Court of Appeal considered whether a partially executed deed was enforceable as a simple contract and which *Masters v Cameron* category it fell within (ie whether it was a binding agreement or merely an agreement to negotiate).

The court held that the purported deed was enforceable as a simple contract, including against a party named in it who had not signed it, but that it constituted an agreement to negotiate in good faith only.

This decision is significant for two reasons:

- it suggests that, in some circumstances, an ineffectively executed deed may be enforceable as a simple contract against a party that has not executed or signed it; and
- it suggests that post-contractual conduct may be examined for the purpose of identifying the parties to a contract.

Facts

Anyoption, a Cyprian company, entered into negotiations with Nurisvan to buy FIBO, a wholly owned Australian subsidiary of Nurisvan. FIBO held an Australian Financial Services Licence (***AFSL***). FIBO and Anyoption each executed a document (purportedly a deed) titled 'Binding Heads of Agreement', in which Nurisvan was listed as a party, but Nurisvan did not execute it. The document provided for the parties to enter into a Share Purchase Agreement, by which Anyoption would acquire Nurisvan's shares in FIBO (and thus acquire the AFSL). Anyoption paid the deposit required under the document.

Negotiations between Anyoption and Nurisvan took place over the following nine months, during which time nine draft Share Purchase Agreements were sent between the parties' solicitors. Ultimately, Nurisvan advised Anyoption that it did not regard itself as bound by any agreement with Anyoption and the sale did not proceed. Anyoption commenced proceedings seeking specific performance of the Binding Heads of Agreement and was wholly successful at first instance.

Judgment

The Court of Appeal granted leave to appeal and allowed the appeal on the *Masters v Cameron* ground.

The court held that the Binding Heads of Agreement was enforceable against Nurisvan, despite it not having signed or attested the document. The court reasoned that Nurisvan had accepted the obligations contained in the document and was 'plainly a necessary party to any contract to sell the shares it owed in FIBO' ([84]). In reaching its conclusion, the court held that it is permissible to examine post-contractual conduct to identify the parties to a contract, a question that had not been settled by previous authorities.

However, the court held that the Binding Heads of Agreement 'constituted no more than a contract between the parties to negotiate in good faith with respect to entering into an agreement for the purchase and sale of the FIBO shares' ([113]). In reaching this conclusion, the court had regard to the following factors:

- the language of the Binding Heads of Agreement, including that clause 3 was a declaration of intention to enter into the Share Purchase Agreement and other clauses were expressed in future tense and not as present obligations;
- the 'nature and extent of the terms left for future negotiation' ([113]); and
- the clauses in the Binding Heads of Agreement 'which would be otiose if it constituted a contract to enter into the Share Purchase Agreement' ([116]).

The court also considered, but did not find it necessary to decide, two grounds of appeal relating to the fact that an order for specific performance was made.

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Woolcorp Pty Ltd v Rodger Constructions Pty Ltd [2017] VSCA 21

› Inferring agreement from a course of conduct

This decision of the Victorian Court of Appeal considered whether a submission by a developer to a local council in relation to the proposed location of a road on a neighbouring developer's site constituted an offer to pay for the proportion of the road which would, if the submission were successful, benefit the developer's own site. The court also considered whether the neighbouring developer's course of conduct inferred that the alleged offer had been accepted.

The court held that no offer had been made and that, even if it had, there was no valid acceptance. This meant that the developer was not liable to contribute to the cost of the road on a contractual basis. The court also considered and rejected a claim by the neighbouring developer that it was entitled to restitution.

This case provides a useful reminder that contractual offers must be sufficiently certain and communicated by the offeror to the offeree. It also highlights that, on the rare occasion that a contract is inferred, the court will need to be satisfied that the conduct relied upon positively indicated that the parties considered themselves bound and would cause an objective bystander to conclude that an acceptance of an offer had been signalled to the offeror.

Facts

The appellant, Woolcorp Pty Ltd, and the respondent, Rodger Constructions Pty Ltd, were developers of large adjacent blocks of land set aside for a residential development project in Warrnambool. Woolcorp owned the southeast block and Rodger was the contractor of Mr Martin, the owner of the northern block.

As part of the council approval process, Rodger prepared a diagram of the development layout including a proposed road. The road was entirely within Martin's land and did not touch Woolcorp's boundary. Discussions were held between the developers about the diagrams, with a number of other surrounding developers expressing concern about streetscape and drainage issues.

On 25 August 2008, Woolcorp sent a letter to the local council, which it described as a submission, attaching an alternative plan. The alternative plan relocated the proposed road to the southern boundary of Martin's land so that it would touch approximately 300m of Woolcorp's boundary. This would reduce the roads required to be built on Woolcorp's land without increasing the roads already planned to be constructed on Martin's land. The submission included the statement: 'Woolcorp offer to contribute to the construction costs for this road where it runs between their east and west boundary.'

Woolcorp emailed a copy of the submission to Rodger. The council also provided Rodger with all of the surrounding developers' submissions, and requested that consideration be given to amending the plan to accord with the developers' preferred layouts. Following further discussions, Woolcorp sent Rodger a new plan, which Rodger incorporated into its own revised development plan. Council approved the plan in December 2008 and construction began on Martin's land in mid-2009.

During 2009 and 2010, Woolcorp and Rodger corresponded and conducted meetings in relation to a number of different issues. The cost of the road was not brought up by Rodger, except in May 2010 in a conversation with Woolcorp's principal, Mr Gleeson. Rodger's principal proposed to have a consultant come up with costings for the shared road, to which Mr Gleeson replied 'Well, I suppose'. Nothing further was said.

A year later, Rodger wrote to Woolcorp stating that Woolcorp had already indicated that it would contribute to a reasonable share of the road's construction costs and asking Woolcorp to sign and return the letter to signify its agreement. Woolcorp did not respond.

Following this letter, there was further correspondence between Rodger (and its solicitors) and Woolcorp, which led to the commencement of proceedings by Rodger in March 2014. Rodger was successful at first instance.

Judgment

Woolcorp did not make an offer capable of acceptance

The Court of Appeal held that Woolcorp had not made an offer to Rodger to pay for part of the road because:

- the 25 August 2008 letter, referred to throughout the matter as a submission, was addressed to the council and did not indicate that a definite offer was being made to Rodger;
- neither the 25 August 2008 letter nor the email to Rodger attaching the submission invited an acceptance;
- there was no clear indication of what was being offered to Rodger (in particular, how much of a contribution would be made); and
- there was no evidence of Woolcorp clearly stating to Rodger that it would contribute to the road. The equivocal 'Well, I suppose' by Mr Gleeson in May 2010, and the fact that nothing further appears to have been said about the contribution until Rodger's letter to Woolcorp in May 2011 requesting payment do not suggest that an offer capable of acceptance was made by Woolcorp.

Rodger's conduct did not positively indicate that both parties considered themselves bound; the mere fact of consistency with the existence of the alleged contract is insufficient

The Court of Appeal also held that, even if an offer had been made, Rodger's conduct was insufficient to infer that a contract existed between the parties. For the court to make the requested inference, the conduct relied upon must positively indicate a binding agreement. The court noted that:

- Rodger's agreement to relocate the road was a step taken in response to a specific request by the council to consider the other developer's suggestions as part of the development plan approval process. It was not a decision in response to an offer by Woolcorp; and
- there was no evidence that Rodger had communicated any acceptance of, or reliance upon, the alleged offer in Woolcorp's submission to the council, either before or after the road was built.

Woolcorp's subsequent construction of its own subdivision allotments facing the road was also inadequate evidence of a contract because it did not positively indicate that Woolcorp considered itself bound by an agreement with Rodger. The court said that the mere fact that the conduct could be considered consistent with the alleged agreement is not enough. The conduct could equally be considered consistent with a situation in which no agreement occurred but, in response to Rodger building the road in that location following a request from council, Woolcorp simply took the benefit of the new layout.

The court also highlighted that its assessment of an intention to contract is an objective one and the conduct relied upon (including the silence of Rodger in relation to the alleged offer) must be able to signify to an objective bystander that an acceptance had indeed occurred and had been communicated to Woolcorp.

Rodger's conduct was inconsistent with the existence of the alleged contract

In addition, the court pointed out that much of Rodger's conduct following the council submission was inconsistent with a pre-existing binding agreement with Woolcorp to contribute to the road because:

- in response to council's final permit approval which stated that the road works must be undertaken at Rodger or Martin's cost, Rodger wrote a letter to the council asking how it would obtain contributions from the owners of adjacent properties who would benefit from the road;
- Rodger's first letter to Woolcorp about the contribution, and subsequent letters from Rodger's solicitors, asked Woolcorp to acknowledge its agreement by signing and returning the letters; and
- there was no clear evidence as to who had said what and to whom and when they had said it, and there were other factual discrepancies in Rodger's evidence which made it unlikely that the alleged contract existed in the manner claimed.

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Feldman v GNM Australia Ltd [2017] NSWCA 107

› Whether a contract is binding in circumstances where certain terms are yet to be finalised

In this case, the NSW Court of Appeal considered whether there was a binding contract on foot in circumstances where there was an agreement between the parties to settle a dispute, but an essential term in the contract was yet to be finalised.

The court held that no binding contract existed. The parties had agreed that a confidentiality clause would be included, and, until the terms of that clause were agreed upon, the contract was incomplete.

This case reiterates the importance of key provisions of a contract being settled and agreed upon by the parties, before they are able to rely upon the agreement. This is so, even in circumstances where the agreement is otherwise settled.

Facts

This matter arose from the publication of allegedly defamatory material by the respondent, GNM Australia Ltd. In early 2015, Feldman, the applicant, threatened defamation proceedings in relation to certain articles on GNM's website.

In April, GNM's solicitors sent an email to Feldman offering to remove the articles if Feldman released GNM from all liability and stated that: 'an agreement reflecting the above would be documented in a Deed of Release which would also include obligations of confidentiality.'

A settlement agreement was eventually reached and GNM's solicitors provided the other side with a draft deed of release. However, the parties found themselves in disagreement over the terms of the confidentiality clause. Further correspondence followed.

In July, Feldman's solicitors advised that their client had withdrawn his offer to settle. GNM's solicitors contended that Feldman could not withdraw the offer as the parties had a concluded settlement agreement.

In December, Feldman commenced defamation proceedings against GNM. GNM sought a permanent stay of proceedings, which it was granted on 30 June 2016. Feldman appealed.

Judgment

The key issue on appeal was whether the primary judge erred in finding that there was a binding agreement between the parties.

The primary judge held that the April email placed the 'formation of an agreement ahead of the process of formal legal documentation.' In other words, the parties intended to be bound by the contract and would finalise the confidentiality clause in due course.

The Court of Appeal did not agree, finding that no binding contract existed.

President Beazley, with whom Justice McColl and Justice McFarlan agreed, held that the emails between the parties in 2015 were merely negotiations. The court held that the language used in the April email was not the language of parties who intended to be immediately bound by a contract. Rather, the parties intended to first reach agreement on all essential terms. Until that time, the contract was incomplete.

The court was persuaded by the fact that the parties had expressly discussed the inclusion of a confidentiality clause, and the terms of this clause therefore required settling before a final agreement could be reached.

Birdsey v Vincent [2017] VSCA 323

› What is required for a binding contract?

In this case, the Victorian Court of Appeal considered whether an email exchange between parties gave rise to an enforceable contract for the sale of shares.

The court held that the relevant exchange did not amount to an offer and acceptance, such that an enforceable contract had been formed. Taken at their highest, the emails manifested an agreement to proceed on a certain valuation of the shares; however, there was no agreement as to sale, the identity of any purchaser(s), time for payment or terms of sale. Accordingly there was no contract, and no damages for breach were payable.

This case highlights that where parties intend to create a binding agreement, they should ensure that the contract has been properly formed through clear offer and acceptance. Parties must be cautious to ensure they include sufficient detail to give rise to a binding contract.

Facts

This case arose out of an application by the defendants seeking leave to appeal. It concerned a purported agreement for sale of shares in a family investment company, Noriel Pty Ltd. The plaintiff, Jennifer Birdsey, and defendants, Susan Vincent and Gregory Gunn, were siblings who benefited under their late mother's will.

Included in the estate were shares in Noriel. Each of the siblings were pre-existing shareholders in Noriel in their own right. During the administration of the estate, Birdsey indicated that she no longer wanted to be a shareholder in Noriel.

Mr Noonan, the accountant for Noriel and for the deceased's estate, and Mr Hearn, Mrs Birdsey's solicitor, exchanged a series of emails discussing possible options for distributing Mrs Birdsey's estate entitlement. The exchange resulted in two key options being presented:

- winding up Noriel and distributing the proceeds accordingly; or
- Mrs Birdsey forgoing her allocated shares and being compensated with a larger share from the rest of the asset pool.

The relevant emails giving rise to the alleged contract were as follows:

- email dated 18 March 2015 in which Mr Noonan provided the solicitors with a valuation of Noriel;
- email dated 11 May 2015 in which Mr Noonan asked Mr Hearn if Mrs Birdsey was happy to accept the 17 March 2015 valuation of Noriel; and
- email dated 10 June 2015 in which Mr Hearn confirmed that Mrs Birdsey was happy to accept the 17 March 2015 valuation.

At first instance, the trial judge found the above email exchange gave rise to a binding contract for the sale of shares. The trial judge accepted Mrs Birdsey's argument that the 10 June 2015 email constituted acceptance of the offer put forward in the earlier emails by Mr Noonan. However, the trial judge refused Mrs Birdsey's corresponding application for interest on the purchase price.

The defendants sought leave to appeal against the judge's declaration that they were contractually bound to purchase the plaintiff's shares in Noriel and contended that the judge erred in finding that there was a binding contract for the sale of shares. The plaintiff sought leave to appeal from the judge's decision to refuse her claim for interest.

Judgment

Justices Santamaria and Beach (Justice Ashley agreeing) found that the relevant email exchange did **not** give rise to a binding agreement. The emails exchanged between the parties did not constitute offer and acceptance of a share purchase. At best, all that was agreed was that the valuation of Noriel performed on 17 March 2015 was a basis from which the parties could calculate their respective entitlements.

The parties had made no agreement as to sale, the identity of a purchaser(s), the time for any payment, or the terms upon which the sale might proceed. Nothing could be found in the language of the emails to support the existence of an offer, or contract. Therefore leave to appeal was granted to the defendants, and their appeal was allowed.

Justice Ashley also identified the lack of detail in the arrangements between the parties. While the documents relied upon by the plaintiff did establish a broad level of agreement that a share purchase agreement in a particular amount, funded out of the deceased's personal estate, would be the vehicle for separating out the financial affairs of her and the defendants, ultimately the position reached failed to provide detail about key matters.

Justice Ashley found that it was not enough that the plaintiff agreed to dispose of her shares for a certain price. Further detail was needed, such as to whom and when the shares would be sold, and who the plaintiff would sue for breach. The broad level of agreement reached between the parties fell short of being an enforceable contract.

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CSR Limited v Adecco (Australia) Pty Limited [2017] NSWCA 121

› What happens when parties keep dealing with each other following expiry of an agreement?

In this case, the NSW Court of Appeal considered whether an expired agreement continued on as an implied contract on the same terms between two parties, and whether an indemnity provision continued as part of that implied contract.

The court held that Adecco was liable to indemnify CSR, as the parties' conduct indicated that an implied contract was in force between them on the same terms as the original agreement, including the indemnity provision.

This case addresses the legal test required for a finding that an implied contract exists between the parties on the same terms as an expired agreement. The Court of Appeal noted that the question as to 'whether an implied contract following upon the expiry of an express fixed term contract may be inferred turns on an objective inquiry'. The ultimate issue is whether a reasonable bystander would regard the conduct of the parties as signalling that their relationship continued on the terms of the expired contract. This is an evidentiary or factual question that considers whether the parties' conduct reflects that the contract has remained on foot. Finding 'exactitude' in performance after the contract has expired is not required.

Facts

The appellants, CSR Limited and Holcim (Australia) Pty Limited, appealed from a decision of Justice Adamson, who held that Adecco (Australia) Pty Limited was not liable to indemnify them in respect of their liability in damages arising from a personal injury claim brought by the plaintiff, David Frewin. Mr Frewin was injured as a result of driving a defective truck during his employment at a CSR concrete plant. The indemnity issue arose as a result of Mr Frewin's personal injury proceedings settling.

The parties had entered into a formal contract for labour supply, in which Adecco provided labour hire services to CSR. This contract expired on 31 March 2002. The agreement had first been extended by the parties until an agreed date (31 July 2002), following which Adecco continued to supply labour, which CSR continued to pay for. CSR argued that after the contract had expired, there existed an implied contract between the parties on the same terms and conditions, which included the indemnity, as had previously been the subject of the agreement (save only as to duration and term).

The indemnity provision provided that Adecco would indemnify CSR against 'any claim by Temporary Staff for personal injury...arising out of or in connection with the performance of Assignment duties' and 'any liability to any person...in respect of or in connection with such personal injury'.

Mr Frewin was engaged by Adecco as a casual employee and was paid weekly upon Adecco's receipt of a correctly completed timesheet. He worked under CSR's direction and control, and said he was 'called to work on a day to day basis' at CSR's direction. The driver's seat of the truck Mr Frewin drove lacked the suspension of other seats in similar vehicles and, as a result, Mr Frewin suffered pain in his lower back. He drove the defective truck from approximately September 2002 until March 2003, after the express agreement had expired.

Justice Adamson at first instance found that the indemnity provision CSR sought to enforce did not form part of the agreement between CSR and Adecco during the period in which Mr Frewin's cause of action arose. Her Honour found that in the event the indemnity did form part of an implied contract, it did not apply, as CSR did not prove that Mr Frewin was 'Temporary Staff', nor that he was working 'in an assignment for CSR'.

Judgment

The Court of Appeal had to consider whether an implied contract containing the relevant indemnity existed between the parties during the period in which Mr Frewin's cause of action arose. The court unanimously allowed the appeal and held that Adecco was liable to indemnify CSR in respect of Mr Frewin's personal injury claim. The court held that it should be inferred from the parties' conduct that they intended the expired contract to continue on the same terms and conditions, including the indemnity provision, beyond July 2002.

After considering various authorities, Justice McColl noted that the question as to whether an implied contract continued after an express fixed-term contract had expired turns on an *objective inquiry*. At [120] her Honour noted that 'the ultimate issue is whether a reasonable bystander would regard the conduct of the parties, *including their silence*, as signalling to the other party that their relationship continued on the terms of the expired contract.' What is required is conduct by the parties as if the contract remained on foot. Justice McColl inferred from the parties' silence on the issue, and their continued course of dealings, that they were conducting their relationship according to the terms of their original agreement.

Justice McColl did not accept Adecco's submission that the authorities mandate that there must be evidence of 'exactitude' in performing the expired contract before an inference of an implied contract can be drawn. Her Honour found that Justice Adamson failed to apply the objective, or reasonable bystander test. CSR had to show that the parties continued to act as though the contract was still in force after the relevant term had expired, not identify any communications which confirmed the terms of their continuing relationship.

The Court of Appeal also stressed the commercial reality of the arrangement between the parties. Justice McColl noted that it does not accord with commercial reality to suggest the parties did not continue to act according to their original contract, given that labour continued to be supplied and paid for and Adecco was anxious to continue providing services (and thereby avoid a public tendering process that would apply if there was a fresh contract).

At [130], Justice McColl found '[i]t is also inconsistent with the size of the parties' operations and the complex agreement under which they had operated to suggest that an equally available inference was that the parties' relationship after July 2002 continued on a quantum meruit basis or that they operated on "terms related to payment for labour hire services, but did not include indemnities".' Further, the court found the indemnities continued to apply as part of this implied contract, so as to recognise the commercial relationship between the parties and the risk allocation they had agreed upon.

In obiter, Justice McColl further commented that it is not apparent that in order for an implied contract to continue it is necessary to establish that the parties continued to conduct themselves as if bound by the agreement for its *entire term*. Justice McColl considered it may be sufficient to call evidence that the parties acted for a *substantial* period as if bound by the contract.

Further, the Court of Appeal found that Mr Frewin came under what was meant by 'Temporary Staff'. The court construed the words 'employed by' broadly, noting that principles of construction require the courts to avoid a construction that makes commercial nonsense or working commercial inconvenience. In construing the indemnity provision, the court found that one would understand 'Temporary Staff' to refer to persons Adecco supplied to CSR.

Chapter 2: Interpretation of contracts

In 1996, the House of Lords considered a reinsurance contract, under which the liability of a reinsurer was dependent on the '*sum actually paid*' by the insurer. In concluding that the phrase 'actually paid' did not require 'actual' payment, Lord Hoffmann made the following curious analogy:

> A wife comes home with a new dress and her husband says 'what did you pay for it?' She would not be understanding his question in its natural meaning if she answered 'Nothing, because the shop gave me 30 days credit'. It is perfectly clear from the context that the husband wanted to know the amount of the liability which she incurred, whether or not that liability has been discharged.

Lord Hoffmann similarly reasoned that an insurer 'actually paid' an amount if it incurred a liability to pay the amount. This judgment of the House of Lords (although not the example of the dress) was referred to by the NSW Court of Appeal in *Treloar Constructions Pty Ltd v McMillan*[13]. In that case, the court considered a contract that gave Treloar Constructions a right to charge for contractors 'organised and paid by Treloar Construction'. The court found that the word 'paid' did not require actual payment of the relevant contractors. In reaching this conclusion, the NSW Court of Appeal had regard to 'the landscape of the instrument as a whole' and adopted the 'reasonable businessman' approach.

13 [2017] NSWCA 72.

In recent years, the NSW Court of Appeal has consistently stated its view that a court may, when interpreting a contract, have regard to external circumstances, whether or not the contract is, on its face, ambiguous. The NSW Court of Appeal repeated this view in *Cherry v Steele-Park*[14]. In that case, the court also had regard to pre-contractual negotiations between the parties, but only to the extent to which they established objective background facts known to both parties. The court referred to a passage of the judgment of Justice Mason in *Codelfa*[15] that:

> Obviously the prior negotiations will tend to establish objective background facts which were known to both parties and the subject matter of the contract. To the extent to which they had this tendency they are admissible. But in so far as they consist of statements and actions of the parties which are reflective of their actual intentions and expectations they are not receivable.

The court made the point that, in this passage, it is important to distinguish between evidence being 'admissible' and the 'use' to which such evidence might be put. In so far as pre-contractual negotiations show both the subjective desires of the parties and objective background facts known to both parties, the communications would be admissible in their entirety, but no use may be made of the communications in so far as they merely indicate the parties' subjective intentions.

The High Court has continued to refrain from stating expressly whether it agrees with the NSW Court of Appeal's approach to the admissibility of extrinsic evidence. There have, however, been a number of dicta from the High Court that are consistent with judgments of the NSW Court of Appeal. In *Ecosse Property Holdings Pty Ltd v Gee Dee Nominees Pty Ltd*[16], the court interpreted a contract that was, on its face, ambiguous. However, in the judgment the court explained that the reason for a court taking into account evidence of surrounding circumstances is to be able to apply the 'reasonable business person' test. It is not controversial that the 'reasonable business person' test is applied whether or not a contract is ambiguous. The High Court judgment would therefore appear to indicate that the evidence of surrounding circumstances would be admissible, for the purpose of interpreting a contract, whether or not the contract is, on its face, ambiguous.

Another issue that the High Court has refrained from expressly addressing is the extent to which an obligation of good faith should be implied into commercial contracts. It is similarly common for many intermediate appellate courts to refrain from expressing a view of the existence or scope of such a duty, but instead to provide reasons why any such duty, if it existed, was not breached. In *Virk Pty Ltd (in liq) v Yum! Restaurants Pty Ltd*[17], the Full Federal Court considered whether Yum!'s discretionary power to set maximum prices was subject to an obligation that it be exercised honestly and reasonably. The court refrained from embarking on a general discussion as to whether there was an implied obligation to act in good faith and reasonably and, if so, whether they were separate obligations (or whether the obligation to act in good faith included an obligation to act reasonably).

The court did hold, however, that any obligation to act 'reasonably' was not equivalent to a duty to exercise due care and skill or to produce a reasonable outcome. Instead, the concept of 'reasonableness' in this context has a meaning close to 'good faith' and is unlikely to be breached if conduct is not arbitrary or dishonest. The court therefore upheld the primary judge's finding that Yum! had acted in good faith and reasonably (in the relevant sense).

14 [2017] NSWCA 295.

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

16 [2017] HCA 12.

17 [2017] FCAFC 190.

Treloar Constructions Pty Ltd v McMillan [2017] NSWCA 72

› Whether the term 'paid' means be actually paid

In this case, the NSW Court of Appeal considered, among other issues, how the terms of a contract (in particular the term 'paid') should be interpreted.

The court set aside the lower court's judgment, holding that the appellant was under no obligation to have already paid its subcontractors to have entitlement under a contract to issue invoices. The court reasoned that the term 'paid' should be viewed through the 'landscape of the instrument' rather than merely the natural meaning.

This judgment highlights the importance of consistent drafting throughout the body of the contract. Parties should also ensure that they act within the terms of the contract, and to the extent possible, issue detailed invoices.

Facts

The appellant, Treloar Constructions Pty Ltd, entered into a contract with McMillan Prestige Pty Ltd for the construction and project management of a car showroom and a service and repair facility on or about 21 December 2005.

The contract terms were attached to a letter sent by Race Treloar to Mr McMillan. The attachment, the Agreement for Conditions of Works at the Jubilee site, provided, among other terms:

> 1) ...Suppliers and contractors organised and paid by Treloar Construction will be charged at cost + 12.5% management fee.
>
> 2) Supervision of suppliers and contractors nominated and paid directly by McMillan will be charged at $75/hr + GST...

Mr McMillan responded, signed the document, and deposited $30,000 to Treloar as per the agreement terms.

Treloar commenced work from December 2005. From 28 April 2006 to 20 September 2006, Treloar issued 11 invoices, totalling $418,991.77 which went unpaid by McMillan. McMillan did not dispute that works had been carried out.

In February 2007, a receiver was appointed for McMillan. Treloar commenced these proceedings to recover the sums still unpaid.

Judgment

The court examined whether the term 'paid' should be confined to a meaning of 'having been paid'. This issue arose because the lower court judge found there was insufficient evidence to suggest that Treloar's subcontractors and suppliers had been paid prior to Treloar's claim against McMillan, and it was on this finding that the claim was originally dismissed.

The NSW Court of Appeal held that the term 'paid' should not be limited to actual payment to the subcontractors and suppliers, which was supported by the following factors:

- the term 'paid' should be interpreted by reference to '*the landscape of the instrument as a whole*'. The court noted that by doing so, the '*words may take on a different complexion*'. This method of contractual interpretation favours a broader approach to interpretation of the whole contract rather than a narrow view of a single term;
- the court cited a passage from *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640 to support the well-established standards of contractual interpretation. This passage highlighted the objective, 'reasonable businessman' approach to contractual interpretation and encouraged the avoidance of any interpretation that would render a contract to be nonsense;
- in the present case, the court accepted Treloar's argument that a narrow interpretation of the word 'paid' would render clause 2, which also contained the word 'paid', to be nonsensical;

- the court also noted that Treloar's entitlement under the contract with McMillan arose from Treloar having issued the invoices to McMillan. If Treloar had not actually paid its subcontractors and suppliers, they had their own contractual remedies against Treloar. These rights were irrelevant to the contract entitlements between Treloar and McMillan; and
- in analysing whether Treloar suffered loss or damage to recover the sums under section 588M of the *Corporations Act 2001* (Cth), the court noted that McMillan did not dispute that the works were carried out, nor made any claim that the invoices were not genuine.

The court's finding on this point was consistent with a long line of other judges who have examined instances where words may have an imprecise meaning unless the context in which they sit is also analysed. In *Provincial Insurance Australia Pty v Consolidated Wood Products Pty Ltd* (1991) 25 NSWLR 541, President Kirby set out the modern approach as being '*to provide meaning to words in the context in which the words appear and for the purpose of achieving the imputed object of the user*'. By interpreting 'paid' through the lens of the 'landscape as a whole', the court has, like other courts before it, focused in on the commercial intention of the drafters of the contract to create a sensible legal document.

It is perhaps for this reason that when the court also considered whether the contractual terms were ambiguous or uncertain, it, unlike the lower court, determined that clause 1 *'contained a clear stipulation as to the terms upon which Treloar was entitled to charge McMillan Prestige.'*

Allens › ‹ Linklaters

Allens › ‹ Linklaters

Cherry v Steele-Park [2017] NSWCA 295

- Evidence of surrounding circumstances to be taken into account when construing a deed of guarantee
- The 'true rule' in *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337

In this case, the NSW Court of Appeal considered the 'true rule' in *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 and whether evidence of the surrounding circumstances could be taken into account when construing a deed of guarantee.

The court held that ambiguity is not necessary for regard to be had to objective matters external to the contract.

This case is a further demonstration that the 'true rule' is not as stringent as first thought, and strict ambiguity may not be required before a broader interpretive approach is adopted. Certainly, in this instance, the court held that a written contract need not be ambiguous before evidence of surrounding circumstances can be tendered to assist with construction.

Facts

This case concerned a contract for the sale of land between the appellants, David Cherry and Richard Sharpe, directors of Bathurst Central Pty Ltd, and the respondents, Phillippa Steele-Park and Jock Steele-Park. The contract was never completed and the respondents served a notice of termination and commenced proceedings against the appellants in the District Court seeking $176,947.16 as a debt due and payable under the guarantee, or, in the alternative, damages for breach of contract.

The contract included a clause that stated that if the respondents validly terminated the contract and resold the land to a third party purchaser for a lower price within one year, the respondents could recover the difference from the appellants. Importantly, the parties had entered into a number of subsequent variations. The first variation extended the completion date and provided that interest would become payable after a certain date. Meanwhile, the second variation removed the obligation to pay interest and instead provided that $30,250 would be paid as consideration for the variation of the completion date.

The appellants sought to tender a number of emails to assist the court interpret the guarantee. Specifically, to show that the guarantee would only cover the price of the second variation, not any damages for failing to complete.

At first instance, the trial judge refused to allow the emails to be admitted as evidence for the purpose of construing the agreement, and held that the guarantee extended to Bathurst Central's obligation to pay the difference in the purchase price.

The appellants appealed this decision on the basis that:

- the email correspondence was able to be used to construe the guarantee; and
- on that basis, the guarantee should be limited to the smaller amount payable under the second variation.

Judgment

Justices Gleeson and Leeming (delivering the majority judgment) dismissed the appeal with costs. While ultimately the outcome remained the same for the parties, the majority did find that the trial judge erred in her approach to extrinsic material and the interpretation of the guarantee.

In doing so, the court held that:

- the court's primary duty when construing a written contract is to ascertain the legal meaning of the document from the words of the instrument in which the contract is embodied, which qualifies the scope for evidence of surrounding circumstances;
- it is not necessary for a contract to be ambiguous before regard may be had to external factors; and

- ambiguity is a conclusion to be reached after evidence of surrounding circumstances has been considered. It is not a precondition to the admissibility of evidence of surrounding circumstances.

Significantly, the majority considered that there was no inconsistency between the 'true rule' and 'the permissibility of resorting to objective evidence of surrounding circumstances' [84]. Further, that the interpretation of a contract may be likened to the process of statutory interpretation, whereby 'the apparently plain words of a provision may wear a very different appearance when they are read in light of the mischief the statute was designed to overcome and of the objects of the legislation' [85].

Therefore, the email correspondence constituted 'specific information as to the genesis of the transaction', and that:

> The emails were objective facts known to both sides of the transaction. Not only did they represent the communicated negotiating position of the parties from time to time, but they also supported the appellants' submission that the commercial purpose of the guarantee was to secure Bathurst Central's obligation to make the additional payments agreed upon as the price of extension [91].

Ecosse Property Holdings Pty Ltd v Gee Dee Nominees Pty Ltd [2017] HCA 12

› Having regard to extrinsic circumstances when resolving an ambiguity

The High Court of Australia considered evidence of surrounding circumstances to resolve an ambiguity in a 99-year lease. Although the court did not expressly resolve the '*Codelfa* controversy', the decision is consistent with the approach recently taken in NSW, that evidence of surrounding circumstances may be taken into account even where a court has not first made a finding that the relevant clause is ambiguous.

In the context of the remaining uncertainty as to the admissibility of surrounding circumstances, one option is to ensure that recitals (or other clauses) expressly state the commercial purpose of a contract. This will both minimise the risk of a court making incorrect inferences as to the commercial purpose, and will ensure that the court will have regard to the commercial purpose when construing the contract.

Facts

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

The key issue was whether the tenant was liable to pay the costs of rates, taxes, assessments and outgoings levied to the landlord. There were two clauses in the lease that pointed to different answers to this issue.

Clause 4 stated that the tenant (with deletions apparent on the face of the lease):

> will pay all rates taxes assessments and outgoings whatsoever ~~excepting land tax~~ which during the said term shall be payable by the ~~Landlord or~~ tenant in respect of the said premises ...

The deletion of the words 'Landlord or' suggest an intention that the tenant would not be responsible for rates payable by the landlord.

On the other hand, clause 13 provided:

> The parties acknowledge that it was the intention of the Lessor to sell and the Lessee to purchase the land and improvements hereby leased for the consideration of $70,000.00 and as a result thereof the parties have agreed to enter into this Lease for a term of ninety-nine years in respect of which the total rental thereof is the sum of $70,000.00 which sum is hereby acknowledged to have been paid in full.

This clause suggests an intention that the tenant would be liable for rates payable by the landlord.

The trial judge decided that the tenant was liable for all such payments, including land tax. This was consistent with the purpose stated in clause 13.

The Victorian Court of Appeal gave greater weight to the apparent intention behind the deletions in clause 4. It therefore allowed the tenant's appeal and found that the tenant was only liable to pay rates, taxes, assessments and outgoings payable by the tenant.

Judgment

Justices Kiefel, Bell and Gordon (delivering the majority judgment) and Justice Gaegler (in a separate judgment) allowed the appeal. Justice Nettle, in dissent, agreed with the Court of Appeal's decision.

The majority held that both:

- the language of clause 13 of the lease; and
- the surrounding facts and circumstances (that a reasonable businessperson in the position of the parties could be taken to have known),

pointed to the conclusion that the parties' intention was to achieve a position as close to a sale of the property as they could. On this basis, the majority held that the proper construction of the relevant payment clause was that it required the tenant to pay all rates, taxes and other outgoings over the lease's term.

The relevant surrounding circumstances included that:

- the leased land was intended to be sold by one party to the other (which was also apparent from clause 13);
- the land could not be sold due to planning restrictions;
- the lease was a mechanism to indirectly achieve the substance of the parties' agreement to sell; and
- the agreed rent for the period ($70,000 paid in advance) was more or less equivalent to the market freehold value of the leased land.

With regard to the correct approach to contractual interpretation, the majority said that:

- each of the parties' proposed constructions of the lease was plausible;
- the terms of a commercial contract are to be understood objectively, by reference to what a reasonable businessperson would have understood them to mean, rather than by reference to the subjectively stated intentions of the parties to the contract;
- in a practical sense, this process of interpretation requires that the reasonable businessperson be placed in the position of the parties. Importantly, the majority went on to say that:

> It is from that perspective that the court considers the circumstances surrounding the contract and the commercial purpose and objects to be achieved by it.

It was not necessary for the court to determine the ambiguity gateway question to decide this case, because the parties did not dispute (before the Court of Appeal or before the High Court) that the clause was ambiguous. While the majority did not directly address the 'ambiguity gateway' question, their Honours' explanation of the context in which a court is to take into account evidence of surrounding circumstances (at the point of applying the 'reasonable businessperson' test) may be interpreted as support for the position taken in recent decisions of the NSW Court of Appeal. It is well established that the process of contractual interpretation is an objective one, to be undertaken by reference to the 'reasonable businessperson' test. That test is to be applied even if the words of a contract are clear and unambiguous. The statement by the majority, that surrounding circumstances are to be taken into account in the process of applying that test, suggests a further erosion of the view that the 'true rule' in *Codelfa* mandates that ambiguity in the language is required before a court may consider evidence of surrounding circumstances.

Justice Nettle, in dissent, preferred the approach of the Court of Appeal. In particular, Justice Nettle stated that the lease was poorly drafted and that, while poor drafting might justify a court being more willing to depart from the ordinary meaning of a clause, it did not give the court licence to change the meaning of a term that was otherwise clear and unambiguous.

Allens › ‹ Linklaters

Virk Pty Ltd (in liq) v YUM! Restaurants Australia Pty Ltd [2017] FCAFC 190

- Duties owed by franchisors
- Implied obligation of good faith and reasonableness in franchising agreements

In this case, the Full Federal Court considered whether a franchisor had acted in bad faith, negligently or unconscionably in setting the maximum price for pizzas sold by its franchisees.

The court held that the franchisor had not breached any duties (in contract, tort or under statute) owed to its franchisees and dismissed the appeal.

The decision is significant because the court clarified the operation of the implied obligation of good faith and reasonableness. In particular, the court held that the obligation is a composite one, which does not require consideration of whether conduct was reasonable in the tort-like sense.

Facts

Yum! Restaurants Australia Pty Ltd (the ***franchisor***) exercised a contractual power under its franchise agreements to set the maximum price of a range of products. The power was exercised according to a 'Value Strategy' which, among other things, drastically reduced the sale price of pizzas. This decision was bitterly opposed by many franchisees, who complained that it would threaten the financial viability of their businesses.

At trial, the franchisees alleged that the franchisor breached contractual duties, was negligent and contravened the statutory prohibition on unconscionable conduct (section 21, Australian Consumer Law). These claims were dismissed. The trial judge's findings and decision with respect to all three claims were the subject of the appeal.

Judgment

The court did not decide whether the franchisor's power to set maximum prices was subject to an implied obligation of good faith and reasonableness because, on appeal, both parties accepted the implied obligation. The court held that 'good faith and reasonableness' was a composite phrase and a composite obligation: '[r]easonableness is not to be approached in a case such as this as akin to a tortious duty to exercise due care and skill or to produce a reasonable outcome' (at [164]).

In relation to the issue of negligence, the court held that the franchisor owed no duty of care to its franchisees for two reasons. First, the franchisor does not provide services to its franchisees. Second, the duty of care was inconsistent with the contractual relationship between franchisor and each franchisee.

The appellant also failed on the grounds of unconscionability. The court applied the factors listed in s22 of the Australian Consumer Law to conclude that the franchisor had not breached s21 by implementing the Value Strategy. Notably, there was no bad faith (s22(1)(f)), the power was exercised to protect the franchisor's legitimate business interests (s22(1)(b)), it was not shown that there was any undue influence of pressure or unfair tactics used against the franchisees (s22(1)(d)), it was not shown that there was non-disclosure of business risks to the franchisees (s22(1)(i)) and the franchisor was merely exercising a contractual power that was conferred upon them in the agreement rather than unilaterally varying the contract (s22(1)(j) and (k)).

Chapter 3: Repudiation and Termination

If a party 'repudiates' a contract (whether by actual or 'anticipated' breaches), then the other party may terminate the contract by 'accepting' the repudiation. Deciding whether to accept a repudiation can often be a very difficult decision because:

(a) whether or not a party's conduct amounts to a 'repudiation' of the contract is often a question of degree; and

(b) if a party wrongly purports to accept a repudiation (for example, because a court ultimately finds that the party's breaches fell just short of being repudiatory), then that 'acceptance' will itself be held to be repudiatory conduct.

Upside Property Group Pty Ltd v Tekin[18] concerned a case where a vendor was found wrongly to have 'accepted' a repudiation of a contract when the purchaser of the property had failed to comply with a notice to complete. As a result, the vendor itself was held to have repudiated the contract. The vendor asserted, however, that the purchaser had no claim against it because the purchaser was not 'ready and willing' to complete the contract. This argument led the NSW Court of Appeal to explain three related but distinct concepts when a party purports to terminate a contract by accepting a repudiation:

(iii) There are conflicting authorities on whether a party may 'accept' a repudiation if that party is not itself ready and willing to perform the contract. The court did not need to resolve these conflicting authorities in this case.

(iv) Having accepted the repudiation, the 'innocent' party must prove that it was ready and willing to perform the contract as an element of its cause of action against the repudiating party (this cause of action is sometimes referred to as a claim for anticipatory breach). The court emphasised that, in this context, 'readiness and willingness' includes the capacity to perform the contract, which is not too onerous a test. The court referred to a judgment of Chief Justice Dixon (in the High Court) which stated that failing this test requires '*a substantial incapacity or definitive resolve or decision against doing in the future what the contract requires*'.

(v) The innocent party, in bringing a claim for loss of bargain damages, must prove on the balance of probabilities that it would have been able to perform the contract itself.

The court concluded that Upside Property had not proved that it was '*not substantially incapacitated from completing*' the contract, and therefore failed to prove an element of its cause of action.

18 [2017] NSWCA 336.

It is common for contracts of a sale of a business to be conditional on satisfactory completion of due diligence. It is also common for disputes to arise as to whether a purchaser is entitled to terminate a contract on the basis of information uncovered during the due diligence process. In *Broughton v B&B Group Investments Pty Ltd*[19], the Victorian Court of Appeal considered a clause in the contract that entitled a proposed purchaser 'having conducted the due diligence' to deliver a written notice to the vendor (described as a 'termination notice').

On its face, the clause did not require any causal connection between the due diligence and the decision to deliver a termination notice: the clause simply stated that, having conducted the due diligence, the purchaser was entitled to deliver a termination notice. The court nevertheless interpreted the contract as requiring a causal connection between the conduct of the due diligence and the decision to serve a termination notice. The court was influenced by a number of other clauses in the contract, including a clause that limited the use of the due diligence material to any purpose except deciding whether to serve the termination notice.

The court held that, to terminate:

- '*the due diligence must give rise to objective matters of concern about*' the business being purchased; and
- the purchaser must have relied on those matters of concern when deciding to terminate the contract (with partial reliance sufficing).

The court held that the purchaser satisfied both these tests and was therefore entitled to terminate.

Where a contract does provide the mechanism for one party to terminate a contract, it is obviously important for the terminating party to comply strictly with the contract's requirements. However, as illustrated by the NSW Court of Appeal decision in *Torbey Investments Corporated Pty Ltd v Ferrara*[20], a failure to comply with the required procedure will not necessarily invalidate a termination notice.

If parties to a contract enter into a new contract, there may be a dispute as to whether that new contract terminates the original contract. An example of such a dispute was *Balanced Securities Ltd v Dumayne Property Group Pty Ltd*[21]. In that case, the Victorian Court of Appeal gave helpful guidance on whether a subsequent agreement amends, or terminates, an earlier agreement. In particular, the court emphasised that inconsistencies between the agreements is a strong factor in support of a conclusion that the later agreement will terminate the earlier agreement. The existence of such an inconsistency led the court to conclude that a later agreement had terminated an earlier agreement.

19 [2017] VSCA 227.

20 [2017] NSWCA 9.

21 [2017] VSCA 61.

Upside Property Group Pty Ltd v Tekin [2017] NSWCA 336

- Action for anticipatory breach
- Ready and willing to perform

In this case, the NSW Supreme Court considered whether the primary judge had erred in dismissing a purchaser's claim for loss of bargain damages following its acceptance of the vendor's repudiation of a contract for sale of land.

The court held that, although the primary judge misdirected himself as to how to satisfy the requirement of readiness and willingness to bring an action in damages for anticipatory breach, the purchaser's action was correctly dismissed.

This case highlights the distinction between two tests: (i) the entitlement for bringing an action for anticipatory breach, which depends on proof that there was a reasonable prospect of the plaintiff being able to complete in the future; and (ii) the entitlement to recover substantial damages for loss of bargain, which depends on proof that more probably than not completion would have occurred.

Facts

The parties entered into a contract for the sale of land. After the time for completion had passed, the respondent vendor wrongly repudiated the contract by issuing a notice to complete and later purporting (wrongly) to terminate the contract.

The appellant purchaser elected to terminate the contract and brought an action for anticipatory breach of contract seeking substantial damages for loss of bargain (or, alternatively, loss of profit).

The primary judge held that (i) the purchaser had failed to prove a condition precedent to its claim that, at the time of repudiation, it was ready, willing and able to proceed to perform its contractual obligations; and (ii) the purchaser had not suffered any damage because the market value of the property did not exceed the contract price.

Judgment

The appeal considered the central distinction between the entitlement to bring a cause of action for damages and the entitlement to recover substantial damages for loss of bargain. The entitlement to bring a cause of action depends on proof that the plaintiff was 'sufficiently on track' to perform and that there was a reasonable prospect of it being able to complete in the future.

On the other hand, the entitlement to recover substantial damages for loss of bargain requires proof that, more probably than not, completion would have occurred. This test is more onerous than the test to bring an action.

A plaintiff that succeeds on the first test but fails on the second will receive only nominal damages. The distinction is also more pronounced where termination occurs well before the time of performance.

The appeal court held that the primary judge had erred when applying the test (for the ability to bring an action for damages) to the appellant's situation at the date of the repudiation, rather than the termination. However, there had not been any change in position in the intervening days and the court affirmed the primary judge's finding that the evidence did not establish that, at the date of termination, there was a reasonable prospect of the appellant completing the contract.

The court also noted, but did not resolve, conflicting authorities on whether an 'innocent' party could accept a repudiation if that party was not ready and willing to perform the contract.

Broughton v B & B Group Investments Pty Ltd [2017] VSCA 227

› Termination of contract following due diligence and burden of proving loss

In this case, the Victorian Court of Appeal considered, among other issues, whether the purchaser under a contract for the sale of a hotel business had been entitled to issue a notice of termination under a special condition in the contract.

The court held that a proper construction of the relevant condition required the purchaser to rely on matters which arose during due diligence in making the decision to terminate. The court, substituting its own findings of fact for those of the trial judge, found that the purchaser had relied on such matters and had therefore validly terminated the contract. The court also found that, had the purchaser been in breach, the vendor had not provided sufficient evidence to enable the court to assess damages, either at the date of breach or at a subsequent date.

This case provides a reminder of the rules of construction of terms in commercial contracts, and highlights the importance of ensuring that termination clauses are carefully drafted to avoid ambiguity. Parties who wish to exercise a right to terminate should ensure that they construe the termination clause correctly by reference to its text, context, and purpose, or risk inadvertent breach or repudiation of the contract.

The case also highlights the importance, in the event of a breach, of a wronged party obtaining evidence of the amount of loss, as well as of steps taken in mitigation of loss, to allow for an assessment of damages.

Facts

The vendor operated a hotel in Melbourne. Before entering into the contract to purchase the hotel business, the purchaser learned of certain adverse matters, including that the hotel leases had a shorter term than advertised. The purchaser also anticipated substantial hotel renovation costs.

The vendor and purchaser entered into a contract for the sale of the business, which included the following relevant special conditions:

- Special condition 2.1(a) made it a condition precedent to completion that the landlord agree to an additional option to extend the leases for five years. A 14-day due diligence period commenced once this condition was satisfied.
- Special condition 2.1(b) made it a condition precedent to completion that the purchaser had not given notice to the vendor electing to resile from the contract (under special condition 3.6) before a certain time after the due diligence period.
- Special condition 3.6 provided that '[h]aving conducted the Due Diligence' the purchaser would be entitled to give notice to the vendor of its decision not to proceed with the contract.
- 'Due Diligence' was defined in special condition 3.1, and special conditions 3.1 to 3.5 set out the parameters for the purchaser's due diligence investigation of the business.

Following the satisfaction of special condition 2.1(a), the purchaser retained an accountant to conduct the due diligence. The accountant undertook a site inspection and the next day advised the purchaser by telephone of some matters of concern, including doubts about the reliability of the vendor's financial records. The purchaser's lawyers subsequently gave notice to the vendor's lawyers that the purchaser no longer wished to proceed with the transaction as agreed. The notice referred to issues including lack of tenure and 'onerous terms', and proposed a number of variations to the contract. The purchaser did not receive the accountant's due diligence report until after the notice was given.

The vendor claimed that the purchaser had repudiated the contract, either by giving notice to terminate without relying on matters arising from due diligence (and so with no entitlement to terminate under special condition 3.6), or through a breach of an obligation of good faith. The vendor at first sought either specific performance of the contract or retention of the deposit plus damages, but abandoned its claim for specific performance after allowing the option to renew the hotel leases to expire.

At first instance in the County Court of Victoria, Judge Cohen found that special condition 3.6 only allowed the purchaser to terminate where the due diligence revealed adverse information and the purchaser was 'genuinely reliant' on that information in giving notice of termination. Judge Cohen found that, while the accountant had discovered matters during the due diligence which could have been relevant to the purchaser's decision whether or not to proceed, in the judge's view those matters had not influenced the purchaser's decision 'to any significant degree'. Because of this construction of special condition 3.6, the judge found it was not necessary to imply a term of good faith in the contract. Judge Cohen awarded the vendor retention of the deposit amount, but found that there was inadequate evidence to enable her to assess the vendor's loss due to the breach.

On appeal, the purchaser argued that special condition 3.6 only required that due diligence be conducted before giving notice to terminate, and did not require notice to be on the basis of matters discovered during due diligence. In any event, the purchaser argued that he had been entitled to terminate given the matters that were discovered during due diligence.

By cross application, the vendor sought leave to appeal on the basis that the primary judge had failed to assess its loss and damage, and sought damages as at the date at which it had abandoned its application for specific performance.

Judgment

The Court of Appeal allowed the purchaser's appeal, and refused the vendor's cross application for leave to appeal.

Construction of termination clause and breach

The court applied the principles of construction as summarised by the High Court in *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* (2015) 256 CLR 104, including that a contractual provision must be determined objectively by reference to its text, the context of the contract as a whole, and its purpose.

Considered in the context of special conditions 2 and 3, and the purpose of the contract to enable the purchase of the hotel business, the court agreed with the trial judge that special condition 3.6 required both a temporal and a causal link between the due diligence and notice of termination in the Court of Appeal's formulation: (1) that due diligence had been conducted and completed in accordance with special condition 3; (2) that the due diligence gave rise to certain 'objective matters of concern'; and (3) that the purchaser relied on those matters of concern in deciding to deliver the notice of termination. The court also found that it made good commercial sense to link the right to terminate to information gained during the due diligence.

However, the court rejected the trial judge's apparent finding that special condition 3.6 required 'significant' reliance, and found that the judge had erred in not finding that the purchaser had placed 'some reliance' on the matters raised in the phone call with the accountant in deciding to terminate the contract.

The court did not reconsider the issue of good faith.

Damages

In the event that its conclusion in respect of breach was wrong, the court set out relevant principles for assessment of damages for breach of contract, including:

- the general principle that the party who has sustained the loss is to be, so far as money can do it, placed in the same position as the party would be in if the contract had been performed;
- damages are generally assessed at the date of breach, unless it is necessary to depart from that rule to properly compensate the wronged party. The onus is on the wronged party to establish that departure from the general rule is necessary in order for the party to be properly compensated; and
- the wronged party is under a duty to act reasonably to mitigate its loss.

The vendor had not adduced evidence of the value of the hotel business on the date of the alleged breach, although there was evidence of a previous offer for the business, and a further contract entered into just before the lease options expired. There was also no evidence as to whether the vendor had maintained the hotel or taken reasonable steps to market the business to obtain the best price.

The court found that the vendor had not provided relevant evidence to allow the assessment of any loss as at the date of the breach, and that the circumstances of the case did not warrant departure from the general rule that damages are assessed at the date of breach. Even if it had, the court found that the vendor had not provided sufficient evidence to allow determinations in respect of mitigation of loss or the value of the business at the date submitted by the vendor.

The court also distinguished this case from that in *Johnson v Agnew* [1980] AC 367, where damages were assessed at the date the remedy of specific performance became aborted through no fault of the vendor in the present case, the remedy of specific performance had become aborted due to the vendor's decision not to renew the leases.

Torbey Investments Corporated Pty Ltd v Ferrara [2017] NSWCA 9

› Does non-compliance with procedural requirements for termination invalidate termination?

In this case, the NSW Supreme Court of Appeal considered whether a building contract had been lawfully terminated in circumstances where the relevant notices of breach and termination did not comply strictly with the termination clause's procedural requirements.

The court held that, on a proper construction of the termination clause, the notice content and method of service terms within the clause were facultative rather than mandatory and therefore, in the circumstances, even though the notices did not comply strictly with the terms, this did not invalidate their purported termination of the contract.

This case demonstrates that where a party does not comply with contractual procedural requirements, even where those requirements are expressed in mandatory language, whether a party will be considered to have complied with the contract's terms is a matter of construction, having regard to the purpose and context of the relevant clause as well as the circumstances of the particular matter.

Facts

The owners of a Maroubra residential property, Mr and Mrs Ferrara , entered into a building contract with the applicant, Torbey Investments (the ***builder***), in June 2005. The building and construction work was expected to be completed by early 2006 but, for several reasons, by January 2007 the work was still incomplete. Despite a meeting convened between the parties by the Office of Fair Trading, the builder agreeing to finish the work by 30 June 2007, and a rectification order being issued by the Office of Fair Trading on 3 July 2007 (the ***rectification order***), no further work was carried out, and on 9 July 2007 the Ferraras began to set the wheels in motion for termination of the contract.

The termination clause of the contract, clause 33, provided for a two-stage termination procedure for substantial breaches of the contract. Regarding the first stage, clause 33.3 provided:

> If a party is in substantial breach of this contract the other party may give the party in breach a written notice stating:
>
> (a) details of the breach; and
>
> (b) that, if the breach is not remedied within 10 working days, that party is entitled to end this contract.

Regarding the second stage, clause 33.4 provided:

> If 10 working days have passed since the notice of default is given and the breach is not remedied then the party giving the notice of default may end this contract by giving a further written notice to that effect.

Regarding the method of service of the notices, clause 33.5 provided:

> All notices to be given under this Clause must be given by certified mail or personally.

By letter to the builder dated 9 July 2007, the Ferraras sought to invoke clause 33.3 of the contract (the ***breach notice***), writing that failure to remedy the substantial breaches (including delay) within the timeframe specified in the rectification order would result in the matter being referred to the Building Investigations Branch for assessment and possible disciplinary action. Relevant to clauses 33.3(b) and 33.4, the expiry date of the timeframe specified for remediation in the rectification order was 27 July 2007 — more than 10 working days from the date of the letter.

The builder undertaking the work responded to this first notice on 23 July 2007, stating that he wished to remedy any breaches and not to end the contract. Following no further work being done, the Ferraras sought to invoke clause 33.4 and sent a further letter to the builder on 3 August 2007, terminating the contract.

The key point relevant to the issue of whether the Ferraras lawfully terminated the contract was that these notices did not comply strictly with the procedural requirements of clause 33, because:

- the breach notice did not expressly identify the 10-day period within which the builder was to remedy the breaches rather, it referred to the timeframe specified in the rectification order; and

- there was no evidence that either notice had been served by registered post or in person. However, it was established during proceedings that both notices had been received by the builder, evidenced in part by the fact that the builder had responded to both notices.

Procedural history

In June 2009, the builder commenced proceedings against the Ferraras in the Consumer, Trader and Tenancy Tribunal, seeking payment of a final progress claim of $170,114. The Ferraras filed a cross-claim in August 2009, seeking the cost of rectification of defective and incomplete building works.

The Tribunal found both parties to be liable, but after setting off the respective amounts owed, the builder was required to pay the Ferraras a balance of $116,580.60. On first appeal, the District Court upheld the Tribunal's decision, subject to a slight increase in the amount the Ferraras were found liable to pay the builder.

The builder was limited to seeking review of the District Court's decision under section 69 of the *Supreme Court Act 1970* (NSW), which allows the court to set aside a judgment of the District Court on the ground of jurisdictional error or error of law on the face of the record.

Judgment

The court held there was no error of law made by the District Court in finding that the Ferraras had lawfully terminated the contract.

In reaching this conclusion, the court had to consider to what extent did the Ferraras have to adhere to the procedural requirements of clause 33 regarding the content of the notices and the notice's method of service. Was it necessary for the notices to expressly identify the time period within which the builder was required to remedy the breaches, and did the notices have to be served via certified mail or in person? The answer to these questions lay in the proper construction of clause 33.

Regarding what could be said to be the key principle in this case, the court said, '[i]n considering what precisely such a notice should include, a construction should be given to the clause, consistent with its purpose and context' (at [33]). Applying this principle to clause 33, the court went on to identify three points relevant to the proper construction of clause 33:

- first, clause 33.3 applied to breaches potentially wide ranging in nature and effects, and to breaches by both parties;
- second, a literal reading would result in failure to comply with clause 33.3(b) if, for example, the breach notice allowed more than 10 working days for remediation of a breach; and
- third, clause 33 was silent as to the date from which the 10 working days will run.

Noting that other clauses in the contract expressed in mandatory terms raised similar potential difficulties, the court said, 'there is much to be said for adopting a flexible construction of language, so as to give effect to its commercial purpose' (at [34]). The court went on, '... in circumstances where it was established that the relevant information had in fact been received, and a purpose of the mandatory language had been achieved, any formal non-compliance should not be seen as rendering the notice ineffective under the contract' (at [34]).

The court then referred to several cases where courts had considered to what extent procedural requirements of similar contractual provisions had to be complied with. The court distinguished the present case from that of *Eriksson v Whalley* [1971] 1 NSWLR 397, in which Justice Collins held that failure to send the relevant notice by registered post meant that its service was invalid and the relevant clause had not been complied with. In reaching this conclusion, Justice Collins stated:

> The provision of this method of service no doubt was intended for the purpose of avoiding subsidiary disputes between the parties to the contract as to whether the notice was given or received. Compliance with its provisions eliminates to a very large extent such disputes, as it provides for a mode of service and receipt of the required notice which can be corroborated from an independent and official source. Further ... the receipt of a registered notice imports a certain solemnity or importance to the giving of the notice which a more informal method of service may not convey.

The court said these purposes were not relevant in the present case, stating that '[s]o far as purpose is concerned, there is ... little to be said for the proposition that an otherwise valid notice, of which receipt and comprehension is duly acknowledged, will not have been given' (at [37]).

The court referred to two further cases where the courts had held that under contractual clauses that mandated service of notices by registered post, service by registered post was sufficient but not necessary. The court quoted a passage of Justice Giles in *Kennedy v Collings Construction Co Pty Ltd* (1991) 7 BCL 25, which provided, '... I see no reason to give [the relevant clause] a construction, under the name of strictness, which would lead to the unreal result that undisputed receipt of the notice would be ineffective because the medium of registered post had not been used' (at [39]). The court said that the same approach should be applied to the terms of clause 33.

The court therefore held that both notices were validly given for the purposes of the contract; the breach notice's reference to the time period specified in the rectification order was sufficient to satisfy the requirements of clause 33.3(b), and in circumstances where the builder had received and responded to both notices, the requirements of clause 33.5 were also satisfied.

Allens › ‹ Linklaters

Balanced Securities Ltd & Anor v Dumayne Property Group Pty Ltd & Ors [2017] VSCA 61

› When a later agreement will legally supplant, rather than merely vary, the operation of the terms of a prior agreement

The Victorian Court of Appeal considered whether a facility agreement entered into by the first appellant (Balanced Securities Ltd, as lender) and the first respondent (Dumayne Property Group Pty Ltd, as borrower) by its terms supplanted the operation of a previous facility agreement between the parties.

The court held that, on its proper construction, the second facility agreement (dated 20 March 2012) between Balanced and Dumayne supplanted the operation of the first facility agreement (dated 12 January 2012). Because of this, the parties' obligations were governed by the terms of the second facility agreement alone. This meant, in the circumstances, that Balanced was not entitled to the payment of penalty interest charges and rollover fees from Dumayne for its alleged failure to repay the facility upon the first facility agreement's expiry.

This decision provides a useful summary of the relevant legal factors in considering whether a subsequent contractual agreement merely varies a prior contractual agreement, or whether, on its proper construction, it legally supplants an existing contractual agreement.

Facts

On 12 January 2012, the first appellant, Balanced, sent loan documentation to the first respondent, Dumayne, under the terms of which Balanced agreed to loan Dumayne the sum of $7.5 million (the ***first facility agreement***). The monies loaned under the first facility agreement were repayable by Dumayne, with interest, 18 months after the 'Interest Commencement Date' as defined in the first facility agreement. Dumayne signed and returned the first facility agreement to Balanced on 6 February 2012.

Subsequently, Dumayne requested alterations to the terms of the first facility agreement. Balanced agreed to these amendments, and on 20 March 2012 sent a further agreement to Dumayne (the ***second facility agreement***). The second facility agreement stated that the monies loaned by Balanced to Dumayne were repayable by Dumayne, with interest, 15 months (as opposed to 18 months) after the 'Interest Commencement Date' as defined in the second facility agreement. Dumayne signed and returned the second facility agreement to Balanced on 28 March 2012.

In 2013, a dispute arose between Balanced and Dumayne as to when the $7.5 million principal with interest was repayable by Dumayne to Balanced. Balanced contended that the loan commenced on 19 January 2012 and was due to expire on 19 April 2013, in line with the terms of the first facility agreement. Dumayne contended that the loan commenced on 27 March 2012 and was due to expire on 27 June 2013, in line with the terms of the second facility agreement.

On 27 June 2013, settlement of the loan occurred between the parties. Dumayne paid to Balanced the total sum of the principal, the interest on the principal, and $521,509.25 for penalty interest charges and facility 'rollover' fees for the purported late repayment of the loan (the ***disputed payment***). Dumayne maintained, from settlement of the loan, that it paid the disputed payment in protest, and that Balanced was not entitled to that money at law, given that the facility was paid out on the expiry date under the second facility agreement as at 27 June 2013.

Dumayne subsequently brought proceedings in the County Court against Balanced, seeking recovery of the disputed payment, together with damages.

At first instance, Judge Kennedy determined that the second facility agreement supplanted the first facility agreement, and that, accordingly, Balanced was not entitled to the disputed payment, given that Dumayne paid out the loan on the correct expiry date: namely, 27 June 2013.

Balanced appealed Judge Kennedy's decision to the Victorian Court of Appeal.

Judgment

The court, constituted by Justices Whelan, Ferguson and Cameron, delivered a joint judgment dismissing Balanced's appeal on all grounds, and held that the second facility agreement legally supplanted the first facility agreement. Their Honours applied the High Court's decision in the *Commission of Taxation (Cth) v Sara Lee Household & Body Care (Australia) Pty Ltd* (2000) 201 CLR 520, in which it was stated that the legal inquiry as to whether a subsequent contract supplants an earlier contract is focused upon 'the intention of the parties as disclosed by the later agreement'.

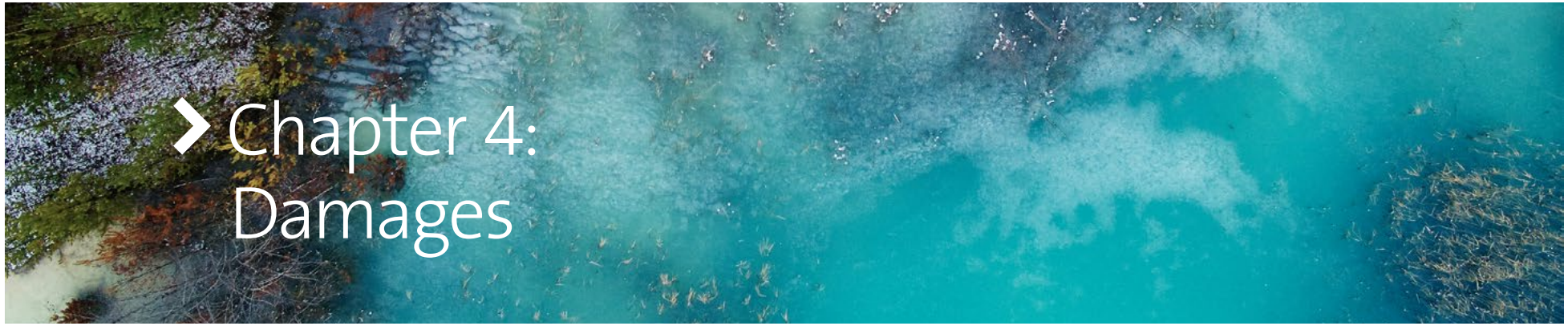
Accordingly, the Court of Appeal found that the second facility agreement supplanted the first facility agreement because:

- both agreements had the same subject matter, and therefore the second facility agreement was inconsistent with the terms of the first facility agreement, and both agreements could not be simultaneously performed, due to this inconsistency;
- the second facility agreement had clearly been drafted to constitute the entire agreement between the parties. Their Honours said that objective intention arose from textual indicators in the second facility agreement, as well as an entire agreement clause present in the second facility agreement; and
- the security documents associated with the second facility agreement indicated that it was to be considered to have supplanted the first facility agreement.

Notably, their Honours held that, given the second facility agreement was clear on its face, regard could not be had to extrinsic material to ascertain the parties' objective intentions in entering into the second facility agreement.

Usefully, their Honours summarised the legal principles that arose from the leading cases regarding where a further agreement will legally supplant a former agreement. Those principles are:

- the relevant issue is whether the subsequent agreement amends the earlier agreement, or brings it to an end and replaces it;
- the earlier agreement may be brought to an end either expressly or by implication;
- the issue is to be resolved by ascertaining the manifest intention of the parties;
- the manifest intention of the parties is to be ascertained objectively by the construction of the subsequent agreement, having regard to the relevant context of that agreement where it is permissible to do so in accordance with the ordinary principles of contractual construction; and
- a potentially critical factor militating in favour of the conclusion that the manifest intention of the parties, objectively ascertained, was to bring the earlier agreement to an end and replace it, is where the terms of the two relevant agreements deal with the same subject matter in different and inconsistent ways.



Chapter 4: Damages

In 1954 the High Court laid down the so-called '*Bellgrove* principle'[22] that:

(a) the usual measure of damages for defective work will be the cost of rectification (rather than, for example, the diminution in value); but

(b) rectification must be both necessary to conform with the contract and also a reasonable course to adopt.

In *Stone v Chappel*[23] the Full Court of the South Australian Supreme Court rejected an argument that the *Bellgrove* principle only applies if the construction work 'substantially' complies with the contract. Instead, the court held that, on the facts of that case, the cost of rectification work was out of all proportion to the resulting benefit.

The first limb of the *Bellgrove* principle – that the cost of rectification be the usual measure of damages for defective work – was also considered and confirmed by the NSW Court of Appeal in *Walker Group Constructions Pty Ltd v Tzaneros Investments Pty Ltd*[24]. In that case, the court also confirmed that a party's entitlement to damages, measured by the cost of rectification, will not necessarily be affected by an intervening sale of the relevant property. The plaintiff in that case was entitled to recover the cost of replacing an entire pavement, despite the fact that only some slabs had cracked by the hearing date, on the basis that the entire pavement was affected by the defective design. The court also declined to make an allowance for betterment, even though the new pavement would have a longer design life than was required by the contract, as the defendant failed to satisfy its burden of showing there was an alternative, cheaper means of rectifying the pavement so as to comply with the contract.

22 *Bellgrove v Eldridge* (1954) 90 CLR 613.

23 [2017] SASCFC 72.

24 [2017] NSWCA 27.

In calculating the cost of rectification (and damages more generally), a plaintiff is entitled to recover external costs, but not the cost of employees' time (unless, for example, the plaintiff had to pay overtime as a result of the breach of contract). The rationale for this principle is that the plaintiff would in any case be obliged to pay employees' wages, so the cost of those wages cannot be caused by the defendant's breach.

This principle was confirmed by the NSW Court of Appeal in *PND Civil Group Pty Ltd v Bastow Civil Constructions*[25]. Interestingly, however, the court did recognise the possibility of obtaining damages if it could be proved that the diversion of management time, due to the breach of contract, meant that the employer lost other valuable business opportunities. The court also noted, however, that quantifying such damages '*could be a matter of some difficulty*'.

Quantifying damages also can be difficult when the performance of the contract involves uncertain events (such as the outcome of a tender). In these circumstances, the court does the best it can to estimate the probability and value of different scenarios. Two appellate decisions last year considered some of the complications that can arise in trying to estimate the value and probability of future contingencies.

In *Principal Properties Pty Ltd v Brisbane Broncos Leagues Club Limited*[26] the trial judge held that a plaintiff was not entitled to damages because it was more likely than not that a commercial opportunity would have been loss-making. The Queensland Court of Appeal overturned this decision, however, and held that, even if on the balance of probabilities an opportunity would have had no value, a court is still obliged to estimate the probability of a profitable outcome and the value of that outcome. On the facts of the case, the court ordered damages of $250,000, based on a less than 10 per cent probability of a profit of $4 million.

In *Port Macquarie-Hastings Council v Diveva Pty Limited*[27] the relevant contingency was whether the defendant council would itself have awarded a contract to the plaintiff. The defendant council relied on the principle that, if a defendant has different methods for performing a contract, it will be assumed the contract would have been performed in the manner that would minimise its liability to pay damages. The court held, however, (following High Court authority) that this principle does not require the court to assume that a defendant would have acted against its own interests. In the present case, had the contract been performed, the council would have awarded the contract to the plaintiff if that were commercially in the council's interest. On that basis, the plaintiff was entitled to damages calculated by reference to the probability of it being the successful tenderer.

25 [2017] NSWCA 159.

26 [2017] QCA 254.

27 [2017] NSWCA 97.

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Stone v Chappel [2017] SASCFC 72

- Building defects
- Cost of rectification disproportionate

In this case, the South Australian Court of Appeal considered the application of the rule in *Bellgrove v Eldridge* (1954) 90 CLR 613, that the proper measure of damages for building defects is the cost of rectifying the building, provided rectification is both necessary to ensure conformity with the contract and a reasonable course to adopt.

The court held that it would be unreasonable to award damages by reference to the cost of rectifying the defective building works and that damages should instead be limited to the loss of amenity suffered by the home owners. Their Honours dismissed the home owners' claim that the builder had engaged in misleading or deceptive conduct when making certain representations about the specifics of the building.

The case demonstrates the correct application of the rule in *Bellgrove v Eldridge*. The test for the rule to be engaged is not whether the construction work fails to 'substantially' comply with the contract; rather, this is relevant only to whether or not the qualification to the rule applies. The case also provides an example of when rectification damages may be denied on the ground that it would amount to either 'economic waste,' or 'the promotion of unconstructive litigation'.

Facts

The plaintiff home owners engaged a builder to construct an apartment according to plans they had previously prepared. One aspect of the plans, which was incorporated into the contract, was that the ceilings would be 2700mm (or 2.7 metres) high.

Due to difficulties experienced during construction, the ceilings of the completed unit were on average 40mm lower than the specified height.

The unit owners commenced proceedings against the builder for breach of contract, and misleading and deceptive conduct, seeking the cost of rectifying the unit so that it complied with the contract's specifications.

At first instance, the trial judge found that the builder breached his contractual obligations to the owners in departing from the plans, but that the rule in *Bellgrove v Eldridge* was not engaged because the building 'substantially' complied with the contract. As a result, the home owners' claim for approximately $330,000 in damages based on the cost of rectifying the breach was rejected. Instead, the trial judge awarded damages of $30,000 for loss of amenity.

The trial judge also rejected the home owners' claim that the builder engaged in misleading or deceptive conduct.

The home owners appealed against the trial judge's decision.

Judgment

The court unanimously dismissed the home owners' appeal against the trial judge's finding that the builder had not engaged in misleading or deceptive conduct. However, the main issue on appeal was the application of the rule in *Bellgrove v Eldridge*, and, in particular, when it will be unreasonable to award damages based on the cost of rectifying defective building works.

While the court's decision to dismiss the appeal was unanimous, the Chief Justice, on the one hand, and Justices Doyle and Hinton, on the other, based their respective conclusions on significantly different reasons.

Chief Justice Kourakis

As a preliminary matter, the Chief Justice found that the trial judge was incorrect to conclude that the rule in *Bellgrove v Eldridge* is not engaged unless the construction work does not 'substantially' comply with the contract (instead finding that this is relevant to whether or not the qualification to the rule applies).

His Honour then identified eight considerations relevant to determining whether an order for rectification costs should be considered unreasonable.

In considering the application of these eight considerations to the facts, the Chief Justice found it significant that:

- the home owners' evidence that they would actually rectify the defective works was 'not unequivocal';
- rectification would cause a significant fire hazard and would likely lead to litigation from other tenants in the block; and
- as a result, it was unlikely that rectification would ever actually be carried out.

His Honour concluded that, in these circumstances, an award of rectification damages would amount to either 'economic waste' or 'the promotion of unconstructive litigation', and consequently dismissed the appeal.

Justices Doyle and Hinton

In two separate, but substantively indistinguishable, judgments, Justices Doyle and Hinton considered the issue of unreasonableness from the perspective of compliance with the contractual objective (also referred to as the home owners' performance interest).

Both judges found that:

- the trial judge was incorrect to conclude that the rule in *Bellgrove v Eldridge* is not engaged unless the construction work does not 'substantially' comply with the contract (agreeing with the Chief Justice that this is relevant to whether or not the qualification to the rule applies);
- the home owners' performance interest comprised both a functional interest and an aesthetic interest;
- as the unit was structurally sound, the functional interest was satisfied; and
- as the ceilings in the unit were higher than average, the aesthetic interest was 'substantially' satisfied.

In these circumstances. both judges found that the limited benefit derived by the home owners in raising the ceiling to the specified 2700mm would be out of all proportion to the approximately $330,000 it would cost to achieve this, and consequently dismissed the appeal.

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Walker Group Constructions Pty Ltd v Tzaneros Investments Pty Ltd [2017] NSWCA 27

- Interpretation of an assignment deed
- Rights of an assignee to sue for an accrued cause of action
- Relevance of the assignee's knowledge of the breach
- Whether damages should be reduced for betterment

In this case, the NSW Court of Appeal considered the rights of an assignee to claim damages for the costs of rectification in relation to defective pavement under a design and construction contract for a container terminal.

The court agreed with the first instance decision that the assignee was entitled to damages to compensate it for the cost of rectifying the breach, and that no discount should be made for betterment.

The NSW Court of Appeal has confirmed that assignment of contractual warranties can be effective to assign the right to sue for accrued causes of action. The case also demonstrates that, where courts examine the drafting history of an agreement, the parties' deletion of specific words does not necessarily evidence a mutual intention to exclude the subject of that deletion. Separately, the Court of Appeal affirmed that rectification damages are generally appropriate in building defect cases.

Facts

Walker Group Constructions Pty Ltd (***WGC***) was responsible for designing and constructing a container terminal under a contract with P&O Trans Australia Holdings Limited, who leased the land from Sydney Ports Corporation.

In April 2004, P&O transferred its lease to a subsidiary, who later transferred its lease to Tzaneros Investments Pty Ltd. P&O purported to assign to Tzaneros, by deed, the warranties given by WGC. WGC provided a letter of consent to this assignment.

Cracks and spalling began to develop soon after the laying of the pavement, and it was apparent that these were structural by the time Tzaneros took on the lease. Tzaneros claimed the cost of replacing the defective pavement from WGC.

Judgment

It was not in dispute that the pavement was defective, and that WCG was in breach of its contractual warranties. Rather, the key issues in dispute before the Court of Appeal were: whether the right to sue for accrued causes of actions had been assigned to Tzaneros; the relevance (and extent) of Tzaneros' prior knowledge of the defects; and quantification of damages, including the application of the 'betterment' principle.

Assignment

WGC argued that the assignment of 'all of the benefits of the [warranties]' was only effective to assign P&O's contractual right to future performance, as opposed to any accrued causes of action for pre-existing breaches. As the defects had become patent at the time of assignment, the causes of action had already accrued.

However, the Court of Appeal refused to make this distinction. *Applying Electricity Generation Corporation v Woodside Energy Limited*, the Court of Appeal stated that commercial contracts had to be determined by what a reasonable businessperson would have understood those terms to mean. In the court's view, the words of the assignment appeared on their face to include a right to sue in respect of past breaches. This interpretation was consistent with the other provisions in the deed, and a contrary interpretation would produce an uncommercial result.

WGC had identified case law indicating that there is no presumption that the assignment of the benefit of an agreement has the effect of transferring debts that had already arisen before the assignment, and argued that there was no relevant difference between debts and other causes of action. However, the Court of Appeal disagreed, and distinguished those cases on the basis that debts have an existence at law independent from the underlying transaction — this could not be said for breaches of contractual warranties.

WGC also argued that the court should have recourse to the deed's drafting history, which had involved the removal of an explicit reference to 'any cause of action' in the description of the building warranties that were to be assigned. However, the court did not think that the final version of the deed was ambiguous. Further, even if the deed was ambiguous, the deletion of the reference to 'any cause of action' did not evidence a mutual intention to exclude past breaches.

Relevance of knowledge

WGC relied on *Allianz Australia Insurance Ltd v Waterbrook at Yowie Bay Pty Ltd*, in which the Court of Appeal had held that a successor in title who acquires a building with full knowledge of its defects suffers no loss as a consequence of those defects. The court distinguished *Yowie Bay* on the basis that an assignee is different to a successor in title — an assignee 'steps in the shoes of the assignor' and is entitled to recover damages of the same kind as the assignor could have recovered. Notably, although it was not necessary to decide the correctness of *Yowie*, the court indicated its preference for the dissenting judgment.

The court also said that, even should the principle in *Yowie* apply, the evidence did not establish that Tzaneros had the requisite 'full knowledge' of the defects, which includes being aware of the significance of the defects as well as their existence.

Quantification of damages

Tzaneros sought compensation for the cost of replacing the entire defective pavement. On the other hand, WGC argued that Tzaneros was only entitled to the costs of rectifying those panels that actually cracked and needed to be replaced.

The court referred to the principles from *Tabcorp Holdings v Bowen Investments Pty Ltd* and *Bellgrove v Eldridge*, which allow building owners to recover damages based upon the cost of rectification, subject to the exception that this work be reasonable. The court found that it was reasonable in the circumstances for Tzaneros to be compensated to enable it to ensure that the entire pavement conformed with the contract, even if ultimately some panels may never crack.

WGC also asked that the damages be reduced under the principle of betterment, as the original contract only provided for a minimum design life of 20 years, yet the method selected for rectification would give an operational pavement with a 50-year design life. The court refused to reduce damages on this basis, because the contract only provided for a *minimum* life of 20 years, and it would not be expected that the pavement would be immediately unusable after this time. Further, WGC had been unable to identify a lower cost alternative for replacing the pavement in conformity with the contract, and had proposed a 'crude percentage discount' method of calculating the betterment discount.

Allens › ‹ Linklaters

PND Civil Group Pty Ltd v Bastow Civil Constructions Pty Ltd [2017] NSWCA 159

› Whether the respondent was entitled to recover the cost of the management time spent by its employees in dealing with the appellant's defective work

In this case, the Court of Appeal considered the cross-appeal of a party seeking to claim damages for management time spent on rectification works.

The court held that while in some instances, it may be 'plainly correct' to award damages for management time, in this instance the cross-appellant did not advance any evidence that demonstrated such loss had occurred.

This case affirms that in particular, for construction projects time and resources that are directed towards rectifying defective works may constitute a portion of damages. However, it is necessary for a party claiming such damages to show it actually incurred relevant losses: eg through employing extra staff, paying current staff additional remuneration, or through losing other valuable business opportunities. Without evidence that an additional expense was actually incurred, a party will be unable to recover the cost of management time.

Facts

This case involved an appeal from the NSW District Court. Bastow, the respondent, engaged PND as a subcontractor on works on a project in Terrigal. Bastow pleaded that PND's work was defective, as it failed to meet certain construction specifications. Consequently, Bastow sued to recover the cost of rectification.

The parties attempted to settle the dispute. However, the settlement broke down, and Bastow sought leave to amend its claim to include one for damages for a breach of the settlement agreement. PND denied this allegation, and pleaded in response that, in fact, Bastow had breached the settlement agreement by declining to have the matter referred to mediation.

At first instance, the primary judge found that the works PND had performed were defective. He determined that Bastow had suffered loss as a result, and quantified this loss as being the cost of rectification. His Honour specifically excluded an amount of management time spent by employees in connection with the defects and subsequent rectification. PND was ordered to pay Bastow's costs of the action, excluding the aforementioned management costs.

His Honour also held that Bastow repudiated the settlement agreement, and was required to pay PND's costs for that aspect of the claim.

Judgment

PND appealed the primary judge's decision and, in doing so, attempted to raise new grounds that had neither been pleaded nor examined in the evidence. The Court of Appeal and, in particular, Justice McDougall found that it would cause a significant injustice to Bastow to allow PND to rely on these arguments, as Bastow was unable to address the facts in its evidence or submissions.

On the cross-appeal, Bastow argued the primary judge erred in holding that it was not entitled to recover the cost of management time spent dealing with the rectification of the defective works. Justice McDougall considered a decision of the Queensland Court of Appeal, *Orlit Pty Ltd v JF&P Consulting Engineers Pty Ltd* [1993] QCA 277, and determined that its decision to include in the damages an amount of more than $44,000 in management time was 'plainly correct' (at [69]). The evidence in *Orlit Pty Ltd v JF&P Consulting Engineers Pty Ltd* clearly demonstrated that the developer had incurred an expense for the time spent by the executives managing the rectification of negligent works.

Though Justice McDougall approved the Queensland Court of Appeal's decision, he found that this did not assist Bastow's cross-appeal. Bastow did not adduce any evidence that demonstrated any additional expense was incurred during the rectification works. Justice McDougall made particular reference to the facts that:

- no staff members were paid overtime, or paid any additional remuneration in connection with the defective works;
- no additional contractors were employed to deal with the issue of the defective works; and
- no additional employees were employed to attend to matters from which current employees had been distracted because of their attention to the defective works.

At [71] Justice McDougall highlighted:

> I can understand that where existing staff are paid more, or additional staff are employed, to manage a breach of contract and its consequences, the damages recoverable may include the amounts so paid. I can understand, also, that if no additional staff were employed, but the diversion of management time to the breach of contract meant that the employer lost other valuable business opportunities, then damages might be allowed, although their quantification could be a matter of some difficulty.

However, there was no evidence before the court that Bastow took any such steps or was unable to take up valuable business opportunities as a result of the rectification works. This ground of cross-appeal therefore failed. However, Bastow did succeed on another ground of cross-appeal, with Justice McDougall finding that it did not breach the settlement agreement. As a result, because the cross-appeal succeeded and failed in part, he made no costs order for the costs of the cross-appeal.

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Principal Properties Pty Ltd v Brisbane Broncos Leagues Club Limited [2017] QCA 254

› Damages for loss of commercial opportunity

In this case, the Queensland Court of Appeal considered damages for the loss of a commercial opportunity.

The court held that a development being loss making did not preclude the award of more than nominal damages.

This case demonstrates that a lost opportunity can have value even if the project in question had only a small prospect of proceeding.

This case also provides useful guidance on how the lost opportunity will be quantified in circumstances where there are a number of competing factors that would have contributed to the venture's profit or loss.

Facts

This case concerned an option to purchase land at Red Hill in Brisbane. Under the agreement, the appellant, Principal Properties Pty Ltd, proposed to develop the land by building apartments and facilities. The requisite development permit was not obtained during the required period, and the appellant did not elect to extend the time for exercise of the option.

The trial judge found that the respondent, Brisbane Broncos Leagues Club Limited, failed or refused to perform its obligations by failing to give consent to the appellant's proposed development application. Therefore, the appellant was entitled to terminate the option.

As a consequence, Principal Properties claimed that it had suffered a compensable loss from being deprived of a valuable commercial opportunity. That is, an opportunity to acquire the land, develop it, and sell the apartments and associated interests at a profit.

At first instance, it was held that because the project was more likely to be loss making than profitable, a valuable commercial opportunity had not been lost. Nominal damages were awarded on this basis, and Principal Properties appealed this decision.

Judgment

Justices Philippides, Boddice and McMurdo (delivering the majority judgment) allowed the appeal.

The court held that:

- the improbability of a profit from the pursuit of a commercial opportunity did not necessarily bar the appellant from recovering substantial damages for the loss of an opportunity; and
- despite the fact that there was only a small prospect the development would proceed, if it had gone ahead, there was a high probability that it would have been profitable.

Regarding the correct approach to the award of damages in cases involving the loss of commercial opportunity, the court said:

- In order to recover substantial, as distinct from nominal, damages, a plaintiff must establish that the lost commercial opportunity had some value. This must be proved on the balance of probabilities.
- If the opportunity had no more than a theoretical or negligible value, there is no compensable loss.
- In circumstances where the 'lost opportunity' is a commercial venture, the notional 'rational investor' will be relevant. A valueless opportunity would be one that no rational investor would pursue, having regard to the probabilities of profit and a loss, and the likely magnitude of each.
- The value of the lost opportunity is 'ascertained by reference to the degree of probabilities or possibilities' of relevant factors that may result in a commercial loss or gain.

In this instance, the court held that the relevant opportunity assigned a value was not 'the opportunity to engage in a business', but instead 'the opportunity to make a profit' on the developed land.

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Significantly, the court held that:

> A likelihood that this would have been a loss making development did not, as a matter of law, preclude the award of more than nominal damages.

Instead, the court considered the potential profit that could be made on the project, finding that there was:

> ... a substantial, rather than a negligible, prospect that the land would have been developed'

and

> while the opportunity was affected by many contingencies, and the prospect that the development would proceed was small ... it was an opportunity which a rational business person might have pursued, although many would not have done so.

To calculate the value of the lost opportunity, the court held, the potential profit should be discounted to allow for the various circumstances that could have prevented it materialising eg the chance the development permit would not be obtained or that the required presales would not be achieved. Therefore, the value of the lost opportunity should be calculated on the basis that the prospects of a profit of $4,000,000 were less than 10 per cent. As a consequence, the appellant was awarded $250,000 as damages for the lost opportunity.

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Port Macquarie-Hastings Council v Diveva Pty Limited [2017] NSWCA 97

› Damages for loss of opportunity

In this case, the NSW Court of Appeal considered questions surrounding contractual construction and the availability of damages for breach of contract and loss of opportunity.

The Court of Appeal assessed the construction of an option to renew in a contract for the supply and laying of asphalt. It also determined whether or not the primary judge had correctly held that the respondent was entitled to damages for lost profits and loss of opportunity.

The court dismissed the appeal, finding that the primary judge had properly construed the contract and had correctly awarded the respondent damages.

The case affirms that, although a speculative exercise, the courts are capable of assessing damages for loss of opportunity.

Facts

The respondent was a civil construction company. In 2005, 2008 and 2011, it won tenders for the supply and laying of asphalt with the appellant council, which led to various contracts between the parties.

The contract the subject of these proceedings was entered into in August 2011. It was for a period of two years, with an option to renew for a further year.

In 2012, the respondent carried out works on Ocean Drive. These works failed, and there was a dispute about whether or not the respondent had complied with the specifications of the 2011 contract.

In March 2013, the appellant informed the respondent that it would not be exercising the option to renew, and informed it that a new tender would be advertised. The respondent subsequently gave notice of its intention to exercise the option to renew the contract. The appellant claimed that the option could only be renewed by mutual agreement.

The appellant subsequently invited tenders, which the respondent did not participate in.

The respondent brought proceedings against the appellant for breach of contract. The primary judge found that the appellant had breached the 2011 contract, and awarded the respondent damages in the sum of $247,443.

The appellant appealed on the grounds that the primary judge:

- had misconstrued the option to renew (grounds 1 and 2);
- erred in awarding the respondent damages, which were calculated on erroneous bases (ground 3); and
- erred in awarding the respondent costs in the proceedings (ground 4).

Judgment

The option to renew (grounds 1 and 2)

The court gave eight reasons why the option should be construed as unilaterally exercisable by the respondent:

- The contract's language clearly established that the extension of the term was being offered by the appellant to the successful tenderer.
- The fact that the appellant had a contractual right to terminate other than for repudiation or breach of an essential term by the respondent tended against the appellant's construction of the option.
- The primary judge correctly found that the option was designed as an inducement to tenderers.
- As the successful tenderer needed to ensure that it had adequate supplies to comply with the contract, it would not be commercially attractive if the option gave the council unilateral control over whether or not it was exercised.

- The appellant having historically informed the respondent that it wished to exercise the option to renew previous contracts had no impact on the construction of this option.
- The primary judge was correct to treat extrinsic evidence carefully when construing the option.
- The *contra proferentum* rule was not misused by the primary judge, who indicated that it 'perhaps' gave additional weight to his Honour's preferred construction.
- The use of the word 'option' distinguished the right it conferred from an agreement to agree.

Damages (ground 3)

The court recited certain principles that apply to the determination of damages for breach of contract. It affirmed that the damages should be commensurate with the expectation of what the party would have received under the contract, proven to the balance of probabilities. Regarding loss of opportunity, the party would need to demonstrate that the contravention resulted in the loss of a commercial opportunity of some value.

The appellant first claimed that the primary judge failed to account adequately for the respondent's alleged insolvency in 2013 when determining the award of damages. However, the court found that the respondent's balance sheet for the year ending 30 June 2013 did not disclose that it was insolvent. Further, the court found that it was open to the primary judge to accept the evidence of the respondent's expert, who 'was the only expert who actually grappled with the task... of calculating the damages.'

Second, the appellant submitted that the primary judge erred in not finding that the respondent's failure to participate in the 2013 tender process was unreasonable. The court rejected this submission, holding that the primary judge was correct to find that the respondent did not need to participate in the 'futile and expensive process of tendering again'. The tender was being conducted in the period in which the respondent was entitled to benefit from the option it had exercised; accordingly, the appellant's repudiation was why the tender was conducted. The primary judge found that officers of the appellant had developed antipathy towards the respondent and, as such, it was unlikely the respondent would have been successful in the tender.

Third, the appellant argued that the primary judge had incorrectly assessed the damages available to the respondent for the loss of opportunity. However, the court found that the primary judge was correct to find that the respondent's lost opportunity to participate in future tenders was a likely result of the appellant's breach, and therefore compensable. But for the council's conduct, which was based on an incorrect view about the Ocean Drive works, the respondent would have exercised the option and had a good chance of winning the next two tenders. Relevant to the court's decision on this point were the following findings:

- the respondent had enjoyed a long and successful incumbency;
- but for the appellant's incorrect view about the Ocean Drive works, it would be incorrect to assume that it would have acted against its own interests by terminating any contract with the respondent or by declining the respondent's future tenders;
- the appellant's submission that the respondent could not have conducted the works due to the sale of its assets failed on the facts; and
- but for the appellant's wrongful view about the Ocean Drive works, which led to its repudiation of the 2011 contract, it could have been expected the respondent would have continued with that agreement and participated in future tenders.

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Fourth, the appellant claimed that it was illogical for the primary judge to find there was an 80 per cent chance that the respondent would have been successful in the first renewal tender and that it had a 60 per cent chance in the second renewal tender. The court rejected this argument, finding that no error had been established. Awarding such damages necessarily involves an element of speculation.
The primary judge was correct to consider that there was greater uncertainty the respondent would win the second renewal tender; as such, it was appropriate for the primary judge to reduce the relevant percentage.

Chapter 5: Penalties and illegality

Illegality can be relevant in considering both:

- the enforceability of a contract in its entirety; and
- the enforceability of specific obligations in a contract.

An agreement that is expressly or impliedly prohibited by statute will not be enforced by the courts. There is more difficulty, however, in determining the enforceability of a contract that is 'associated with or in the furtherance of illegal purposes'. In that situation, the High Court held in 2012[28] that '*the court must discern from the scope and purpose of the relevant statute "whether the legislative purpose will be fulfilled without regarding the contract … void and unenforceable"*'.

In *REW08 Projects Pty Ltd v PNC Lifestyle Investments Pty Ltd*[29], the defendant argued that an agreement should not be enforceable because it was entered into for the purpose of avoiding stamp duty. In rejecting this argument, the NSW Court of Appeal had regard to a number of factors, including that: the plaintiff had not knowingly broken the law; the plaintiff had paid relevant stamp duty; the detriment to the plaintiff in not being able to enforce the contract would be disproportionate to the relevant breach; and the desire to avoid conferring a windfall on the defendant.

There are cases where an agreement is not entered into for an unlawful purpose, but the performance of particular obligations may be illegal. In *Bayside Council v VCorp Constructions Pty Ltd*[30], the NSW Court of Appeal considered a contractual obligation on a developer to replace overhead powerlines with underground cables. Such work could only be undertaken lawfully with the consent of Energy Australia, which did not provide its consent. The council sued the developers for damages, but was unsuccessful. The court's reasons turned, in part, on the particular wording of the contract. The court also confirmed, however, that where different interpretations of a contract are possible, a court will prefer the interpretation that is lawful.

The court also held that the council would not have been entitled to damages in any case. The council had sought to recover the cost of performing the work itself, but the court held that, because the work could not occur, there would be no entitlement to damages.

28 *Equuscorp Pty Ltd v Haxton* (2012) 246 CLR 498.

29 [2017] NSWCA 269.

30 [2017] NSWCA 120.

In comparison with many recent years, there were no significant developments in the doctrine of penalties during 2017. In *Melbourne Linh Son Buddhist Society Inc v Gippsreal Ltd*[31], the Victorian Court of Appeal considered whether an establishment fee of $26,625 was a penalty. The issue arose because the 'establishment fee' was also a component of liquidated damages in the event the loan did not proceed. The majority held that the forfeiture of the establishment fee was a penalty because it bore '*no relation to any possible damage to, or interest of, the respondent arising from the putative breach*' and that it was '*not commensurate with any legitimate commercial interest of the respondent which is sought to be protected by the deed in the event of its breach*'. One reason in support of the court's conclusion was that the establishment fee was calculated as 1.5 per cent of the original proposed loan amount of $1,775,000, whereas the actual proposed loan amount later became $500,000. However, President Maxwell (in dissent on this point, but not on the outcome of the appeal), held there was insufficient evidence to support a finding that the establishment fee was a penalty. The case illustrates how the application of the penalties doctrine can be a matter of impression and degree.

31 [2017] VSCA 161.

REW08 Projects Pty Ltd v PNC Lifestyle Investments Pty Ltd [2017] NSWCA 269

- Illegality
- Contracts contrary to public policy

In this case, the Court of Appeal considered whether a disputed contract was a contract to commit an unlawful act and therefore unenforceable.

The court held that the legislative regime in issue did not render the contract unenforceable, and to deprive the respondent of the benefit of the contract would impose a penalty disproportionate to its assumed wrong.

This case usefully sets out the principles that render a contract unenforceable when it may be contrary to public policy to enforce it. It also provides that not every contract that is associated with an illegal purpose will be rendered void for illegality.

Facts

REW08 and PNC were involved with the development of land for subdivision and sale. Special Condition 53 provided that the vendor had a right to rescind the contract and simultaneously enter into a new contract every three months. The first contract was entered into at the end of 2013. In mid 2014, the parties signed two sale contracts that were backdated, and also entered into deeds of rescission for two earlier contracts.

Following disagreements between the parties, PNC commenced proceedings for specific performance of one of the backdated contracts. REW08 alleged in response that the contract was void for illegality, as it had been entered into for the 'express purpose of avoiding stamp duty'. PNC subsequently paid the full amount of stamp duty payable on the transactions to the Office of State Revenue, together with interest calculated from the end of 2013.

At first instance, Justice Darke rejected the illegality argument and found that the contract should be specifically performed. On appeal, REW08 argued that his Honour erred in failing to find the contracts for sale and deeds of rescission were unenforceable for illegality. It submitted that as the purpose of the transactions was to delay the payment of stamp duty (an unlawful act), the contract was unenforceable by reason of public policy considerations.

Judgment

Justice Macfarlan (Justices Beazley and Gleeson agreeing) found that there were a number of reasons why the primary judge was correct in finding that the contract should be specifically performed:

- The legislative regime that regulates stamp duty does not expressly render an agreement made for the purpose of avoiding duty unenforceable. The purpose of the statutory scheme is to ensure that the state receives the proper amount of duty for relevant transactions. The *Taxation Administration Act 1996* (NSW) provides for a penalty tax where tax is not paid lawfully, and various other offences. The Court of Appeal found that the fact the legislature stopped short of providing the sanction of unenforceability was a powerful indication that it did not intend such an outcome.
- REW08 did not establish that PNC knowingly broke the law. The primary judge found that PNC (through its director) was guided by lawyers, and had no reason to think that its actions were improper. Citing another High Court case, Justice Macfarlan noted that those who deliberately set out to break the law cannot expect to be aided by a court, but it is a different matter when a party unwittingly breaks the law.
- The delayed payment of stamp duty was not essential to the parties' bargain but, rather, an incidental consequence. The intent did not go to the substance of the transaction, and therefore did not invalidate the whole transaction.

- The illegal purpose itself was not carried into effect, as PNC paid the relevant stamp duty with interest, and REW08 did not establish that there were any penalties left unpaid.
- Depriving PNC of the benefit of the contract would impose a penalty that was disproportionate to its assumed wrong (particularly so as PNC had paid the relevant stamp duty and interest).
- Similarly, to free REW08, when it had suffered no loss by the alleged impropriety, of the obligation to perform the sale contract at the price specified at the end of 2013 would confer a windfall on the appellant.

The Court of Appeal set out case law that outlines the circumstances in which the court may allow enforcement of a contract even when its formation was associated with illegal purposes. The courts will not refuse relief where:

- the claimant was ignorant of, or mistaken as to, the factual circumstances that render an agreement illegal;
- the statutory regime that renders a contract illegal was enacted for the benefit of a class to which the claimant belongs;
- the claimant entered into an illegal agreement where it was induced by the defendant's fraud, oppression or undue influence;
- the illegal purpose has not been carried into effect; or
- the contract, though not coming under one of the above exceptions, was merely associated with, or in furtherance of, an illegal purpose, or was not made in breach of a statutory prohibition when it was formed.

Further, the Court of Appeal found that not every act of wrongful conduct on the part of a plaintiff will give rise to a defence of unclean hands. For the conduct to be relevant, it must have 'an immediate and necessary relation to the equity sued for'. In this case, the issue of stamp duty was incidental to the contract and it had actually been paid, bringing the impugned conduct to an end.

Bayside Council v V Corp Constructions Pty Ltd [2017] NSWCA 120

> Can illegality excuse non-performance of a contractual obligation?

In this case, the NSW Court of Appeal considered whether a developer was in breach of a contractual obligation to procure the replacement of overhead power lines with underground cables in a situation where Energy Australia refused to consent to the works.

The court held that the developer did not breach its obligation because the relevant clause should be construed as being subject to Energy Australia's consent. In the absence of that consent, the developer was not able to lawfully fulfil its obligation and the clause had no effect. The court also held that, in any event, the party to whom the obligation was owed suffered no loss from the alleged breach.

This case highlights the importance of ensuring that contractual drafting clearly deals with contingencies, and is a helpful reminder of the court's approach to interpretation.

Facts

In October 2004, Bayside Council granted consent for V Corp Constructions to develop a site in Mascot. A condition of that consent was that V Corp enter into a deed with the council, which, in clause 2.1, obliged V Corp to procure the replacement of the existing overhead wires directly adjacent to the site with underground cables 'in accordance with the standards and requirements of Energy Australia'.

Before entering into the deed, Energy Australia indicated that it would be necessary to replace the wires for the entire street, rather than just the wires directly adjacent to the site. V Corp and the council discussed the matter with Energy Australia over the next few months, with a view to coming to a suitable arrangement, and were still in discussions when V Corp signed the deed with the council in May 2006.

Shortly afterwards, Energy Australia wrote to the council, stating its conclusion that underground cables were not in fact suitable for the street at all. Following discussions with the council, V Corp paid a sum of $10,000 in lieu of meeting the requirements of clause 2.1.

In June 2007, the certifier issued V Corp with an interim occupation certificate.

In correspondence between the council's solicitors and V Corp's solicitors in the following years, the council asserted that it was entitled to require compliance with clause 2.1 and that there was no agreement to vary the terms of the deed upon the payment of $10,000 such that compliance was no longer required.

In July 2013, the council began proceedings against both the certifier and V Corp in the District Court.

In relation to the certifier, the council alleged that it was owed a duty of care and that by issuing an occupation certificate in circumstances where there was non-compliance with the consent, the certifier had been negligent. This claim was rejected at first instance and on appeal because no loss was proven.

In relation to V Corp, the council sought damages for an alleged breach of clause 2.1. The council claimed that it had suffered loss because it would itself have to replace the wires. The trial judge rejected these claims and the council's appeal was dismissed.

Judgment

The Court of Appeal upheld the trial judge's conclusion that V Corp had not breached the obligation to procure the replacement wires and, in any event, the council suffered no loss. The appeal did not deal with the $10,000 payment and the question of whether the deed had been varied.

Energy Australia's consent was a condition of the obligation

The court acknowledged the parties' assumption that Energy Australia would consent to the replacement of the wires but might impose certain restrictions or mandate the manner in which this was done.

However, the court held that the words 'in accordance with the standards and requirements of Energy Australia' in clause 2.1 were also expressly consistent with a situation in which Energy Australia did not consent at all. In that situation, V Corp would not be able to procure the replacement of the wires but its failure would not constitute a breach of clause 2.1 because there was no way for V Corp to lawfully perform its obligation. Under section 65 of the *Electricity Supply Act 1995 (*NSW), it is a criminal offence to interfere with electricity works unless authorised to do so by the network operator or retailer.

The court also held that, even if Energy Australia's consent was not an express condition, the implication of a condition to that effect was both necessary and obvious, and would meet the requirements of *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266 at 283.

Justice Ward also noted that an interpretation which conditioned the obligation on Energy Australia's consent was both commercially and legally sound. The parties must be assumed to have known that no work could be done on the wires unless Energy Australia consented. In this context, two interpretations are possible. Either V Corp had an:

- absolute obligation and effectively promised to compensate the council for loss in the event that Energy Australia, a third party over which V Corp had no control, did not consent to the work; or
- obligation which was subject to Energy Australia's consent and promised to perform its obligation if that consent is granted and, if not granted, the clause would have no application.

The second interpretation is to be preferred because the deed, construed as a whole, did not evince an intention to allocate the risk of Energy Australia's potential non-consent to V Corp. Furthermore, in construing a clause with multiple possible meanings, a meaning that is lawful should be favoured.

V Corp was not in breach because Energy Australia has not consented

The court upheld the trial judge's factual finding as to Energy Australia's lack of consent. It held that the only reasonable inferences to be drawn from the correspondence between the parties and Energy Australia was that Energy Australia did not consent to the replacement of the wires because such a project was not viable in that location and the parties understood this.

Council did not suffer any loss from the alleged breach

The court also held that, independent of the its findings regarding breach, the council suffered no loss from V Corp's failure to replace the wires. This was because the loss that the council claimed was the amount of money it would expend in replacing the wires itself. However, since that expenditure could not take place without Energy Australia's consent to the works, which had been refused, no loss arose.

Melbourne Linh Son Buddhist Society Inc v Gippsreal Ltd [2017] VSCA 161

- Right to terminate contract
- Whether set establishment fee a penalty

In this case, the Victorian Court of Appeal considered whether a lender was entitled to terminate a contract following an alleged breach and whether a set establishment fee (also payable as liquidated damages) was a penalty.

The court held that the borrower did not breach the contract, and therefore the lender's withdrawal of its offer constituted a repudiation. As a result, the lender was unable to seek any relief under the loan agreement.

This case illustrates a strict approach to compliance with contractual terms and gives a wide application to the doctrine of penalties.

Facts

The applicant is an incorporated association that sought funds from the respondent, a managed investment scheme that offers loans to borrowers who might not qualify for loans from major banks.

The parties agreed that the loan would be for $1,775,000 or 50 per cent of the value of the property, with a term period of two years; and a 1.5 per cent establishment fee of $26,625. The establishment fee was payable as liquidated damages if the applicant failed to settle the loan. However, it soon became clear that the value of the property being used to secure the loan was worth substantially less than previously thought. Thus, the applicant sought a reduced loan amount of $500,000.

The respondent provided an amended offer for a loan of $500,000; however, the offer stipulated a term period of one year and retained the establishment fee of $26,625. The respondent also advised that the applicant had three days to accept the offer.

The applicant wrote to the respondent stating that it did not accept the revised offer and requested the term and establishment fee be amended to reflect the original position. The respondent refused to do so and withdrew its offer of finance on the basis that the applicant had breached the contract.

Judgment

The most significant grounds of appeal considered by the court concerned whether:

(a) the respondent was entitled to withdraw its offer of finance because the applicant failed to settle a one-year loan within three days (***breach issue***); and

(b) the establishment fee was in fact a penalty.

The court held as follows:

- In relation to (a) the respondent sought to change the term of the loan, which was an essential term of the contract, and only provided the applicant with three days in which to settle, despite the fact that the loan deed allowed seven days for the applicant to accept. This was unreasonable and the applicant did not breach the contract by failing to settle within three days. Thus, it was not open to the respondent to terminate and its attempt constituted a repudiation of the contract.
- In relation to (b) the majority held that the establishment fee of $26,625 was a penalty as it had no relation to any possible damage or interest of the respondent arising from the alleged breach by the applicant, and was not commensurate to any legitimate commercial interest of the respondent.

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