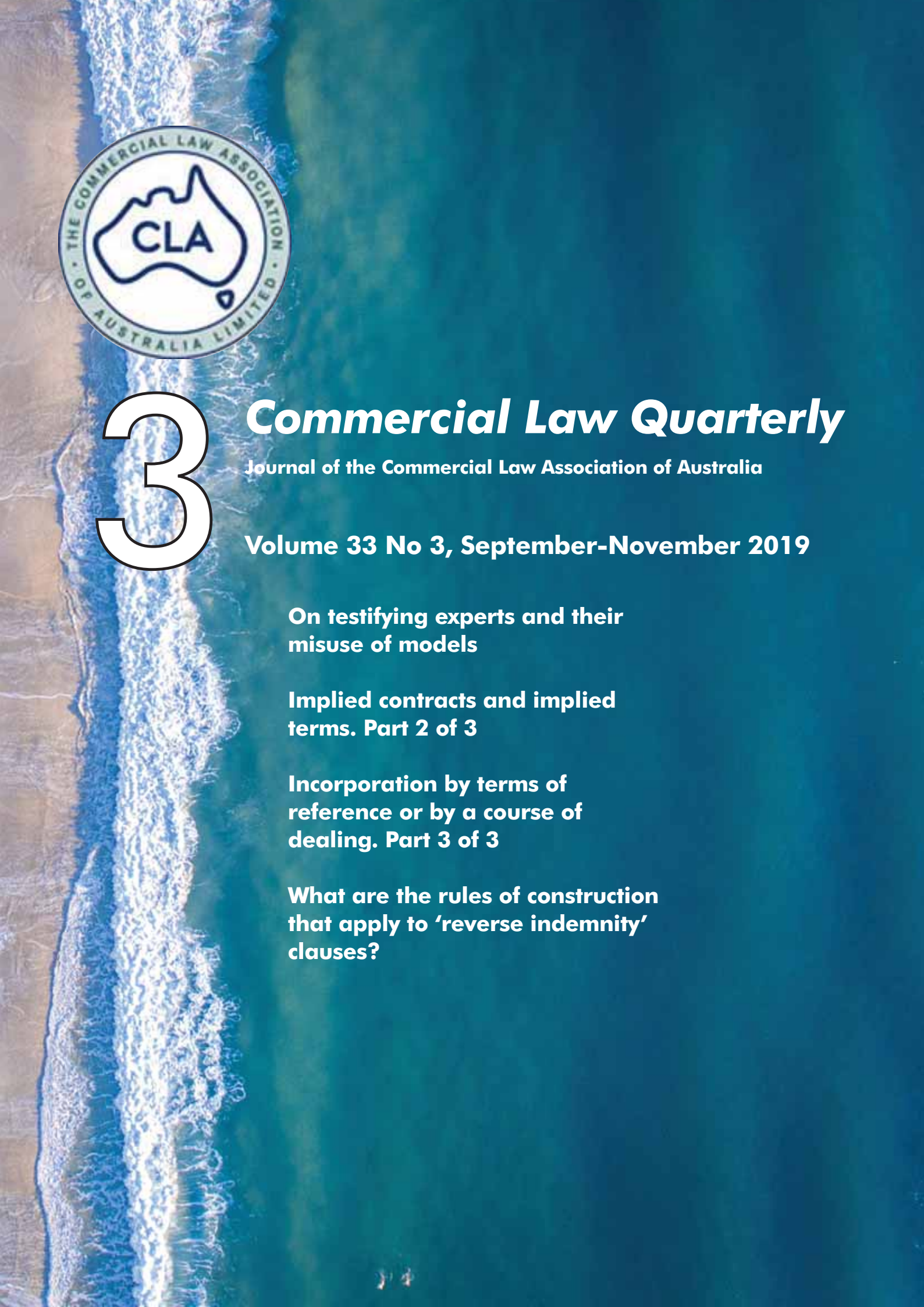

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REQUEST FOR MANUSCRIPT. The Editors welcome the submission of notes to cases and issues of law reform, and longer articles. Submissions should be sent to Max Wilson (maxwilson@cla.org.au) or Dr Gregory Tolhurst (gtolhurst@nswbar.asn.au). All manuscripts submitted to the *Commercial Law Quarterly* which are to appear as articles are refereed prior to acceptance for publication.
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STYLE GUIDELINES. In preparing material for submission of articles or comments authors should be guided by the following points.
Endnotes. These should be numbered consecutively throughout using Arabic numerals. All bibligraphical details, case citations, etc, should be contained in the endnotes and not in the text. As a rule endnotes should not be used to make substantive points.
References and Citations. Cases: The full citation of a case should always be used when a case is first mentioned, eg, *Peden v Little* (1915) 20 CLR 555 or *Tolhurst v Associated Portland Cement Manufacturers* (1900) Ltd [1903] AC414. Note that full points should not be used. The citation should be repeated when subsequently referred to, unless it is repeated in the immediately following footnote in which case 'Ibid' or 'Id at xx' should be used. Books: Initial references to books should be as follows: J W Carter, Elisabeth Peden and G J Tolhurst, *Contract Law in Australia,* 5th ed, LexisNexis, Sydney, 2007, p2. Subsequent references should appear as 'Carter, Peden and Tolhurst, above, n2, p3' unless it is repeated in the immediately following footnote in which case 'Ibid' or 'id, pxx' should be used. Chapters within books should be cited as follows: P Birks, 'Mixtures' in *Interests in Goods*, 2nd ed, N Palmer and E McEndrick (eds), Lloyds of London Press, London, 1998. Journal articles should be cited as follows: B Coote, 'Consideration and Benefit in Fact and in Law' (1990) 3 JCL 23. Subsequent references should be presented as 'Coote, above, n5 at 26' unless it is repeated in the immediately following footnote in which case 'Ibid' or 'Id at xx' should be used. Legislation references to statutes should be as follows: Sale of Goods Act 1923 (NSW).

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President's message

What do Nicholas Cage movies and pool drownings in the US have in common? The numbers, as it turns out — but a curious correlation does not suggest causation. Gene Phillips and Ron Bewley explore the difficulties of testifying experts and their use of models in the opening paper of this issue of CLQ. They want to help you understand the modelling process and also gain a more nuanced appreciation of a model's limitations. For those of you who missed out on Gene's seminar earlier this year, you'll find this to be an excellent substitute and a cautionary tale.

Following on from last issue, we have Parts 2 and 3 of Jeffrey Goldberger's paper from his master class 'Contract law in the cases: 2018 in review'. I have always found this to be an invaluable tool and a very worthwhile read.

'Few clauses attract as much attention throughout contract negotiation as indemnities …', writes William Potts. Too true. In his first paper for CLQ, William is concentrating on the case law on reverse indemnity clauses, with the aim of ascertaining how indemnities are interpreted as a matter of contract construction, particularly in the context of negligence.

Moving away from questions of law, I'd like to congratulate Michela Gallimore on winning our mid-year membership draw. Michela won a mid-week escape to Spicers Balfour Hotel in New Farm, Brisbane. We'd like to thank Spicers Retreats for once again providing us with such a wonderful prize.

We were very pleased to see an excellent roll-up at Robert Angyal's seminar on mediation despite everyone having to fight their way through 50,000 people (the climate change march) to get to it. Robert did a wonderful job of holding everyone's attention despite all the distractions going on outside.

I feel sure that not only will you enjoy this issue of CLQ, but will be looking forward to the next one when I tell you it will feature papers from John Carter, Elisabeth Peden (our congratulations on having made SC) and John Eldridge from their 'Contract provisions not to be taken for granted' half-day seminar.

I look forward to seeing you at a seminar soon.

Norman Donato

On testifying experts and their misuse of models

Ron Bewley, PhD
Gene Phillips[1]

For the great enemy of truth is very often not the lie – deliberate, contrived and dishonest — but the myth — persistent, persuasive, and unrealistic. Too often we hold fast to the clichés of our forebears. We subject all facts to a prefabricated set of interpretations. We enjoy the comfort of opinion without the discomfort of thought.

John F. Kennedy, Yale commencement speech, 1962

Introduction

At moments of heightened stress, pressure or intensity, adrenaline is released in our bodies, causing our heart rates to increase, our air passages to our lungs to expand, and even our pupils to dilate. We are prone to panicking and exhausting ourselves, often making poor decisions in the process. Sports coaches and fire safety wardens implore us to relax and take a deep breath — to combat the otherwise natural physical reaction.

Our thought processes, similarly controlled by our brains, are likewise susceptible to automatic triggers or mental overrides, at times in a suboptimal way. We are exposed to any number of unintended biases. When we expect to see something, our 'mind's eye' sometimes fills in the blanks.

In our immediate context here, expert witnesses often expect to find certain results — they are hired to prove something or disprove something. They expect to be able to achieve the desired result and are sometimes hired on that basis. This is called 'priming'; but there are other behavioural influences at play, including 'confirmation bias' and 'anchoring', that same force that acts so powerfully on us in the context of a negotiation, in which the first party to mention a number sets the battlefield, thereby anchoring the subsequent interplay.

When experts are primed to expect certain results, they can sometimes read too much into the results of their models, misinterpreting the results or over-relying on them; or they may even convince themselves that small changes to their models are permissible or excusable, given those changes culminate in the 'right' results they would ordinarily have expected to see.

Formidable scientific experts seldom err in mis-specifying their models or misreading the results. Strong experts bring with them a strong scientific intuition, which could best be described as a set of strict rules or routines, often mental but sometimes written, for approaching the modelling process: those rules limit their potential for error. Strong experts know when and how to apply certain models, when not to apply them, when to adjust them, and how much confidence to place in them.

The objective of this article is to help litigators understand the modelling process and general concepts concerning the limitations of models employed. With an improved understanding of the modelling process, litigators can gain assurance in the nature and validity of their experts' approaches, or a more nuanced appreciation for their limitations.

Usage of models

A golf manual might explain how to hold the grip (right hand below the left hand) and how to swing (bend the left knee, pivot on the right hip etc). But it might also caution us: 'this procedure is best for right-handers. If you are left-handed, replace the word left with right in our instructions, and the word right with left'.

We would call the initial instruction an approach, here, to playing golf. The cautionary statement may be obvious and it may sometimes be omitted; but its message is clear and this approach likely only works for certain people. Others need to adjust the approach to achieve a similar level of success or satisfaction.

The same is true of models. They work as is in certain settings, need to be tweaked to work in some settings, and are completely useless or unhelpful in yet other settings.

That is why we have experts: they need to understand the 'when, what, where,why and how'. It is seldom the case that the same model or approach can blindly be applied time-after-time in litigation matters. Litigation generally concerns humans and human conduct, and complex models are built to analyse or estimate events in a real, complex and dynamic world. Models and modelling approaches need similarly to be

adaptable, so as to accommodate the particular specifications of the situation at hand.

What is a model?

George Box, a famous statistician, once wrote, 'all models are wrong, but some are useful'.[2] We think this hyperbole is extremely useful in placing models in context.

A model, by definition, is a simplification of a real world that is otherwise too difficult to understand. It is worth exploring this idea that a model provides a representation of something in a specific setting. It seldom, if ever, perfectly captures the at-issue scenario, certainly not in all settings. Thus, when a model is used, its limits often need to be articulated.

A model is necessarily a simplifying construct. It could be a theoretical construct — clearly espoused — or a set of mathematical equations and formal statistical assumptions, estimates and significance tests.

A model usually takes assumptions (eg, growth rates, interest rates) as inputs to the calculation engine, and produces outputs, such as the estimated price of a stock or a physical asset or contract under the scenarios tested. Ideally, an expert's description of her model and its results should clearly state the key assumptions made and the steps taken and decisions made in arriving at the final model itself. Without these specifications, or production of the model itself, it can be difficult to test whether the model used was appropriate, or determine whether the conclusions reached are meaningful.

All models are subject to the relevance and accuracy of the data. This may fall to the expert performing the modelling analysis; or sometimes it is the domain of a separate expert, in which case the modelling expert assumes the data to be correct, and any interrogation of the data is left to a separate cross-examination.

In a litigation context, litigators would benefit from an appreciation that a model can be wrong (or, less than perfect) in several respects, while still being useful. Similarly, experts often come off as most credible when they readily accept imperfections of their models, as opposed to too strongly defending their models as being 'right'. Just as an expert's opinion (as we shall explain) is to be informed by her model — rather than being dictated by her model — so the courts should not expect to be entirely convinced by any model as proving the case, but would do well to favour the most credible of the experts and models provided when weighing the evidence.

Models for litigation

Experts use models in numerous contexts as part of a litigation matter. Often, the nature of an allegation requires a determination of cause-and-effect. Fraud claims and other claims that include a mental element (scienter) might further require a showing be made that the alleged misconduct caused the plaintiff(s) or claimant(s) to act in a certain way or suffer certain negative consequences. A fraudulent inducement claim might require a showing of transaction causation, and then loss causation — did the alleged misrepresentation(s) cause the aggrieved party to buy into an investment or enter a contract, for example, and was the subsequent loss causally linked to the alleged misrepresentation?

Upon or in anticipation of a showing of reliance and causation, an expert might need to calculate damages. But-for the alleged misrepresentation, what would the investment have been worth?

Showing causation, estimating the value of investments in the but-for, and calculating damages in the counterfactual, are just some of the analyses for which experts build models. These models are all different, but some principles apply regularly to all or most of them.

Use and abuse of statistics

An oft-made assertion is that one can achieve any result desired with statistics. In one sense this statement is true. A mischievous or malevolent professional statistician has the skill base to create an illusion of truth by selectively choosing how the results are calculated and presented — just as a stage magician can fool an audience with a sleight of hand.

Statisticians, like many other professionals, have certain methodologies or rules by which they support their expert views. There is not one fixed set of rules that all statisticians follow to the letter. Rather, there are broad principles by which they practice their science. In the following sections we present commonly used examples to flesh out what we believe are the essential components that distinguish professional statisticians from the inexpert.

Diagnostic testing

Although lay people may not be aware, the proper interpretation of most model outputs, like correlation coefficients, depends heavily on a number of specific assumptions being upheld.

Consider, for example, a very simple model that the relationship between one variable (say company profits, denoted by the letter y) has a relationship with a possibly causal input variable (say turnover of the company, denoted by x) for a number of companies at a single point in time.

One popular analytical approach (called a 'linear regression') is to fit a straight line that seeks to approximate the data.

The line would seek to represent the dots on a scatter diagram of observed profits against turnover (see the chart) but it would be an estimate — the fitted line would not necessarily connect with any of the dots. For a fitted line, the slope of that line of y against x would measure the impact of an additional amount of turnover, regardless of the base level of turnover).

Fitting a linear regression is popular: it is a common scientific technique taught in most universities. But that does not make it right. Even if the fitted line seems to adequately depict the data, the fitting of the straight line merely incorporates the assumption made that a straight-line relationship exists (if, indeed,

there is a significant relationship),[3] rather than determining the relevance of the relationship. One may therefore need to test this key assumption.[4]

Part of the modelling process and associated expertise required might be exhibited when determining which of these three lines best represents the relationship. In this case the expert judgment is not in the observation of the points of the graph, but what the relationship ought to be on fundamental or theoretical grounds (and then modified or rejected by observation of actual data points). One may be correct or best in context but it might be difficult to tell the difference between some or all of them. (Also, importantly, it may be the case that none is 'correct'.) The greater the range over the x axis, the easier it is to choose one over the others. Standard statistical procedures are available but sometimes the expert can use the context to help in this process.

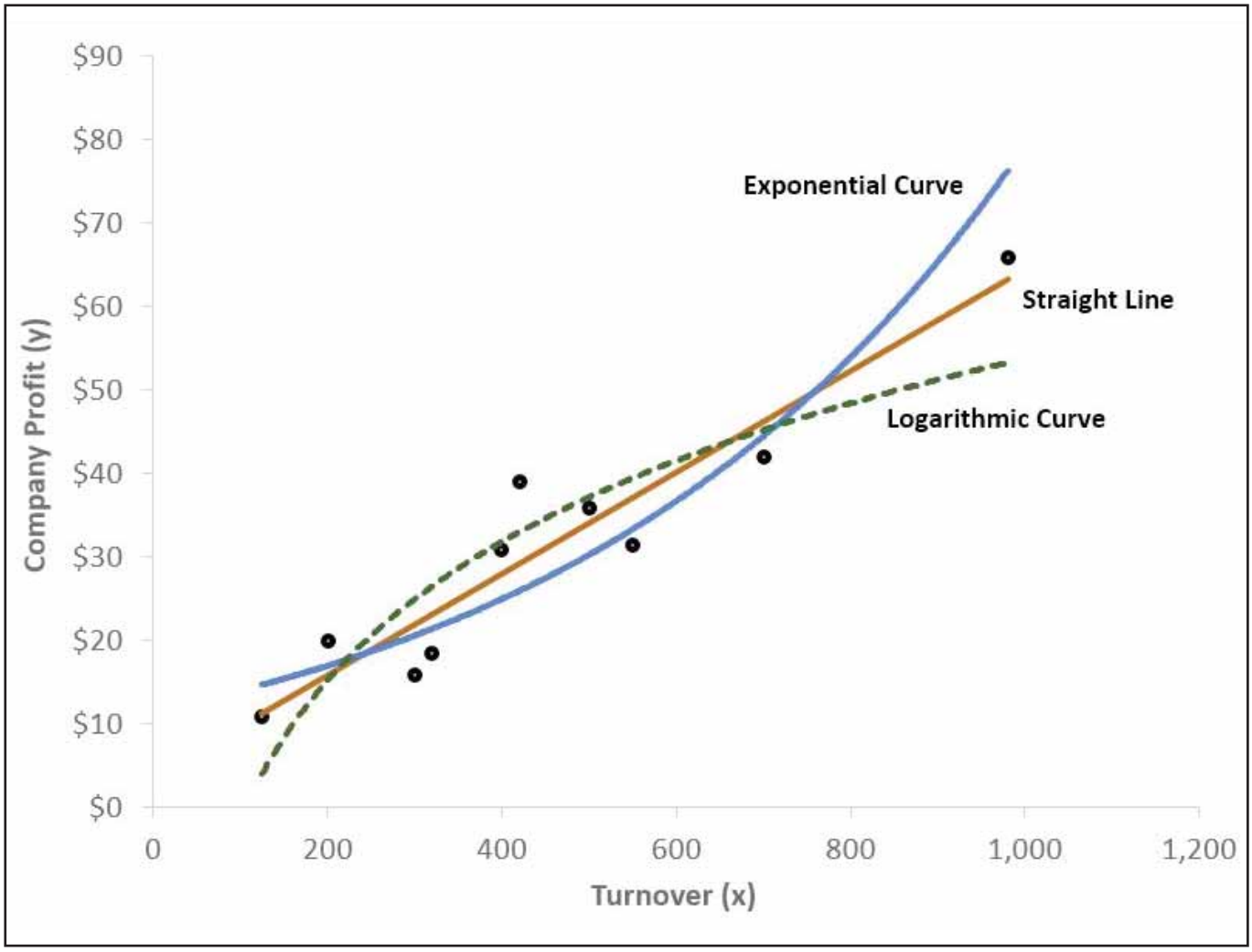
The associated chart is illustrative — it does not have very many data points but the various lines fit to them are quite descriptive. Notice that context matters. If an expert were trying to predict Company Profits for large Turnovers (say 1,200), she might be better off using the straight line as opposed to the alternatives, as it more closely mimics the only data represented (albeit a single data point) at the high end of the range on the right-hand side of the chart. As an imperfect rule of thumb, it may be most prudent to choose the simplest model that adequately represents the data if there are several reasonable choices that pass the expert's statistical analysis.

If there are no such patterns — and diagnostic tests allow the expert to form a view on that question — the estimate of, say, the slope of the straight line might be used in forming a view about the magnitude of the incremental impact of an additional unit of turnover.

The separate question would be whether that estimated slope is sufficiently different from zero: is there a discernible relationship? The validity of this so-called significance test also depends on assumptions — such that the deviations of the dots from the line conforms to a certain distribution, often the Gaussian distribution (also called the normal distribution).[5] Different distributional assumptions would produce different probabilities of rejecting a hypothesis for the same estimated slope.

The model is a construct that allows the testing and estimation between hypothesized input and output variables. That is, the model is not an end in itself, it is the framework by which the expert can test a hypothesis of interest. For example, it might be relevant to build a model that will allow the expert to deduce

Scatter Plot with Alternative Models



whether demand for a specific service is price sensitive. As a base case, the expert might specify an assumption that there is no price sensitivity. The data and the model are then used to challenge that assumption to deduce whether or not there is a significant price sensitivity.

A poorly specified model might mask a possibly true price sensitivity, so it is important that the variant of the model used has sufficient powers of discrimination — in a statistical sense — to enable a meaningful determination to be made.

Assumptions must be made in building a relevant model about (1) the relevance of input variables, (2) the specific mathematical relationship between the input and output variables — as illustrated in the chart — and (3) the deviations of the observed output variable from those predicted by the model. If a model is not a valid or reasonable representation of the data, an estimate of the slope and a value of the significance level in the simple straight-line example can usually still be calculated but they have no valid contribution to make in forming an expert view. As such, an important plank in sound econometric practice is that we subject the relevant assumptions to what is called diagnostic testing.

Indeed, there was a high-profile academic interchange in the early 1980s regarding the misuse of econometric devices and how such misuse could have been mitigated.[6] Diagnostic testing was one of the solutions found to meaningfully lower the potential for error — it seeks to test the authoritativeness of the assumptions embedded in the model and whether the model is robust to reasonable alternatives. Would different assumptions produce a markedly different result?

For one, over-testing can be as much a sin as under-testing. Put another way, doing a thousand tests on a model is almost certain to find one or more rejections by chance alone. While each test might have a known significance level — or chance of producing a false positive — multiple testing also has an overall significance level which might be so large as to make it of limited use.

Given the potential for an over-rejection of the hypothesis by implementing a poorly designed testing strategy, it follows that a select set of important diagnostics — a carefully planned set compiled before seeing the data — is more likely to produce a diagnosis that is appropriate.

Correlation and causation

An expression popular in scientific fields is that 'correlation does not mean causation'.

Two things may be related, but that does not mean that one causes the other. If we were to mistakenly construe a causal link between all seemingly related events, we might never sit in an ambulance or visit a hospital, because people die in both ambulances and hospitals with outsized regularity. The nuance, of course, is that those who passed did not die because they went to hospital or entered the ambulance. There is correlation, but not causation.

Causation: but which way?

Suppose we find a relationship exists between an occurrence A and an occurrence B. Before concluding that occurrence A caused occurrence B (or vice versa) we would want to subject the analysis to a variety of diagnostic tests.

One such test is to consider whether reasonable alternative explanations might be possible.

Before we could have confidence that A caused B, we might want to test whether (1) B caused A, (2) A caused C which in turn caused B, or even (3) whether C caused both A and B. At least one other tricky possibility exists — that A and B are entirely independent and that it is only by pure chance that a relationship between the two has been found. The solution to this conundrum requires knowledge of the underlying problem (and there may be no solution).

Spurious correlations

There are countless examples of two variables on a chart 'moving together' over a specified period.

One such co-movement happens to be the number of drownings in swimming pools in the USA over a period of years, compared to the number of Nicholas Cage movies released in those same years: these two variables move, oddly enough, in lock-step. We assert that no reasonable person could think that there is a causal relationship between the two variables in either direction — so how do we deal with such an unreasonable criticism of the statistics profession?

A 'Cage Movies and Pool Drownings' chart may indicate that the two variables have indeed broadly moved together over time, but while there seems to be a curious correlation, we cannot know that there is causation — the graph does not (and cannot) tell us whether Cage caused Drownings or vice versa. Did they have a common cause? Or are they purely coincidental?

Importantly, charts and models can seldom answer the question: 'What caused this outcome?'. Models are better at ruling out certain causes, but they are seldom useful in pinpointing the specific cause. This is often left to an expert, to show a relationship (correlation) and to explain why she expects that one of the variables causes the other. An expert might also explain what other theories were considered plausible and why she dismissed them. It is often an error for an expert to conclude, based on a model, that x caused y; but it is safer to explain why one would expect x to cause y, and that a model's output showing their relationship gives the expert comfort in asserting a causal link.

Anecdotes versus patterns

Suppose a form of misconduct is thought to have occurred. A financial institution might stand accused of having:

A. charged an indisputably unfair (or usurious) amount of interest; or

B. charged its clients higher fees (versus other financial institutions) on a specific type of product or advice.

Statistical analyses help us answer several questions.

In scenario A, we may wish to understand whether this was an isolated or infrequent incident, or whether sufficiently many other customers were subjected to similar unfair charges. This helps us separate outliers, or anecdotes, from patterns. Anecdotes might be the result of individuals erring, as opposed to firm-wide emblematic misconduct — and the response appropriate from the financial institution would likely be different. In the provision of any product or service, there will be an error rate.

In scenario B, we might want to understand whether the higher fees are in fact significantly higher. In any rank-ordered grouping, there will necessarily be a first place and a last place: the fact that one firm charges more than others is not alone suggestive of there being a problem. The first question may be whether it charges significantly more. A second question is prescient too: are there other countervailing explanations that would warrant the firm charging more? Are there any attributes of the product, clientele, or risks taken by the institution that may require the higher charges? We call this an analysis of reasonable alternatives or joint causal variables.

Control groups

Perhaps one of the bigger 'sins' in expert modelling is to attempt to value a loss in an absolute sense, rather than valuing the loss compared to reasonable alternatives.

It was common after the so-called Global Financial Crisis ('GFC') for litigants to claim they lost (absolute) wealth in the GFC due to certain allegedly poor advice rendered to them. But it often rests with the plaintiff to prove 'loss causation' — not only did the ill-advised investment lose money, but the loss was causally linked to the improper advice. Loss is only relevant if any alleged loss is compared to what the loss would have been based on other reasonable advice at the time. These are well-established propositions in statistics.

Example A: medical drug tests

To test the effectiveness of a certain new drug as a remedy for curing the common cold, you would collect a group of people who exhibit the symptoms of the common cold. This is not an easy process, and it can itself introduce error. Assuming that the initial group is appropriately formed, you would next approach the testing in a controlled fashion.

First, you would create a subdivision of the group of individuals that would be given the new drug.

A second subdivision of the group would not be given the new drug. Individuals having the common cold often recover on their own (or feel that they have). Therefore, to test the effectiveness of the drug, you need to be able to measure it against the effectiveness of simply not taking it.

A third control group is necessary to accommodate an intricacy - our minds and our bodies are interlinked. When a person is prescribed a drug, she is sold both the drug and the story about how the drug will impact her. Because human minds can be tricked to believe that the drug is working, which may actually make it work (often temporarily) you will need to control for what is called the placebo effect.[7] To control for the impact of the placebo effect itself, this control group would be told it is being given the drug, while in fact being provided with an inert substitute, called a 'placebo', such as an empty capsule or a so-called sugar pill. To determine that a drug works, it should materially outperform the placebo.

An expert in testing medical drugs knows to test for the placebo effect: which is commonplace in this day and age. A non-industry statistical expert may not know about the placebo effect, and may erroneously find a basic analysis that shows drug-taking individuals to recover faster than non-drug-taking individuals to be convincing.[8]

Example B: non-compliant mortgages in the GFC

In the aftermath of the GFC, much of the litigation surrounding investments in subprime mortgaged-backed securities focused on the non-compliant nature of mortgages being deposited into the mortgage-backed securities. The question, then, became a battle as to whether the securities underperformed due to the non-compliant nature of the mortgage supporting them, or whether the compliant mortgages performed just as poorly in the mortgage meltdown.

Example C: straw men (and women) hypotheses

Hypothesis: 'If one were to rebuke the losers (of a game) they will do better next time.'

In testing this statement, an overly enthusiastic analyst might tackle this question by analysing the losers who are rebuked, and seeing if they perform better the next time around. That analysis could render an erroneous result. The statement requires the testing of a causal relationship 'if one rebukes losers, then ...' But simply testing the subsequent performance of rebuked losers does not test the causality. It tests only the subsequent (conditional) performance of rebuked losers.

This error is easily exposed if we consider a game of chance — say flipping a coin. Given it is a game of pure chance, the losers in one round will (on average) win the next round 50% of the time. Rebuked losers and non-rebuked losers will both do better on average the next round, winning 50% of the time. Thus, rebuked losers did better (so our enthusiastic analysts would deliver a 'Yes'), but the question asked something else — and the answer is No: it is not 'if you rebuke losers that they will do better.' It has nothing to do with the rebuke.

Here, one should have created a sample of rebuked and non-rebuked losers. The test would then be whether rebuking has a more positive impact on the outcome for the rebuked losers than the non-rebuked losers. We can think of the non-rebuked losers as a control group.

Example D: antidepressants

Suppose an antidepressant is being tested on individuals suffering from depression. One element that may improve such an analysis is if the analysis can incorporate information about the individuals themselves. It is very difficult to define depression and as a consequence, many people grieving (from losing a parent or loved one) exhibit the symptoms of depression and are thus defined as being depressed. How long the grievance lasts would change from one individual to the next — some may recover within days or weeks, while others may grieve over a lost one for months or years. The nuance, thus, is that a grieving individual may naturally come out of her depression after a period of time, independent of the taking of the antidepressant drug. When testing the results of a sample of depressed individuals, a skilful clinical technician might try to control for the variable of grievance among the 'depressed' individuals subjected to the tests.

Hold-out samples

In cases where it is difficult to pose a useful hypothesis before analysing the data, some experimentation is condoned. However, if this line of inquiry is followed it is vital to set aside a reasonable portion of the data, known as a 'hold-out sample'. The data mining is conducted on the first part of the data set. If a hypothesis is formed, it can then be tested on the hold-out sample without further experimentation. We provide some examples of analyses that can go awry absent the proper application of hold-out samples.

Example E: Gates Foundation and the testing of a factor that make schools good

Hypothesis: 'If one were to identify a factor that makes good schools good, one could build good schools.'

When the Gates Foundation posed the question, 'what factor(s) help to determine good schools?' it erroneously first sought out a sample of good schools and then analysed them for potentially relevant factors.

In classical statistics, the hypothesis comes before the data collection and analysis.

The Gates Foundation's approach to the question can be criticized for seeking out correlation where they should have sought causation!

In the absence of theory, the Gates Foundations' approach is reasonable provided that a hold-out sample of 'not good' schools was retained for further testing of the hypothesis.

Researchers trying to ascertain what attributes were common among good schools found that smaller schools were, disproportionately, more regularly good. But the test was not performed as to what attributes were shared among bad schools. Oddly, the same scenario: small schools are more regularly bad. It just happens that small schools are less often middle-of-the-road — they are disproportionately more regularly either outperformers or underperformers. It was a costly and embarrassing error. Taking big schools and breaking them down into smaller schools thus did nothing, on average, to improve the quality of the schools in question.[9]

Understanding the distribution around point forecasts

One of Dostoevsky's characters, after he apparently lost his fortune at roulette tables in Baden-Baden, proclaimed that 'Only a fool is certain in an uncertain world'.

To understand the reliability of an estimate or forecast, we might do well to question the distribution of possibilities rather than just the best estimate itself.

An expert might be tasked with valuing something for the court, perhaps an asset or debt instrument or pipeline of receivables. An expert's valuation of, say, $100 is called a point estimate, and it is often accompanied by a confidence interval — such as a valuation of $100 plus or minus $10.

Here, too, context matters.

For whatever reason, 95% confidence intervals are commonplace in statistical analysis, especially in the context of legal matters, but experts should nevertheless be open to considering other more stringent criteria when the context requires it.

A 95% confidence level is not always appropriate. The width of the interval (or probability level) should relate to the importance of the decision — or the consequences of being wrong. One might be more than sufficiently enthusiastic about entering a bilateral trade that has a 95% chance of success; but one would not pull the plug given only a 95% chance of a patient's failure to recover.

Whatever the agreed-upon confidence level may be, non-experts often misunderstand the concept in an important way. The definition of a range does not necessarily mean that each outcome in that range is equally likely, and so it can be important to understand the nature of the distribution of possible outcomes, and how the expert came about generating the distribution.

Example F

The $100 ± $10 range sometimes leads lay people to conclude that the outcome could be 'anywhere in the range of $90 to $110'. Except in unusual circumstances, not all answers (within a specified range) are equally likely, and it requires an understanding of the distribution of results to gauge the relative likelihood of a specific result.

Consider a normal (bell-shaped) distribution[10] with a mean 10 and standard deviation of 5. It can readily be shown that the 95% interval is 0.2 to 19.8, which might be rounded to an interval of 0 to 20 (approximately 10 plus or minus two standard deviations). If, for simplicity, we consider numbers within the range -0.5 to 0.5 to be rounded to 0 (and 9.5 to 10.5 to 10) it can be shown that the probability of an outcome rounded to zero is

1.0852% and rounded to 10 is 7.9656%, meaning that an answer of '10' is 7.34 times more likely that a '0'!

Moreover, if one were tempted to assume a value of zero as being a reasonable finding from this experiment, one must also consider 20 as equally likely! That is why it is usually best for experts to use the mid-point of the distribution (or point forecast) when proposing an evaluation. It can be important to describe the range of possible outcomes and the level of assurance the expert attaches to each value within the specified range.

How far can a model be pushed?

In statistical modelling, a prediction (or confidence) interval grows wider and less reliable as the distance grows from the average of the observed data. When data points used to make any predictions depart significantly from the observed data range, we steadily lose confidence in the integrity of the forecasts.

By way of analogy, consider holding a metre-long ruler between finger and thumb at the mid-point of the ruler. Small adjustments in the fingers' positioning will produce minimal movement in the ruler near the mid-point but large movements at the ends, as the ruler sways noticeably — even though the slope of the ruler is the same from end-to-end at any point in time.

In the confines of classical statistics it is assumed that the model and its assumptions are correct. But in reality, since we know that models are necessarily simplifications from a real world, we often need to incorporate model uncertainty.

Example G: rentals

When estimating growth rates on residential properties, it is questionable whether and to what degree we can infer information from growth rates known in the context of commercial properties. Similarly, if we know what commercial rentals cost last month, we may be able to estimate what they will cost today. But what if we only know what commercial rentals cost a year ago? We would have less confidence as to today's level. And if our data was stale by 20 years?

Sometimes we can learn something, but sometimes we cannot learn anything at all.

Consider a simple example of fitting a straight line to trending data. Over short periods differences between a straight line and some specified curve may be barely distinguishable; but at some point the differences can become material (see scatter plot chart above). When forecasting well outside of observed data values, model complexity — such as the curvature of the model being fitted — needs to be introduced. This complexity is compounded by the variation depicted in the ruler example above.

A related issue often arises in that we usually cannot extrapolate ad absurdum. For example, a straight-line model with a gradient will predict negative values of y for some values of x. It becomes an expert judgement as to whether that is reasonable. It could be that those values of x are so far removed from the range of the data incorporated in the model, that an otherwise accurate model, within a range, is entirely compromised. Here, too, context can matter. When there is a lack of clarity it may be useful to present more than one model so that the model's sensitivity can be properly judged. That is, when an expert reasonably considers alternative models before selecting a preferred model, the expert might do well to share with the court what was once considered possible but later dismissed in favour of the preferred model.

Example H: markets

The market for new books may tell us something about the price of used books — if we know that new books appreciated in value over a certain period, we might be able to conclude that it is more likely than not that the price of used books would have similarly appreciated over that same period: there's a marketplace for both (eg, Amazon) and there are significant overlaps in the nature of the buyers and sellers.

But how can we learn about the value of a single (unpaired) shoe? Suppose a pair of shoes would regularly sell for $50. Does that mean that single shoes would be worth $25, half of the value of the pair?

Certainly not. There is no real market for unpaired shoes, and there would be very few buyers. The answer may be closer to $0. If a single shoe were found on the street, many or most passers-by might simply not stop to pick it up.

Basing a model for unpaired shoes (no real marketplace) on the model for valuing paired shoes (a known marketplace) would likely be a poor start, because almost nothing we can learn from the market for pairs of shoes would help us value a single, unpaired shoe. The market is entirely different — those buying paired shoes seldom buy unpaired shoes; and sellers of paired shoes (ie, stores) seldom sell unpaired shoes.

Thus, as we develop our models, the more closely related our unobserved data (eg, the price of used books) are to our observed data (price of new books) the more likely our models are to be reliable. The more significantly we depart from observed data (eg, paired shoes) when testing our unobserved data (unpaired shoes) the more unreliable our results become, and the more prone to exposure on examination.[11]

An expert's opinion can sometimes be derived entirely from a model; but experts sometimes stretch too far in trying to prove something with a model.

Suppose an expert were asked: 'What was the impact of this handful of large trades, on a certain day, on the traded price of the stock six weeks later?'

An answer to this question can be arrived at via a model, but the level of certainty afforded would be limited. An expert who understands market mechanics can and should use models to express her thought process, but in such cases her opinion is more credible when it is simply informed by her models, rather than proven by them. Experts would be going too far in saying that, 'According to a certain model, the impact would be $3.41.'

Experimental versus observed data

It is sometimes argued in litigation that experimental data — constructed with the case in hand — is purer that the otherwise observed data that is more often used in econometrics. That is, models constructed using experimental data might be valid while those based on observed data are not — or at least less reliable.

In experimental situations, the researcher controls values of input variables and measures the outcomes. At first glance this situation seems laudable; but consider an experimenter trying to test whether or not some stimulus (such as playing a certain type of music during study periods) increases the ability to learn. The experimenter chooses several musical scenarios and records the outcomes. If the experimenter had not happened to have also measured other possible inputs such as temperature in the room, social anxiety, or IQ (and controlled for them) the results would probably be meaningless.

If another researcher with non-experimental data properly accounts for these relevant variables, this researcher can be in a better position to evaluate an outcome than the experimenter. Each case needs to be assessed in its own context.

There are two key properties to be considered.

First, is there sufficient variation in the specified 'causal' (input) variable to produce a meaningful result? Failure to verify this may produce a 'no significant' effect bias, or a so-called lack of statistical power. That a significant effect has been found shows that there is sufficient variation in the data regardless of whether the data are experimental or observed. Failure to find a significant effect can be the result of there being no underlying non-zero effect, or that there is insufficient variation in the data. Second, it can be shown that omitting possible causal variables does not bias the results of the included model estimates if those omitted variables are uncorrelated with the included variables. Put in simple terms, a poorly-designed experiment can produce much worse results than a well-considered model based on otherwise observed data.

Rebuttal experts' models

A rebuttal expert is often hired to contest an expert's analysis or findings. Rebuttal experts have something of an easier job. They have a defined target at which to aim. While being charged with seeking out shortcomings in the original report, rarely is the rebuttal expert asked to conduct a stand-alone independent report answering the same questions put to the original expert. In that sense an argument can be made that the rebuttal expert is prone to certain biases: it is more crisply known, before she undertakes her analysis, what the hiring party seeks to achieve.

In appreciating the nature of the rebuttal expert's task — and remembering that the art of statistics allows one to come up with alternative model specifications, methods and tests — it may be fruitful to ask whether a rebuttal expert's differences are valid and, if so, whether implementing the proposed alternatives produces a materially different outcome. More importantly, one might investigate whether the rebuttal contains a cohesive methodology on which to judge the findings of the original expert. For example, one might find that a rebuttal expert champions alternative approaches in two different sections of the report, but that the two different approaches are mutually exclusive — they cannot both occur.

On experts and expertise

Experts come in all shapes and sizes, bringing with them a wide variety of skill sets. It is important to understand the expert's expertise, and her limitations. Some expert economists are only qualified to dabble in statistics. Meanwhile, expert statisticians may be inexpert in all other fields, and therefore need to be paired with economists, engineers and other industry experts to understand the context and tailor their analysis accordingly.

No model is perfect, indeed 'all models are wrong' to re-quote George Box. There will always be another way to have built the model, and a rebuttal expert may naturally pose an alternative. But is that alternative any better, and will your expert be able to explain why she chose her model over that of the rebuttal expert? It is up to the expert to argue why alternative models are inferior and/or do not conflict with the general conclusions drawn by the expert.

So is it all too hard? We think not. True experts can weave a story across the whole problem that fits together. It is the cohesion of the full argument that is the test of the value of the expert, and not individual bits and pieces from the armoury of the expert.

Conclusion

In certain extreme contexts, it may be plausible or even advisable for an expert to reach an opinion without employing any model. But when a model is deployed, as it often needs to be, certain accommodations need to be made to account for what we know— that models are necessarily simplifications of the real world. That is where expertise comes in.

Experts use their models to express their understanding of and approach to the question at hand. A simple presentation of that model is often insufficient, and while it may be difficult to dispute it, it can be less compelling. Formidable experts are generally able to articulate the methodologies employed and their reasoning and process for selecting and implementing the chosen model, including the key decision points along the way.

In certain contexts, an expert brought in to discredit another expert's model could be held to the same high standard. If the rebuttal expert cannot articulate the reasoning behind or demonstrate the importance of the negative criticisms levied — or fails to espouse a cohesive methodology of her own — it may not be easy to weigh her credibility or judge the authoritativeness of her remarks.

It is important to stress that the model is not the expert. Expertise is exhibited, rather, in the choosing of the (right) model, the appreciation of its limitations and shortcomings, the appropriate drawing of conclusions from it, and the understanding of when and in what ways it is acceptable to adjust the model or deviate from it.

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1 Ron Bewley, PhD, FASSA is an econometrician (a retired Professor of Econometrics at UNSW). He spent a significant part of his working career at CBA where, among other things, he built and supervised the construction of financial models and relevant risk analyses. He now works as an independent consultant at Woodhall Investment Research, including as a testifying expert. Ron is based in Sydney. (ron.bewley@woodhall.com.au).
Gene Phillips is a director at PF2 Securities, a litigation consulting and model review firm. He is primarily engaged in the oversight of technical evidence, including experts' reports. PF2 has offices in the United States and Australia. Gene is based in Los Angeles. (gene.phillips@pf2se.com) The opinions shared here are their own and do not necessarily reflect those of the institutions with which they are affiliated.

2 Box, G E P (1976), 'Science and statistics', *Journal of the American Statistical Association*, 71: 791–799.

3 It is often convenient to assume a linear relationship. The linear regression method is simple to deploy. But while convenient, it is often simply wrong.

4 One can assume first that a straight-line is the best fit, then test whether any pattern exists in the deviations of the observed data from the straight line that impairs the ability to measure the slope. For example, if the true relationship was a curve — perhaps the exponential curve or logarithmic curve shown in the chart — and not a straight line, obvious patterns would be discernible if the variation in x were sufficiently large.

5 Any number of statistical tests can be applied to verify that the data do in fact comport with the Gaussian distribution. The so-called K-S test, more formally known as the Kolmogorov-Smirnov test, is one such example.

6 Leamer, E L (1983), 'Let's take the con out of econometrics,' *American Economic Review* 73, 3143; Leamer, E and H Leonard (1983), 'Reporting the fragility of regression estimates,' *Review of Economics and Statistics* 65, 306-317; McAleer, M, A R Pagan and P A Volker (1985), 'What Will take the Con Out of Econometrics?' *American Economic Review* 75, 293-307.

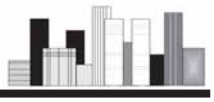
7 For example, some researchers believe the impact of many antidepressant drugs is largely if not exclusively due to the placebo effect. In fact, many patients are often given a false story about how the drugs correct an imbalance of chemicals in the brain, but scientific research does not support this narrative. The provision to the patient of a story may, however, better enable the placebo effect to take effect. See, for example, Kirsch, I (2014), 'The emperor's new drugs: medication and placebo in the treatment of depression,' *Handbook of Experimental Pharmacology*. doi: 10.1007/978-3-662-44519-8_16. https://www.ncbi.nlm.nih.gov/pubmed/25304538

8 For more on this topic, visit the research findings of Professor Ioannidis, which casts serious doubt on the integrity of clinical research studies. 'Of 49 highly cited original clinical research studies, 45 claimed that the intervention was effective. Of these, 7 (16%) were contradicted by subsequent studies, 7 others (16%) had found effects that were stronger than those of subsequent studies, 20 (44%) were replicated, and 11 (24%) remained largely unchallenged.' Ioannidis, J P A (2005), 'Contradicted and Initially Stronger Effects in Highly Cited Clinical Research' *The Journal of the American Medical Association.* 294 (2): 218–228. doi:10.1001/jama.294.2.218. PMID 16014596.

9 See Bill & Melinda Gates Foundation's Annual Report 2009, page 11.

10 Although different confidence intervals have possibly different statistical distributions, for the most part they are assumed to be 'bell-shaped' or close to normally distributed.

11 See, for example, the recent UK High Court ruling in *BritNed Development Ltd v ABB AB and ABB Ltd* [2018] EWHC 2616 (Ch). The Court opined, rightly or wrongly, that the expert's 'regression analysis is insufficiently reliable to be used in any way at all.' The expert 'defined too complex a regression, with the result that the outcomes [...] are so unspecific that they simply cannot be relied upon.'



Seminar paper

Implied contracts and implied terms Part 2 of 3

Jeffrey Goldberger*

1 SCOPE

This paper covers:

(1) contracts implied or inferred by conduct;
(2) implication of terms generally;
(3) the duty to co-operate in contract performance; and
(4) incorporation of terms by reference or by a course of dealing.

2 IMPLIED OR INFERRED CONTRACTS

2.1 General

There is ample authority both in England and Australia supporting the proposition that a contract may be implied or inferred from the acts and conduct of the parties as well as, or in the absence of, their words.

Further, the traditional analysis of contract formation based on the classic offer and acceptance framework no longer represents an exclusive foundation for determining the existence of contractual relations.

2.2 The principles

The authorities appear to establish the following broad principles.

(1) A contract may be implied or inferred from the acts and conduct of the parties even though it may not be possible to identify a clear offer coupled with an unconditional acceptance. The seminal Australian decision in this area is *Brambles Holdings Ltd v Bathurst City Council*.[50]

In his reasons for judgment Heydon JA referred to the following passage from the judgment of McHugh JA in *Integrated Computer Services Pty Ltd v Digital Equipment Corp (Aust) Pty Ltd*:[51]

It is an error 'to suppose that merely because something has been done then there is therefore some contract in existence which has thereby been executed'. Nevertheless, a contract may be inferred from the acts and conduct of parties as well as or in the absence of their words. The question in this class of case is whether the conduct of the parties, viewed in the light of the surrounding circumstances shows a tacit understanding or agreement. The conduct of the parties, however, must be capable of proving all the essential elements of an express contract.'

In respect of the traditional offer and acceptance analysis of contract formation Heydon JA noted at 74:

'Thus offer and acceptance analysis is a useful tool in most circumstances, and indeed is "normal" and "conventional" ... But limited recognition has been given to the possibility of finding that contracts exist even though it is not easy to locate an offer or acceptance.'

Heydon JA concluded by positing the following key question at 81:

'In the light of the above cases, it is relevant to ask: in all the circumstances can an agreement be inferred? Has mutual assent been manifested? What would a reasonable person in the position of the Council and a reasonable person in the position of the defendant think as to whether there was a concluded bargain?'[52]

It is also worth noting the following observations of Allsop P in *Branir Pty Ltd v Owston Nominees (No.2) Pty Ltd*[53] at 525:

'... a number of authorities discuss the need not to constrict one's thinking in the formation of contract to mechanical notions of offer and acceptance. Contracts often, and perhaps generally do, arise in that way. They can also arise when business people speak and act and order their affairs in a way without necessarily stopping for the formalities of dotting i's and crossing t's or where they think they have done so ... Sometimes this failure occurs because having discussed the commercial essentials and having put in place necessary structural matters, the parties go about their commercial business on the clear basis of some manifested mutual assent, without ensuring the exhaustive completeness of documentation.

'In such circumstances, even in the absence of clear offer and acceptance, and even without being able ... to identify precisely when a contract arose, if it can be stated with confidence that by a certain point the parties mutually assented to a sufficiently clear regime which must, in the circumstances, have been intended to be binding, the court will recognise the existence of

a contract. Sometimes this is said to be a process of inference or implication. For my part, I would see it as the inferring of a real intention expressed through, or to be found in, a body of conduct, including, sometimes, communications, even if it be the case that the parties did not consciously advert to, or discuss, some aspect of the relationship and say: "and we hereby agree to be bound" in this or that respect. The essential question in such cases is whether the parties' conduct, including what was said and not said and including the evident commercial aims and expectations of the parties, reveals an understanding or agreement or, as sometimes expressed, a manifestation of mutual assent, which bespeaks an intention to be legally bound to the essential elements of a contract.'

And in *Laidlaw v Hillier Hewitt Elsley Pty Ltd*[54] Macfarlan JA said at [5]:

'The decision of the House of Lords in *Brogden v Metropolitan Railway Co* (1876-77) 2 App Cas 666 establishes that the conduct of parties may give rise to a contract. It was made clear however that the character and circumstances of the conduct must indicate unambiguously that the parties intended to contract. For example the Lord Chancellor said about the conduct in question in that case that "no explanation can be given of it unless it refers to the contract in question" (at 678) and that the conduct was "referable in my mind only to the contract ..." (at 680). Lord Hatherley spoke in similar terms about the conduct:

'"It does establish a course of action on the part of the Plaintiffs of such a character as necessarily to lead to the inference on the part of the Defendants that the agreement had been accepted on the part of the Plaintiffs, and was to be acted upon by them; and they did act upon it accordingly (at 686)."'

(2) The acts and conduct relied upon as the basis of the inference or implication must be capable of proving all the essential elements of an express contract.

(3) The conduct relied upon must point to the existence of the particular contract in the terms alleged in the proceedings.[55]

(4) Where it is alleged that an informal agreement was made by or on a certain date, the conduct of the parties including conduct after that date may be considered in deciding whether a contract has been concluded.[56]

(5) A contract will only be inferred where the evidence is clear and such a conclusion is a necessary inference from the proven facts.[57]

The most recent significant appellate authority dealing with implied contracts is the decision of the New South Wales Court of Appeal in *CSR Limited v Adecco (Australia) Pty Limited.*[58]

I turn to the facts.

On 1 April 2000, Adecco entered into an agreement with CSR described as a Supply Agreement for Labour Hire Services. The initial term of the agreement was two years with CSR having an option to extend for a maximum of two years. The agreement incorporated an indemnity under which Adecco agreed to indemnify CSR against any claim by Temporary Staff for personal injury arising out of or in connection with performance of so called Assignment duties.

A Mr David Frewin who was an employee of Adecco Industrial Pty Limited drove a truck at CSR's Batemans Bay concrete plant. The driver's seat in the particular cement mixer truck which Mr Frewin drove lacked the suspension of other seats in similar vehicles causing Mr Frewin to suffer pain in his lower back. He drove the truck from approximately September 2002 until March 2003 but continued to work at the Batemans Bay plant until he was dismissed in December 2004.

Mr Frewin commenced proceedings against Adecco Industrial seeking damages for breach of contract and by an amendment to his Statement of Claim, CSR was joined as a defendant. In a Cross Claim CSR sought indemnity from Adecco Australia under the 2000 Labour Hire Agreement. Relevantly, that agreement expired in March 2002 but was extended by agreement until 30 June 2002 and then until 31 July 2002. Between June 2002 and May 2004 the parties unsuccessfully endeavoured to negotiate the terms of a new agreement. Adecco contended that post-July 2002 the indemnity ceased to be part of any agreement between the parties. Conversely, CSR's primary submission was that after the 2000 Agreement expired there was an implied contract between the parties for the supply of labour hire services by Adecco Australia to CSR on the same terms and conditions as had previously been the subject of a fixed term contract save only as to duration.

The primary Judge considered that the facts gave rise to the following three possibilities:

(1) either CSR exercised its option to extend the agreement or the parties agreed, by their conduct, to extend their further agreement;

(2) the parties allowed the Agreement to expire at the end of July 2002 but Adecco continued to provide labour on a quantum meruit basis;

(3) the parties by their conduct agreed to continue to comply with some of the terms of the agreement even though it had not been formally extended. These terms dealt with payment but did not include insurance and indemnity.

The primary Judge held that post-July 2002 the relationship between Adecco and CSR continued on a more basic footing under which Adecco supplied the labour and CSR paid amounts stipulated in the expired Agreement. Insurance and indemnity were left to be agreed on another day.

The Court of Appeal in reversing the primary Judge held that there was an implied contract between the parties post-July 2002 on the terms of the expired Agreement.

McColl JA in delivering the principal judgment of the Court first identified the relevant test for determining the existence of an implied contract. Her Honour said:

'[120] As is apparent from the authorities to which I have referred, and as both parties accepted, the question whether an implied contract following upon the expiry of an express fixed

term contract may be inferred turns on an objective inquiry. This was the approach the Court of Appeal took in *Brambles* where their Honours clearly adopted the objective formulation of the test from *Steed v Busby* to which they referred. Adapting the language of McHugh JA in *Empirnall,* 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 was "required [was] conduct by the parties as if the contract remained on foot". Whether the inference will be drawn is "an evidentiary or factual question".'

In dealing with the approach of the primary Judge her Honour said:

'[124] The primary judge, with respect, failed to apply the objective, or reasonable bystander, test. Rather, it is apparent that her Honour was of the view that, in order to infer there was an implied contract under which the Agreement was extended, it was necessary to identify communications between the parties "confirm[ing] the terms of their continuing relationship pending further agreement". To the extent this statement implies the parties had to refer expressly to the contract continuing, it flies in the face, with respect, of the notion of an implied contract.

'[125] What CSR had to establish was that the parties continued to act as though the Agreement still bound them after the term expired. In such a case the Court may infer that the parties have agreed to renew the express contract for another term or the Court may infer an implied contract drawing on some of the terms of the earlier contract, but omitting others. As the Supreme Court of Arkansas held in *Steed v Busby*, "[w]hen an agreement expires by its own terms, if without more the parties continue to perform as before, an implication arises that they have mutually assented to a new contract containing the same provisions as the old …".

'[126] As CSR submitted, the parties to the Agreement were "sizeable and sophisticated entities" which contracted for the supply to CSR by Adecco Australia of labour for a substantial return, including, in the nine months following the expiry of the Agreement, an amount of $13.285 million. The primary judge recognised the value of the Agreement to Adecco Australia when her Honour found that there was a commercial benefit to it in continuing to provide labour hire services after the expiry of the Agreement, notwithstanding the lack of express extension by CSR, as it would thereby circumvent the public tendering process that would be likely to apply if there was a fresh contract. Such a finding was, in my view, a strong foundation for the inference that, in such circumstances, Adecco Australia would be concerned not to 'rock the boat' by departing from the terms of the Agreement in continuing to provide its services.

'…

'[129] The primary judge held that, notwithstanding the fact that CSR continued to pay Adecco Australia according to the same terms and conditions as in the Agreement until October 2002, that fact did not permit a distinction to be drawn between the three possibilities concerning the relationship between the parties after the expiry of the Agreement.

'[130] In so doing, her Honour failed, with respect in my view, to have regard to the commercial realities of the parties' relationship to which I have already referred. The parties' conduct was consistent with them acting as though the Agreement still bound them. It does not conform with commercial reality, in my view, to suggest that after the Agreement expired, notwithstanding that labour continued to be supplied and paid for, and Adecco Australia was anxious to continue to provide its services in order to circumvent a public tendering process that would be likely to apply if there was a fresh contract, no inference was available that the terms of the Agreement continued to apply to the relationship. It 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".

'[131] Neither the primary judge, with respect, nor Adecco Australia, in my view, identified any conduct of the parties which supported theoretical possibilities (2) and (3), each of which involved a departure from the terms of the Agreement. In my view, the alternative possibilities would have required evidence of conduct indicating the parties intended to so act. Neither the primary judge nor Adecco Australia pointed to any such conduct.'

And her Honour concluded:

'[150] In my view, the course of conduct between CSR and Adecco Australia in the relevant period supported the proposition that the parties continued to act as if bound by the Agreement, including cl 23.2. I cannot discern the basis upon which the primary judge found that after 31 July 2002 they intended to conduct their relationship "on a more basic footing", involving no more than payment of the amounts stipulated in the Agreement, in return for labour supply, but in effect disregarding or leaving to future agreements the "finer points of insurance and indemnity". As CSR contended, this was, in effect, an unrealistic conclusion suggesting the parties intended to continue doing business in a state of uncertainty, a conclusion inconsistent with the commercial realities of the parties' relationship.'

2.3 Implied contracts under English law

The approach of the English courts to implied contracts has developed consistently with their approach to the implication of terms, that is, on a necessity basis. The focus of analysis is thus somewhat different to that adopted by the Australian courts.

The decision of the English Court of Appeal in *Baird Textile Holdings Limited v Marks & Spencer PIc*[59] is illustrative of the approach of the English courts.

I turn to the facts.

Baird had been one of the principal suppliers of garments to Marks & Spencer (M&S), for 30 years. On 19 October 1999 M&S, without warning, terminated all supply arrangements between them with effect from the end of the then current production season.

At no time had the parties entered into any formal written contract.

Baird asserted the existence of an implied contract and sought damages for breach.

In its particulars of claim, Baird averred the following:

'Marks & Spencer deliberately abstained from concluding any express contract or contracts with BTH either to regulate the parties' on-going relationship or their respective rights and obligations season by season because it considered that it could thereby achieve much greater flexibility in its dealings with BTH than could be achieved under a detailed contract or contracts. The absence of such an express contract or contracts was accepted by BTH because, as Marks & Spencer knew and intended or ought to have known, BTH understood from the above pleaded conduct of Marks & Spencer that there existed a relationship between the two companies which was to continue long term and be terminable only on the giving of reasonable notice and under which the parties had the reciprocal rights and obligations pleaded in paragraph 9 above.'

In the alternative to implied contract, Baird pleaded an estoppel by convention.

The trial judge rejected Baird's implied contract case noting that a court would only imply a contract based on the conduct of the parties if it were necessary to do so. The trial judge went on to note that it would be fatal to the implication of a contract that the parties would or might have acted as they did without any such contract. In other words, it must be possible to infer a common intention to be bound by a contract which has legal effect. If there were no such intent the claim would fail. The Court of Appeal held that Baird's claims based on both contract and estoppel had no real prospect of success and that in the circumstances a summary judgment should be entered for M&S.

Turning specifically to the implied contract claim.

Mance LJ made the following observation:

'For a contract to come into existence, there must be both (a) an agreement on essentials with sufficient certainty to be enforceable and (b) an intention to create legal relations.

'Both requirements are normally judged objectively. Absence of the former may involve or be explained by the latter. But this is not always so. A sufficiently certain agreement may be reached, but there may be either expressly (ie, by express agreement) or impliedly (eg, in some family situations) no intention to create legal relations.

'An intention to create legal relations is normally presumed in the case of an express or apparent agreement satisfying the first requirement ... It is otherwise, when the case is that an implied contract falls to be inferred from parties' conduct: ... It is then for the party asserting such a contract to show the necessity for implying it. As Morison J said, if the parties would or might have acted as they did without any such contract, there is no necessity to imply any contract. It is merely putting the same point another way to say that no intention to make any such contract will then be inferred.

'That the test of any such implication is necessity is, in my view, clear ... It could not be right to adopt a test of necessity when implying terms into a contract and a more relaxed test when implying a contract — which must itself have terms.

'...

'Objectively, the only sensible analysis of the present situation is in my judgment that the parties had an extremely good long-term commercial relationship, but not one which they ever sought to express, or which the court would ever seek to express, in terms of long-term contractual obligations. The upshot is that I agree with the judge's conclusion that there was never here any agreement on essentials.'

2.4 Implied contracts and 'subject to contract' provisions

One of the principal sources of dispute relates to the commencement of performance of work or services without first putting in place an appropriate contract governing such performance. To accommodate the absence of a contract parties may agree to commence performance on the basis of a binding letter of intent designed to operate for a limited period and on limited terms pending the conclusion of final contract negotiations and the entry into of a final contract.

The problem is compounded where the parties agree that no final contract will come into existence until the execution of a formal document.

This problem is illustrated by the decision of the Court of Appeal of Victoria *PRA Electrical Pty Ltd v Perseverance Exploration Pty Ltd.*[60]

Perseverance was the owner of a gold mine near Bendigo in Victoria. PRA was an electrical contractor.

On 2 July 2004 Perseverance's project manager, Cullen, invited PRA to tender for major electrical works.

The tendered document included special and general conditions of contract. Relevantly SC4 headed 'Evidence of Contract' provided that GC6 was deleted and replaced with the following:

'The Contract shall not come into effect until the formal instrument of agreement (Conformed Contract Document) is executed by the parties.'

On 16 August 2004 Perseverance sent a letter of award to PRA.

As noted by Ashley JA, the conduct of the parties after 16 August 2004 included the following:

- Weekly site meetings were held, attended by representatives of PRA and Cullen. The first of them was held on 19 August. At that meeting, *inter alia*, PRA advised that it was organising the

security required under the contract, Cullen explained the process of progress payment certificates and tax invoices for which the contract provided, and Cullen undertook to provide PRA with updated milestone dates for access to the various areas on site. Cullen, it was also recorded, was collating all the latest documents — scope of works, drawings, schedules — for forwarding to PRA.

• Perseverance gave PRA possession of the site — although not, according to PRA, in accordance with the tender.

• PRA's workmen came on site and from early September 2004 performed works which — subject to the disputes which arose - were undertaken in accordance with the provisions of the tender and the further documents listed in the 16 August letter.

• On 25 August 2004, PRA gave bank guarantees in accordance with the correspondence of 30 July and 2 August. It renewed a guarantee as late as 23 August 2005. PRA had agreed to submit the guarantees to Perseverance, and they were directed to the latter. Absent any suggestion that Perseverance did not receive them, it is an inevitable inference — the material before the Court does not permit a direct finding — that it did so, and accepted them.

• PRA provided a construction programme, on 26 November, which was an update of the construction programme that had been provided on 2 August. By late November, completion times had been enlarged — at least in part, it may be conjectured, by reason of variations to the works.

• PRA made requests that Cullen give directions for contract variations as contemplated by GC36.

• PRA issued progress claims, and sought payment under the general conditions. It sought to rely upon 'our contract'.

• PRA relied upon GC34 'of our contract' to notify delays to the works.

• Cullen, as agent for Perseverance, superintended the performance of work by PRA.

• On 21 December, Perseverance issued a show cause notice to PRA reliant on 'cl 39.2 of the Contract'.

• On 23 December PRA responded substantively, notwithstanding that it referred to having received advice that the notice was defective for the purposes of 'cl 39.2'. In its response, PRA said, *inter alia*, that 'the Principal issued the Contract and this occurred on 17 August 2004'. It made other references to 'the contract'.

• On 27 May 2005 PRA gave notice of dispute in respect of the work being taken out of its hands. That was the procedure authorised by GC42.1. Under the heading 'Background', the notice stated, inter alia, that 'the parties entered into a contract on 16 August 2004.' Thereafter in the document it was claimed that 'the Principal has breached the Contract'.

No formal instrument of agreement was ever executed by the parties.

Work ceased on or about 30 December 2004 when Perseverance gave notice to PRA that it, Perseverance, was taking the work out of the hands of PRA. PRA gave a notice of dispute and following some negotiations the parties agreed upon the appointment of an arbitrator.

In proceedings commenced in December 2005 PRA sought, *inter alia*, the following:

• a declaration that at no time did Perseverance and PRA enter into a binding contract;

• that there was no arbitration agreement between the parties; and

• an injunction restraining the arbitrator from taking any further step in the arbitration.

The short point was whether there was an implied contract despite the terms of SC4.

The Court of Appeal held that such an implied contract existed comprising the general and special conditions as set out in the tender form except Special Condition 4.

Ashley JA noted:

'57. In my opinion, implied contract does provide the appropriate characterisation of the events which occurred, and no reason has been demonstrated why this Court should remit the issue for the delivery of pleadings, the taking of evidence, and then determination by the learned trial judge. To be clear, I consider, for reasons which I will develop, that PRA's further submissions should be rejected. The implied contract, I consider, was in the terms of the documents identified in the 16 August letter, except that it did not include SC4. The preferable view, in my opinion, is that such agreement commenced on 25 August 2004, or at latest within a day or so thereafter.'

And later his Honour noted:

'68. I have already described in considerable detail the way in which the parties behaved after 17 August 2004. I should say that the objective bystander, considering such conduct, and being apprised of the contents of the documents identified by the 16 August letter — including SC4 — would conclude that the parties had by intent entered into a binding and operative agreement notwithstanding that no conformed contract document had been prepared and executed; and that the terms of the agreement — absent SC4 — were to be found in the documents identified by the 16 August letter. So much, it would be concluded, was discernible from the conduct of each of the parties — whether it be the undertaking of obligations or the reaping of benefits.

'75. If the conduct of the parties on 16 and 17 August had been considered by an independent observer at that time, eschewing the significance of later occurring events, I should say that the observer would not have then been satisfied that a contract was operative between the parties. It might have been concluded that their conduct was consistent with, although it did not bespeak, SC4 having effect. The same might be said of the events which occurred at the site meeting on 19 August.

'76. But moving forward to 25 August, PRA arranged for the giving of bank guarantees referable to contract FCC 306. That

was the contract to which the tender document related. It was a feature of the tender conditions that security should be given. The guarantees which were given were consistent with correspondence which had passed between the parties, and which was part of the documentation identified by the letter of 16 August. That correspondence had noted a requirement, accepted by PRA, that the latter submit guarantees within 28 days of award of tender. The objective observer would note that, since the award of tender had not been converted into a conformed contract document, the effect of SC4 was that PRA had been under no obligation to provide the guarantees. The fact that PRA had in fact provided the guarantees, which at least inferentially Perseverance had accepted, the observer would think, was a powerful indication that a contract was operative in the terms of the documents identified by the 16 August letter, but excepting SC4. In so concluding, the observer would be entitled to take into account, although in the particular instance I do not think it would be necessary, such colour as might be provided by earlier circumstances — I refer particularly to the events at the site meeting held on 19 August — even though such events if considered at that earlier time had been equivocal'.

3 IMPLICATION OF TERMS

3.1 Basis for implication of a term

The starting point is the decision of Heydon JA in *Brambles Holdings Limited v Bathurst City Council*[61] in which his Honour stated as his fifth relevant principle that terms may be implied in one of four ways. In this context His Honour referred with manifest approval to an interlocutory judgment by Hodgson J which was cited by Young J as the trial judge in *Carlton & United Breweries Ltd v Tooth & Co Ltd.*[62] Young J in quoting from Hodgson J's judgment said:

'A more precise classification of the different types of implied terms was given by Hodgson J in his first interlocutory judgment in the current proceedings. His Honour set out four classes of implied terms, the first two of which are in the class of terms implied in law, the second two the implied terms in fact. His Honour said:

"There is a spectrum of different types of implied terms covering, inter alia, the following:

(i) Implications contained in the express words of the contract: see *Marcus Clarke (Vic) Ltd v Brown* (1928) 40 CLR 540 at 553-4.

(ii) Implications from the 'nature of the contract itself' as expressed in the words of the contract: see *Liverpool City Council v Irwin* [1977] AC 239.

(iii) Implications from usage (for example, mercantile contracts).

(iv) Implications from considerations of business efficacy: see *BP Refinery (Westernport) Pty Ltd v Hastings Shire Council* (1977) 52 ALJR 20 at 26; Codelfa Construction Pty Ltd v State Rail Authority of NSW (1982) 149 CLR 337."'

Young J added the following comment at 606:

'The first observation that should be made about this is that the business efficacy considerations that are applicable to terms implied in fact do not apply to these first two categories which are usually classified as terms implied as a matter of law. This is made clear by Mason J in *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1982) 149 CLR 337 at 345.'

3.2 Implication ad hoc

This form of implication is supposedly based upon the presumed common intention of the parties. The underlying theory is that the parties having left a gap in their contract would, upon its discovery, point to an omitted term so obvious in its content that it went without saying. However that is pure theory. In this context Priestly JA noted in *Renard Constructions (ME) Pty Ltd v Minister for Public Works*[63] at 255:

'In recent years terms implied in contracts have been said to fall into two classes the first of which has come to be called, somewhat misleadingly, implication in fact, the second, implication by law. The so-called implication in fact is really implication by judge based on the judge's view of the actual intention of the parties drawn from the surrounding circumstances of the particular contract, its language, and its purposes, as they emerge from the language and in the circumstances. This has been called implication ad hoc ...'

Mason J in *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*[64] added a cautionary note in respect of the process of implication as follows:

'For obvious reasons the courts are slow to imply a term. In many cases, what the parties have actually agreed upon represents the totality of their willingness to agree; each may be prepared to take his chance in relation to an eventuality for which no provision is made. The more detailed and comprehensive the contract the less ground there is for supposing that the parties have failed to address their minds to the question at issue. And then there is the difficulty of identifying with any degree of certainty the term which the parties would have settled upon had they considered the question.

'Accordingly, the courts have been at pains to emphasise that it is not enough that it is reasonable to imply a term; it must be necessary to do so to give business efficacy to the contract.'

Further, in *Codelfa* Mason J reaffirmed the conditions for implication ad hoc as set out by the Privy Council in *BP Refinery (Western Port) Pty Ltd v Hastings Shire Council.*[65] In order to be implied a proposed term must satisfy the following requirements:

(1) it must be reasonable and equitable;

(2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it;

(3) it must be so obvious that 'it goes without saying';

(4) it must be capable of clear expression; and

(5) it must not contradict any express term of the contract.

Barrett J in *Equity 8 Pty Ltd v Shaw Stockbroking Ltd*[66] noted the need for caution in implying a term. Relevantly, his Honour cited the following passage from the reasons for judgment of Kirby J in *Roxborough v Rothmans of Pall Mall Australia Ltd*:[67]

'Whatever may be the precise legal criterion for implying terms into a contract upon which the parties have not expressly agreed, it would always be necessary for a court of our legal tradition to be very cautious about the imposition on the parties of a term that, for themselves, they had failed, omitted or refused to agree upon. Such caution is inherent in the economic freedom to which the law of contract gives effect. Absent some statutory or equitable basis for the intervention, it is ordinarily left to the parties themselves to formulate any agreement to which they consent to be bound in law.'

In *Renard* Priestley JA addressed the 'business efficacy' test. In that case the question was whether the following termination clause was subject to an implied term as to reasonableness:

'44.1 If the Contractor fails within the period specified in the notice in writing to show cause to the satisfaction of the Principal why the powers hereinafter contained should not be exercised the Principal ... may:

(a) take over the whole of the work ... and ... exclude from the site the Contractor ... or

(b) cancel the contract ...

'The short point was whether or not the Principal was required to act reasonably in relying on the subclause.'

In dealing with the 'business efficacy' requirement Priestley JA noted at 257:

'The question of "effectiveness" will only come up when a dispute has arisen about the way a contract is to work, and one party is saying that a term needs to be implied which will produce what that party claims is a fair (or reasonable, or proper, or just) way of resolving the dispute, and the other party is saying that the contract can work (which implicitly means "for practical purposes" or fairly, reasonably, properly or justly) without the claimed implied term. In such cases the opposing parties will adopt different views of what amounts to effectiveness so far as their contract is concerned.'

And later:

'The overriding purpose of the contract from both the contractor's and the principal's point of view is to have the contract work completed by the contractor in accordance with the contract, in return for payment by the principal in accordance with the contract. The insertion of a subclause such as subcl. 44.1 not subject to the constraint of reasonable use by the principal is quite inconsistent with all the main contractual promises by each party to the contract to the other. The contract can in my opinion only be effective as a workable business document under which the promises of each party to the other may be fulfilled, if the subclause is read in the way I have indicated, that is, as subject to requirements of reasonableness.'

Each of the conditions for the implication of a term was thoroughly analysed by Einstein J in *New South Wales v Banabelle Electrical Pty Ltd*.[68] In relation to the 'business efficacy' requirement Einstein J endorsed Priestly JA's approach in *Renard*. Having reviewed all the authorities Einstein J concluded as follows at 49:

'To my mind, these authorities indicate that the requirement that a term be 'necessary to give business efficacy to the contract' does not mean that the term must be so necessary that without the term the contract would, for all purposes be ineffective, but that the term must be necessary to make the contract effective and workable according to the presumed intention of the parties, as disclosed by the terms of the contract and the admissible surrounding circumstances.'

An illustration of the process of implication ad hoc is provided by the Western Australia Court of Appeal in *Technology Management and Marketing Pty Ltd v Hydrocool Pty Ltd*.[69]

The plaintiff provided certain services to the defendant in connection with the procurement of a Commonwealth grant. The defendant had previously procured a 'start grant' in respect of an earlier project.

The relevant letter agreement entered into on 23 September 2003 contained the following paragraph in respect of payment of fees:

'Option 1

'The upfront fee is $11,000 (GST incl) payable in two instalments. The first instalment of $2,200 is payable when you accept our proposal. The second instalment of $8,800 is payable on lodgement of the application.

'If grant funding is approved, the success fee is 7.5% of the amount approved (plus GST). This success fee may be paid in instalments as grant payments are received.'

Option 2 in the letter agreement was irrelevant for the purposes of the proceedings.

On 23 March 2004 Ausindustry approved a start grant of some $1,943,037 and on 13 May 2004 the defendant entered an agreement with the Commonwealth.

In May 2004 the defendant received $283,429.30 from Ausindustry.

On 3 January 2005, the Executive Chairman of the defendant wrote to the plaintiff stating that the defendant was having discussions with the Commonwealth with a view to suspending the implementation of the grant for up to a year, but in the meantime the defendant did not propose to apply for any further funds pursuant to the grant. Ultimately on 26 July 2006 the defendant and the Commonwealth entered into a deed terminating the grant agreement.

The plaintiff submitted an invoice for the balance of the success fee less the part it had already received.

The plaintiff made two submissions.

First, the defendant was required to pay the success fee in full upon approval although the plaintiff would accept payment in

instalments as the grant payment instalments were received by the defendant.

Secondly, there was an implied term that if the respondent failed for any reason attributable to the conduct of the respondent to receive any further grant payment instalments, the balance of the success fee outstanding at that time had to be paid in full by the respondent to the appellant within a reasonable period after that time.

The primary judge rejected both submissions.

In reversing the primary judge Pullin JA noted:

'18 The trial judge's conclusion in [38] concentrates on when the success fee was payable. That conclusion must have followed from an undue concentration on the second sentence in the fee clause which unquestionably dealt with the subject of payment. When it was payable was a different question from when the success fee fell due. When it fell due was the subject of the first sentence. Although it is always necessary when construing an agreement to have regard to the whole of the agreement, this rule of construction does not require the conflation of two separate provisions.'

And in supporting the implied term his Honour noted:

'23 However, the trial judge's reasons and the respondent's submissions did not take into account the conclusion reached above about the correct construction of the fee clause, namely, that upon approval, the success fee then became due (meaning owing) by the respondent to the appellant. In those circumstances, the implied term contended for was necessary to give business efficacy to the contract. It would have been obvious to the parties at the time the agreement was signed, that if the appellant performed all its services and if the success fee fell due, and if the respondent exercised its right to pay by instalments, that the parties would have agreed that the balance of the fee should become payable if the grant instalments were not made as a result of conduct solely attributable to the respondent. It would be reasonable and equitable to imply such a term because it would supply the means of ensuring that the appellant recovered the money which was due and owing to it in circumstances where it had performed all the services required of it.'

Subsequently in *Regreen Asset Holdings Pty Ltd v Castricum Brothers Australia Pty Ltd*[70] the Court of Appeal of Victoria having considered the decision of the High Court in *Commonwealth Bank of Australia v Barker*[71] said:

'76 Later in their judgment, French CJ, Bell and Keane JJ made further reference to the issue of whether implication of a term is to be regarded as an exercise in the construction of a contract without making any definitive pronouncement. While the two processes have not been authoratively equated, it is clear that they share some common features.

'78 A contractual term implied as a matter of fact is specific to the contract in question, and derives from the court's view of the intention of the parties.

'79 We listed the five conditions in the BP Test for implying a term at [62] above. We will now consider those that are relevant to the present application in greater detail'.

3.3 Implied terms and inferred terms; is there a difference?

There has been some discussion in the Australian cases as to whether there is a difference of substance between the concept of an implied term and the concept of an inferred term. Most recently in *Masters Home Improvement Pty Ltd (formerly Shellbelt Pty Ltd) v North East Solution Pty Ltd,*[72] the Victorian Court of Appeal noted:

'[59] The distinction between implied and inferred terms is not always easy to identify. Inferred terms are those which "can properly be inferred from all the circumstances as having been included in the contract as a matter of actual intention of the parties". On the other hand, the implication of terms is directed to what the parties would have agreed upon had they turned their minds to it at the time they entered into the contract. Some of the authorities speak of a two stage process for the identification of the terms of the contract and observe that the two stages may overlap — first, inference of terms based on actual intention and secondly, implication of terms based on presumed intention.

'[60] In *Byrne v Australian Airlines Ltd,*[73] McHugh and Gummow JJ considered that, where a contract was not in writing and was oral or partly oral, or it appeared that the parties had not reduced their agreement to a complete written form, courts should exercise caution and avoid an automatic or rigid application of the conditions set out above for implying terms. They observed:

'"In such situations, the first task is to consider the evidence and find the relevant express terms. Some terms may be inferred from the evidence of a course of dealing between the parties. It may be apparent that the parties have not spelled out all the terms of their contract, but have left some or most of them to be inferred or implied."

'[61] As observed in *Grocon,*[74] the case law dealing with when terms will be inferred concerns contracts where not all the terms are in writing and will have limited application to detailed written contracts between experienced and sophisticated commercial parties.'

Also in *Byrne,* McHugh and Gummow JJ, having considered the comments of Deane J in *Hawkins v Clayton,*[75] said at 573:

'If the contract has not been reduced to complete written form, the question is whether the implication of the particular term necessary for the reasonable or effective operation of the contract in the circumstances of the case; only where this can be seen to be true will the term be implied.'

Their Honours also stated at 446:

'In contracts of this nature, apparently lacking written formality and detailed specificity, it still is necessary to show that the term in question would have been accepted by the contract-

ing parties as a matter so obvious that it would go without saying. That cannot be postulated here.'

3.4 Terms implied by law

The High Court has recognised the distinction between implication in fact and implication in law. That distinction was clearly captured by the following passage in the reasons for judgment of Gaudron and McHugh JJ in *Breen v Williams*[76] at 102:

'The common law draws a distinction between terms which are implied in fact and terms which are implied by law. Leaving aside terms that are presumed to apply because of the custom of a trade or business, the courts will only imply a term in fact when it is necessary to give efficacy to the contract. A term implied in fact purports to give effect to the presumed intention of the parties to the contract in respect of a matter that they have not mentioned but on which presumably they would have agreed should be part of the contract. A term implied by law on the other hand arises from the nature, type or class of contract in question. Some terms are implied by statutes in contracts of a particular class, for example, money lending and home building contracts. Such terms give effect to social and economic policies which the legislature thinks are necessary to protect or promote the rights of one party to that class of contract. Other terms are implied by the common law because although originally based on the intentions of parties to specific contracts of particular descriptions, they "became so much a part of the common understanding as to be important to all transactions of the particular description".'

One of the difficult questions is how to determine at what point a term first becomes identifiable as a term to be implied as a matter of law in a particular class of contract. In *Byrne* McHugh and Gummow JJ, in considering the basis for implication by law, noted at 450:

'Many of the terms now said to be implied by law in various categories of case reflect the concern of the courts that, unless such a term be implied, the enjoyment of the rights conferred by the contract would or could be rendered nugatory, worthless, or perhaps, be seriously undermined. Hence, the reference in the decisions to "necessity".'

The touchstone therefore appears to be 'necessity'. Thus McHugh and Gummow JJ continue:

'This notion of "necessity" has been crucial in the modern cases in which the courts have implied for the first time a new term as a matter of law.'

One other important point emerges from *Byrne*. The High Court recognises that there is force in the suggestion that terms that would now be classified as terms implied by law in particular classes of contract had their origin as implications based on the intention of the parties, but had become so much part of the common understanding in the particular class of contract as to be imported into all contracts of that class. Assuming that this is the proper basis for the development of such an implication, a question arises as to whether the parties may by agreement exclude such an implied term.

In this context McHugh and Gummow JJ in *Byrne* noted at 449:

'This understanding of the matter is consistent with the proposition that terms of this kind, although treated as implied by law, may be excluded by express provision made by the parties and also as a result of inconsistency with terms of the contract. The result is that, even if treated as rules of law, they only apply in the absence of an expression of contrary intent.'

This conclusion is most important in relation to the proper approach to the implication of a duty of good faith as a matter of law.

In *Commonwealth Bank of Australia v Barker*[77] the High Court revisited the relationship between implication in law and implication in fact. Relevantly, the plurality stated:

'[28] An implication in law may have evolved from repeated implications in fact. As Gaudron and McHugh JJ observed in *Breen v Williams,* some implications in law derive from the implication of terms in specific contracts of particular descriptions, which become "so much a part of the common understanding as to be imported into all transactions of the particular description". The two kinds of implied terms tend in practice to "merge imperceptibly into each other". That connection suggests, as is the case, that the "more general considerations" informing implications in law are not so remote from those considerations which support implications in fact as to be at large. They fall within the limiting criterion of "necessity", which was acknowledged by both parties to this appeal. The requirement that a term implied in fact be necessary "to give business efficacy" to the contract in which it is implied can be regarded as a specific application of the criterion of necessity. The present case concerns an implied term in law where broad considerations are in play, which are not at large but are not constrained by a search for what "the contract actually means".

'[29] In *Byrne v Australian Airlines Ltd,* McHugh and Gummow JJ emphasised that the "necessity" which will support an implied term in law is demonstrated where, absent the implication, "the enjoyment of the rights conferred by the contract would or could be rendered nugatory, worthless, or, perhaps, be seriously undermined" or the contract would be "deprived of its substance, seriously undermined or drastically devalued". The criterion of "necessity" in this context has been described as "elusive" and the suggestion made that "there is much to be said for abandoning" the concept. *Necessity does, however, remind courts that implications in law must be kept within the limits of the judicial function. They are a species of judicial law-making and are not to be made lightly. It is a necessary condition that they are justified functionally by reference to the effective performance of the class of contract to which they apply, or of contracts generally in cases of universal implications, such as the duty to co-operate. Implications which might be thought reasonable are not, on that account only, necessary. The same constraints apply whether or*

not such implications are characterised as rules of construction.' (emphasis added)

Kiefel J said:

'[85] ... The requirement of necessity for the implication of a term in a contract, or a contract of a particular kind, cannot be brushed aside as "elusive". It is fundamental to the basis for implications. It is not uncertain. It has the meaning referred to in *Irwin* and in *Byrne*. It has the advantage of providing objectivity to the test employed by the courts.'

And Gageler J said:

'[114] Determination by a court of whether or not a new term should be implied in law into a particular class of contracts has often itself been described as involving the application of a "test" of "necessity". The sense in which "necessity" is used in this context is that of "something required in accordance with current standards of what ought to be the case, rather than anything more absolute". The requisite inquiry is informed by a consideration of what is needed for the effective working of contracts of that class. But the inquiry is not exhausted by that consideration; it does not exclude considerations of justice and policy. Couching the ultimate evaluation in terms of necessity serves usefully to emphasise this and no more: that a court should not imply a new term other than by reference to considerations that are compelling'.

There has also been some debate in the Australian case law as to the status of good faith as a term implied into commercial contracts. The approach adopted by the New South Wales Court of Appeal is, however, significantly different from that adopted by the Victorian Court of Appeal.

In *Alcatel Australia Ltd v Scarcella,*[78] Sheller JA (Powell JA and Beazley JJA agreeing) said at 369:

'The decisions in *Renard Constructions* and *Hughes Bros* mean that in New South Wales a duty of good faith, both in performing obligations and exercising rights, may by implication be imposed upon parties as part of a contract. There is no reason why such a duty should not be implied as part of this lease.'

Subsequently, in *Burger King Corporation v Hungry Jack's Pty Limited*[79] the Court of Appeal noted:

'159 A review of cases since Alcatel indicates that courts in various Australian jurisdictions have, for the most part, proceeded upon an assumption that there may be implied, as a legal incident of a commercial contract, terms of good faith and reasonableness.'

Finally, in *Cordon Investments Pty Ltd v Lesdor Properties Pty Ltd*[80] Bathurst CJ (Macfarlan and Meagher JJA agreeing) said at 144:

'Lesdor did not dispute that it was appropriate to imply into the Agreement an obligation that the parties would act in good faith towards each other. That is consistent with the approach adopted in a number of decisions of this court: *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234; *Burger King Corporation v Hungry Jack's Pty Ltd* [2001] NSWCA 187; (2001) 69 NSWLR 558 at [186]; *Alcatel Australia Ltd v Scarcella* (1998) 44 NSWLR 349 at 369; *United Group Rail Services Ltd v Rail Corporation* (NSW) [2009] NSWCA 177; (2009) 74 NSWLR 618 at [58]-[61]; *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service* [2010] NSWCA 268 at [11]-[12], [146]-[147]. However, these decisions have emphasised that the obligation does not require a party to act in the interests of the other party or subordinate its own legitimate interests to those of the other party, although it does require it to have due regard to the rights and interests of the other party. The necessity for the implication of such terms in commercial contracts has not been universally accepted: *Service Station Assn Pty Ltd v Berg Bennett & Associates Pty Ltd* (1993) 45 FCR 84 at 91-98; *Royal Botanic Gardens & Domain Trust v South Sydney City Council* [2002] HCA 5; (2002) 240 CLR 45 at [88], [155]. However, it is not necessary to discuss the matter further in the present case.'

Thus it would appear that in New South Wales a duty of good faith will be implied into commercial contracts as a matter of law.

In the leading Victorian Court of Appeal decision in *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum* NL81 Warren CJ said:

'[3]If a duty of good faith exists, it really means that there is a standard of contractual conduct that should be met. The difficulty is that the standard is nebulous. Therefore, the current reticence attending the application and recognition of a duty of good faith probably lies as much with the vagueness and imprecision inherent in defining commercial morality. The modern law of contract has developed on the premise of achieving certainty in commerce. If good faith is not readily capable of definition then that certainty is undermined. It might be that a duty of good faith is no more than a duty to act reasonably in performance and enforcement, a long established duty. Of course, some commentators have regarded the duty to act reasonably as properly subsumed within the duty of good faith.

'[4] Ultimately, the interests of certainty in contractual activity should be interfered with only when the relationship between the parties is unbalanced and one party is at a substantial disadvantage, or is particularly vulnerable in the prevailing context. Where commercial leviathans are contractually engaged, it is difficult to see that a duty of good faith will arise, leaving aside duties that might arise in a fiduciary relationship. If one party to a contract is more shrewd, more cunning and outmanoeuvres the other contracting party who did not suffer a disadvantage and who was not vulnerable, it is difficult to see why the latter should have greater protection than that provided by the law of contract.'

And Buchanan JA said:

'[25] I am reluctant to conclude that commercial contracts are a class of contracts carrying an implied term of good faith as a legal incident, so that an obligation of good faith applies indiscriminately to all the rights and power conferred by a commer-

cial contract. It may, however, be appropriate in a particular case to import such an obligation to protect a vulnerable party from exploitive conduct which subverts the original purpose for which the contract was made. Implication in this fashion is perhaps ad hoc implication meeting the tests laid down in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings,* rather than implication as a matter of law creating a legal incident of contracts of a certain type.'

In *Specialist Diagnostic Services Pty Ltd v Healthscope Ltd,*[82] the Victorian Court of Appeal noted:

'[86] We do not accept that an obligation of good faith should be implied indiscriminately into all commercial contracts.'

3.5 Construction of the express terms

A convenient starting point for a discussion of this aspect of implication is to be found in the following passage in the joint judgment of Allsop P and Sackville AJA in *Gordon & Gotch Australia Pty Ltd v Horwitz Publications Limited*[83] at 36:

'Interpretation is the ascertainment of the meaning which a document would convey to a reasonable person in the context: ... That interpretation can shade into implication and, indeed, that both may perhaps be seen as part of the one process of the construction of words in a document to identify linguistic and legal meaning can be accepted. However, the distinction between interpretation and implication of terms is recognised (even if the limits of each are not capable of clear definition): see *Codelfa Construction Pty Limited v State Rail Authority* (NSW) (1982) 149 CLR 337 at 345 (per Mason J, with whom Stephen and Wilson JJ agreed in this respect); ...'

In *Codelfa* Mason J noted at 345:

'When we say that the implication of a term raises an issue as to the meaning and effect of the contract we do not intend by that statement to convey that the court is embarking upon an orthodox exercise in the interpretation of the language of a contract, that is, assigning a meaning to a particular provision. Nonetheless, the implication of a term is an exercise in interpretation, though not an orthodox instance.'

In explaining this passage Campbell JA in *Franklins Pty Ltd v Metcash Trading Ltd*[84] commented at 245:

'One of the reasons why *Codelfa* was not an orthodox instance of interpretation was because whether a term is implied into a contract by ad hoc implication is restrained by the tests in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266 at 283 (UKPC). The specific question that Mason J was addressing in *Codelfa* was whether, in the application of those tests, "it is legitimate to take into account the common beliefs of the parties as developed and manifested during their antecedent negotiations".'

Accordingly, although the implication of terms forms part of the broad process of construction there remains the distinct requirement to satisfy each of the criteria for implication promulgated in *BP Refinery*.

However, Lord Hoffmann, in delivering the advice of the Privy Council in *Attorney-General of Belize v Belize Telecom Ltd,*[85] sought to assimilate the principles informing implication of terms within the overarching approach to construction generally.

His Lordship noted at 1993:

'[17] The question of implication arises when the instrument does not expressly provide for what is to happen when some event occurs. The most usual inference in such a case is that nothing is to happen. If the parties had intended something to happen, the instrument would have said so. Otherwise, the express provisions of the instrument are to continue to operate undisturbed. If the event has caused loss to one or other of the parties, the loss lies where it falls.

'[18] In some cases, however, the reasonable addressee would understand the instrument to mean something else. He would consider that the only meaning consistent with the other provisions of the instrument, read against the relevant background, is that something is to happen. The event in question is to affect the rights of the parties. The instrument may not have expressly said so, but this is what it must mean. In such a case, it is said that the court implies a term as to what will happen if the event in question occurs. But the implication of the term is not an addition to the instrument. It only spells out what the instrument means.

'[19] The proposition that the implication of a term is an exercise in the construction of the instrument as a whole is not only a matter of logic (since a court has no power to alter what the instrument means) but also well supported by authority.'

And later his Lordship noted at 1994:

'[21] It follows that in every case in which it is said that some provision ought to be implied in an instrument, the question for the court is whether such a provision would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean. It will be noticed from Lord Pearson's speech that this question can be reformulated in various ways which a court may find helpful in providing an answer — the implied term must "go without saying", it must be "necessary to give business efficacy to the contract" and so on-but these are not in the Board's opinion to be treated as different or additional tests. There is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?'

His Lordship then turned to the significance of the various *BP Refinery* criteria and how they should be considered within the overall construction approach.

Importantly, Lord Hoffmann noted at 1994:

'[22] There are dangers in treating these alternative formulations of the question as if they had a life of their own. Take, for example, the question of whether the implied term is "necessary to give business efficacy" to the contract. That formulation serves to underline two important points. The first, conveyed by the use of the word "business", is that in considering what the instrument would have meant to a reasonable person who had

knowledge of the relevant background, one assumes the notional reader will take into account the practical consequences of deciding that it means one thing or the other. In the case of an instrument such as a commercial contract, he will consider whether a different construction would frustrate the apparent business purpose of the parties. That was the basis upon which *Equitable Life Assurance Society v Hyman* [2003] 3 All ER 961, [2002] 1 AC 408 was decided. The second, conveyed by the use of the word "necessary", is that it is not enough for a court to consider that the implied term expresses what it would have been reasonable for the parties to agree to. It must be satisfied that it is what the contract actually means.'

However in *Marks and Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd*[86] the United Kingdom Supreme Court returned to orthodoxy in the treatment of implied terms. Lord Neuberger (Lord Sumption and Lord Hodge agreeing) said:

'[22] Before leaving this issue of general principle, it is appropriate to refer a little further to *Belize Telecom,* where Lord Hoffmann suggested that the process of implying terms into a contract was part of the exercise of the construction, or interpretation, of the contract. In summary, he said at para 21 that "[t]here is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?". There are two points to be made about that observation.

'[23] First, the notion that a term will be implied if a reasonable reader of the contract, knowing all its provisions and the surrounding circumstances, would understand it to be implied is quite acceptable, provided that (i) the reasonable reader is treated as reading the contract at the time it was made and (ii) he would consider the term to be so obvious as to go without saying or to be necessary for business efficacy. (The difference between what the reasonable reader would understand and what the parties, acting reasonably, would agree, appears to me to be a notional distinction without a practical difference.) The first proviso emphasises that the question whether a term is implied is to be judged at the date the contract is made. The second proviso is important because otherwise Lord Hoffmann's formulation may be interpreted as suggesting that reasonableness is a sufficient ground for implying a term. (For the same reason, it would be wrong to treat Lord Steyn's statement in *Equitable Life Assurance Society v Hyman* [2002] 1 AC 408, 459 that a term will be implied if it is "essential to give effect to the reasonable expectations of the parties" as diluting the test of necessity. That is clear from what Lord Steyn said earlier on the same page, namely that "[t]he legal test for the implication of ... a term is ... strict necessity", which he described as a "stringent test".)

'[24] It is necessary to emphasise that there has been no dilution of the requirements which have to be satisfied before a term will be implied, because it is apparent that *Belize Telecom* has been interpreted by both academic lawyers and judges as having changed the law. Examples of academic articles include C Peters, "The implication of terms in fact" [2009] CLJ 513, P Davies, "Recent developments in the Law of Implied Terms" [2010] LMCLQ 140, J McCaughran, "Implied terms: the journey of the man on the Clapham Omnibus" [2011] CLJ 607, and JW Carter and W Courtney, "*Belize Telecom*: a reply to Professor McLauchlan" [2015] LMCLQ 245). And in *Foo Jong Peng v Phua Kiah Mai* [2012] 4 SLR 1267, paras 34-36, the Singapore Court of Appeal refused to follow the reasoning in *Belize* at least in so far as "it suggest[ed] that the traditional 'business efficacy' and 'officious bystander' tests are not central to the implication of terms" (reasoning which was followed in *Sembcorp Marine Ltd v PPL Holdings Pte Ltd* [2013] SGCA 43). The Singapore Court of Appeal were in my view right to hold that the law governing the circumstances in which a term will be implied into a contract remains unchanged following *Belize Telecom.'*

And his Lordship continued:

'[26] I accept that both (i) construing the words which the parties have used in their contract and (ii) implying terms into the contract, involve determining the scope and meaning of the contract. However, Lord Hoffmann's analysis in *Belize Telecom* could obscure the fact that construing the words used and implying additional words are different processes governed by different rules.

'[27] Of course, it is fair to say that the factors to be taken into account on an issue of construction, namely the words used in the contract, the surrounding circumstances known to both parties at the time of the contract, commercial common sense, and the reasonable reader or reasonable parties, are also taken into account on an issue of implication. However, that does not mean that the exercise of implication should be properly classified as part of the exercise of interpretation, let alone that it should be carried out at the same time as interpretation. When one is implying a term or a phrase, one is not construing words, as the words to be implied are *ex hypothesi* not there to be construed; and to speak of construing the contract as a whole, including the implied terms, is not helpful, not least because it begs the question as to what construction actually means in this context.

'[28] In most, possibly all, disputes about whether a term should be implied into a contract, it is only after the process of construing the express words is complete that the issue of an implied term falls to be considered. Until one has decided what the parties have expressly agreed, it is difficult to see how one can set about deciding whether a term should be implied and if so what term. This appeal is just such a case. Further, given that it is a cardinal rule that no term can be implied into a contract if it contradicts an express term, it would seem logically to follow that, until the express terms of a contract have been construed, it is, at least normally, not sensibly possible to decide whether a further term should be implied. Having said that, I accept Lord Carnwath's point in para 71 to the extent that in some cases it could conceivably be appropriate to reconsider the interpreta-

tion of the express terms of a contract once one has decided whether to imply a term, but, even if that is right, it does not alter the fact that the express terms of a contract must be interpreted before one can consider any question of implication.'

In *Sam Management Services (Aust) Pty Ltd v Bank of Western Australia Ltd,*[87] Rein J in considering the principles informing the implication of terms restated the traditional approach that for a term to be implied it must, under Australian law, meet the criteria in *BP Refinery*. Accordingly, if the term propounded fails to satisfy anyone of these criteria it will not form part of the relevant contract. However Rein J did refer without detailed comment to *Belize Telecom.* His Honour noted that the case represented the latest enunciation of the approach taken in the United Kingdom which places less emphasis on these additional requirements, that is, the *BP Refinery* criteria.

The High Court in *Commonwealth Bank of Australia v Barker*[88] went some way to endorsing Lord Hoffmann's approach in *Belize Telecom* although without doubting the continued operation of the *BP Refinery* conditions for implication.

French CJ, Kiefel, Bell and Keane JJ, in their joint reasons, said:

'[22] Implication of a term in fact in a contract, by reference to what is necessary to give it business efficacy, was described in *Codelfa Construction Pty Ltd v State Rail Authority* (NSW) as raising issues "as to the meaning and effect of the contract". Implication is not "an orthodox exercise in the interpretation of the language of a contract, that is, assigning a meaning to a particular provision". It is nevertheless an "exercise in interpretation, though not an orthodox instance". The implication of terms in fact was also characterised in *Attorney General of Belize v Belize Telecom Ltd* as an exercise in construction. Lord Hoffmann, delivering the judgment of the Privy Council, said:

"... it is not enough for a court to consider that the implied term expresses what it would have been reasonable for the parties to agree to. It must be satisfied that it is what the contract actually means."

The distinction thus drawn is appropriate even though the scope of the constructional approach adopted by Lord Hoffmann has been debated.

'[23] In *Codelfa,* the implication of a term in law was said to be based upon "more general considerations" than those covered by the concept of business efficacy. That distinction attracted authoritative support in *Con-Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (Aust) Ltd.*

'[24] It has also been argued that some "terms" said to be implied in law are in fact rules of construction and that all implied "terms" of universal application fall into that category. The application of that proposition to what has been treated as a contractual duty to co-operate is considered below. Debates about characterisation have attracted persuasive protagonists on both sides. They involve taxonomical distinctions which do not necessarily yield practical differences. Those debates are not concerned with the distinct question whether, and when, implication of a term is to be regarded as an exercise in the construction of a contract or class of contract.

'[25] It has been accepted in this court that some rules treated as implications of terms in law in particular classes of contract, or contracts generally, can also be characterised as rules of construction. Mason J, in *Secured Income Real Estate (Aust) Ltd v St Martins Investments Pty Ltd,* so characterised the principle enunciated by Lord Blackburn in *Mackay v Dick:*

"... where in a written contract it appears that both parties have agreed that something shall be done, which cannot effectually be done unless both concur in doing it, the construction of the contract is that each agrees to do all that is necessary to be done on his part for the carrying out of that thing, though there may be no express words to that effect. What is the part of each must depend on circumstances."'

However, prior to *Barker* the Australian authorities were circumspect about a construction based approach to implication. The point was taken up by Giles JA in *Vodafone Pacific Ltd v Mobile Innovations Ltd*[89] when dealing with a submission that the duties of co-operation and good faith sought to be implied in the contract subject could arguably be derived from a proper construction of the express words of the contract.

His Honour was not impressed with this submission and he noted as follows at 205 and 206:

'As so often in the law, it is necessary to make sure that words are the servants, not the master. If it is said that, in determining the full import of clause 18.4, as a matter of law the power conferred on Vodafone must be exercised in good faith and reasonably, and if that is described as a process of construction, so be it. But it is not construction by regard to the ordinary meaning of the words used in the agreement. There is an imposition of law, as explained by McHugh and Gummow JJ in *Byrne v Australian Airlines Ltd* by attribution of a contractual intent to the parties, and the rule of construction to which their Honours refer is a rule for imposing in law a meaning on the parties. I have no difficulty in using, in that situation, the accepted description of a term implied by law.

'The obligation to exercise the power in clause 18.4 in good faith and reasonably, if found, is an obligation imposed by law by adding to the express words "will have the sole discretion" the further words "to be exercised in good faith and reasonably". It seems to me an accurate use of language to give it the description of an implied term, when from the premise of a contractual intent attributed in law to the parties they did not in fact use the express words with the added meaning. It is also a preferable use of language, since it recognises that the obligations imposed by law — because a term is implied in law — and does not proceed on a fiction that an intention of the parties is being found by a process of construction.'

Justice Robert McDougall writing extra judicially in a paper entitled 'Exploring the Recent Uncertainty Surrounding the

Implied Duty of Good Faith in Australian Contract Law' (2006) supported Giles JA's approach as to the relevance of construction in the implication of terms generally. His Honour noted:

'In general terms, the process of construction involves ascertaining the meaning of words used in the context in which they are used. The starting point is the ordinary meaning of the words; and departure from that ordinary meaning, or the grafting of something on to that ordinary meaning, may be justified where the context (including that ascertained by reference to the factual matrix) so demands. But, as Giles JA pointed out in the passage that I have quoted, the ascertainment of an obligation of good faith by a process of construction is not construction in the sense that I have described. This analysis finds support in the judgment of Mason J in *Codelfa* where His Honour described the process of implication in law as "an illustration of the process of construction, though differing from the more orthodox establishment of the meaning of a contractual provision". In this context, Dr Peden's analysis of construction as applying the principle of good faith to determine the full impact of the express terms of the contract is not analysis of the meaning to be attributed to the words, but of the incidents to be engrafted upon the words that the parties have chosen.'

The relationship between the process of construction and the process of implication was considered by Davies J in *AAP Industries Pty Ltd v Rehau Pte Ltd.*[90] Davies J noted:

'[27] It is apparent from the authorities that there is no bright line between properly construing the terms of a contract and the implication of a further term to give the contract business efficacy. However, the difference between the two concepts may be significant because of rules relating to adducing evidence about post-contractual conduct. The general rule is that evidence of the way the parties have conducted themselves after the contract is made cannot be relied upon to construe the meaning of the contract. On the other hand, authority suggests that such conduct can be admitted to determine whether a term should be implied: *Council of the City of Sydney v Goldspar Australia Pty Ltd* [2006] FCA 472 at [164]. Further, that position is clearer where the asserted contract is not clearly embodied in an agreement with the terms spelt out: *County Securities Pty Ltd v Challenger Group Holdings Pty Ltd* [2008] NSWCA 193 at [17], [20]–[21].'

Relevantly, in *Council of the City of Sydney v Goldspar Australia Pty Limited*[91] Gyles J said:

'[164] ... I can see no difficulty in regarding subsequent conduct as relevant to the question as to whether a term is necessary to give business efficacy to the contract. Indeed, if a contract has been performed without adhering to, or without inconsistency with, the claimed term, without complaint or commercial difficulty, that would be powerful evidence that the term is not necessary. The law prefers facts to prophecies (*HTW Valuers (Central Qld) Pty Ltd v Astonland Pty Ltd* (2004) 217 CLR 640 at [39]). It would be odd to imply a term as necessary where such a conclusion would be contrary to the facts as they later appeared. If conduct may be relevant to negative the implication of a term as being necessary then it should also be relevant to support the implication of a term on the same basis ...'

And in *Regreen Asset Holdings Pty Ltd v Castricum Brothers Australia Pty Ltd,*[92] the Victorian Court of Appeal noted:

'[140] ... in *Barker,* French CJ, Bell and Keane JJ referred to the view of Mason J in *Codelfa* that the implication of a term is an instance — albeit not an orthodox instance — of the construction of a provision of a contract.'

The New South Wales Court of Appeal recently considered the constructional approach to implication of terms in *Rehau Pte Ltd v AAP Industries Pty Ltd*[93] on appeal from Davies J.

I turn to the facts.

By a supply agreement Rehau, a Singapore entity, agreed to purchase nine specified plumbing articles from AAP. The Supply Agreement was prepared on Rehau letterhead. The agreement incorporated, *inter alia,* the following conditions:

Clause I

REHAU shall purchase the following articles from AAP:...

Clause II

REHAU's Conditions of Purchase supplement and form an essential part of this Supply Agreement.

Clause III

AAP undertakes to make available and keep ready for consignment as specified in the Technical Delivery Specifications sufficient production capacity for the quantities required by REHAU ...

AAP shall maintain a minimum buffer stock of two months of the articles subject to this Supply Agreement for REHAU free of charge. The quantities held shall follow the break-down of quantities to be delivered as stipulated by REHAU.

Clause IV

AAP shall ensure delivery fulfilling the deadlines and required quantities specified by REHAU. The deadlines for delivery and any deadlines for collection are fixed.

These deadlines are thus absolutely binding. Any failure to meet a deadline shall place AAP in default of performance (delivery). REHAU shall then be entitled at its discretion (a) to demand later delivery or compensation for non-performance or (b) to withdraw from this Supply Agreement. REHAU is further entitled to make covering purchases to maintain production.

Clause V

The agreed prices are fixed. They shall remain valid even if the scope of deliveries conveyed or performance be changed with respect to the work subject to ± 10%.

The prices are for packaged goods and are inclusive of packaging material.

The fixed prices are valid for one year.

Clause VI

REHAU shall be entitled to withdraw from this Supply Agreement should deliveries be made repeatedly in non-compliance of technical delivery specification.

Clause XI

This Supply Agreement comes into force with immediate effect and is made for a term of one year upon signing of agreement. The right to immediate termination on good reason remains unaffected. In particular, breach of the obligations set out in this Supply Agreement shall be considered good reason for termination notwithstanding the date of expiry of the minimum term.

This Supply Agreement shall be extended by one year each time it is due to expire unless notice of termination be given at least three months before the date of expiry.

Rehau's Conditions of Purchase contained the following provisions:

Prices

3. The prices for the goods listed in the order are fixed and are not subject to change without the agreement in writing of the Buyer. The Buyer shall not be responsible for the cost of packing or transportation costs unless the same has been agreed in writing by the Buyer.

Termination

15. The Buyer may at any time in its absolute discretion terminate this contract in whole or in part by notice in writing irrespective of whether the provisions of Clause 17 are applicable or not and upon such termination the Seller shall cease all further work under this contract and terminate all orders directly relating thereto. The Buyer shall pay to the Seller the price (if unpaid) under this order for all work actually completed and the reasonable costs of all work actually incurred by the Seller in carrying out this order to the date of such termination provided such costs are directly attributable thereto.

Acceptance of terms

17. All orders accepted by the Seller shall be subject to these conditions. The Buyer shall not be bound by any terms or conditions of the Seller which are inconsistent with these conditions. Neither the Buyer nor the Seller shall be bound by any variation of these conditions unless the same be agreed in writing by the Buyer and the Seller.

Construction

18. This contract shall be constructed [sic] in accordance with and governed in every respect by by the laws of Singapore and all actions arising out of or connected with this agreement shall be brought in the courts of Singapore.

Rehau ceased placing any orders with AAP after 11 July 2013. AAP commenced proceedings in the common law division on 12 December 2014.

The point at issue in the trial was whether an implied term of exclusivity formed part of the supply agreement so as to preclude Rehau from obtaining the relevant articles elsewhere.

The primary judge, Davies J held that a term of exclusivity was to be implied as a matter of construction although he also concluded as an alternative basis for his finding that the five conditions for implication articulated in the *BP Refinery* case were satisfied. In arriving at his conclusion Davies J identified the following six matters as suggesting that the supply agreement on its proper construction required Rehau to obtain supplies of the specified items exclusively from AAP. Those matters were:

(a) The first requirement of the agreement is that Rehau shall purchase the stipulated articles from AAP. Prima facie, the word 'shall' means 'must' in the sense that there is an obligation on Rehau to do so.

(b) The parties state that they make the agreement 'for AAP to reserve production capacity to meet the requirements of Rehau and to plan the raw material necessary to ensure that deadlines are met'. Such a term would be unnecessary if Rehau was entitled to satisfy its requirements from other sources either because AAP did not have the required production capacity or because it did not have the raw material to ensure that deadlines were met.

(c) That is underlined by the undertaking in clause III by AAP to make available and keep ready for consignment sufficient production capacity for the quantities Rehau requires. That is further emphasised by the third requirement in clause III that AAP is to maintain a minimum buffer stock of two months of the stipulated articles free of charge to Rehau.

(d) The matter of deadlines is said to be absolutely binding in clause IV and a failure in that regard gives the right of Rehau to withdraw from the Supply Agreement. If exclusivity was not required there would be no necessity to stipulate the consequence of a right to withdraw from the agreement.

(e) In similar vein is the right in clause VI for Rehau to withdraw should deliveries be made repeatedly in non-compliance of technical delivery specification.

(f) Clause XI says that the Supply Agreement is in force for one year upon signing of the agreement and is then automatically extended by a year each time it is due to expire unless Notice of Termination is given in accordance with the clause. If Rehau is under no obligation to purchase all of the articles from AAP there would be no need for such provisions. The parties do not contend that condition 15 of the standard conditions of purchase detracts from what is in clause XI of the Supply Agreement.'

The Court of Appeal endorsed the approach of the primary judge. Sackville AJA said:

'45 In view of this conclusion, it was not necessary for his Honour to deal with AAP's alternative argument that the Exclusivity Term should be implied in the Supply Agreement as a matter of business efficacy on the principles stated in *Codelfa Construction Pty Ltd v State Rail Authority (NSW).* Nonetheless his Honour concluded that the requirements for implying a term were satisfied. Since AAP was required to reserve produc-

tion capacity and raw materials and to hold two months buffer stock, it was "entirely equitable and reasonable to imply the [Exclusivity Term]". Furthermore, without the Exclusivity Term the Supply Agreement would for all purposes be ineffective as it would impose no obligation at all on Rehau.

'53 The primary judge distinguished between two kinds of implied terms in a contract. The first comprises implications contained in the express words of the contract. The second consists of implications from considerations of business efficacy. The distinction drawn by the primary Judge is consistent with the conventional classification of implied terms and was not challenged by Rehau.

'54 Rehau challenged — as it had to — both bases for the primary judge's conclusion that the Supply Agreement should be construed to include the Exclusivity Term. Most attention, however, was devoted in argument to the primary Judge's holding that the express terms of the Supply Agreement, properly construed, required the Exclusivity Term to be implied. ...

'82 Accordingly, the Supply Agreement should be construed as incorporating an implied term that during the currency of the Agreement Rehau was obliged to purchase all its requirements for the nine specified articles exclusively from AAP. In view of this conclusion it is not necessary to consider whether the primary Judge was correct to conclude that the Exclusivity Term should be implied in the Supply Agreement on the principles stated in *Codelfa Construction Pty Ltd v State Rail Authority (NSW).'*

The Court of Appeal was clearly of the view that a constructional approach to the implication of terms is to be treated as an alternative to the business efficacy test based on the five conditions set out in *BP Refinery* and confirmed in *Codelfa.* Although in the majority of cases either analysis may yield the same result, the approach of the Court of Appeal is consistent with Lord Hoffmann's approach in *Belize.* However, it does not sit comfortably with either *Codelfa* or the United Kingdom Supreme Court decision in *Marks & Spencer plc*, where satisfaction of the *BP Refinery* conditions were considered a prerequisite for the implication of a term.

3.6 Custom

In *Can Stan Industries of Australia Pty Ltd v Norwich Winterthur Insurance (Australia) Ltd*[94] the High Court set out the conditions for the implication of a term based on custom or usage.

Paraphrasing the language of the Court those conditions are as follows:

(1) the existence of a custom or usage that will justify the implication of a term into a contract is a question of fact;

(2) there must be evidence that the custom relied on is well known and acquiesced in that everyone making a contract in that situation can reasonably be presumed to have imported that term into the contract;

(3) a term will not be implied into a contract on the basis of custom where it is contrary to the express terms of the agreement; and

(4) a person may be bound by a custom notwithstanding the fact that he had no knowledge of it.

The High Court also accepted that the importation of a term based on custom reflects the presumed intention of the parties. The High Court explains this 'presumed intention' in the following way at 237:

'In matters of this kind, that phrase means no more than that the general notoriety of the custom makes it reasonable to assume that the parties contracted on the basis of the custom, and it is therefore reasonable to import such a term into the contract.'

4 CO-OPERATION IN CONTRACT PERFORMANCE

The duty to co-operate has both positive and negative components and has found expression in different formulations.

First, in *Mackay v Dick*[95] Lord Blackburn said:

'Where in a written contract it appears that both parties have agreed that something shall be done, which cannot effectually be done unless both concur in doing it, the construction of the contract is that each agrees to do all that is necessary to be done on his part for the carrying out of that thing, though there may be no express words to that effect.'

Secondly, in *Butt v M'Donald*[96] Griffith CJ formulated a somewhat broader principle as follows:

'It is a general rule applicable to every contract that each party agrees, by implication, to do all such things as are necessary on his part to enable the other party to have the benefit of the contract.'

Thirdly, in *Stirling v Maitland*[97] Cockburn CJ expressed the principle in negative form as follows:

'... if a party enters into an arrangement which can only take effect by the continuance of a certain existing state of circumstances, there is an implied engagement on his part that he shall do nothing of his own motion to put an end to that state of circumstances, under which alone the arrangement can be operative.'

Stirling v Maitland was considered by the New South Wales Court of Appeal in *Australis Media Holdings Pty Ltd v Telstra Corporation Ltd.*[98] The Court noted at 123:

'It may be significant that this case was determined before the emergence of the doctrine of anticipatory breach. It certainly covers much if not all of the same ground, apart from the principle that repudiation may flow from an unintended supervening incapacity to perform. See *De Medina v Norman* (1842) 9 M& W 820 [152 ER 347]; *Foran v Wight* (1989) 168 CLR 385 at 397, 424, 451.'

In relation to Cockburn CJ's dictum the Court continued at 124:

'Whether or not it is seen as a precursor to the modern doctrine of anticipatory breach (*cf Rawson v Hobbs* (1961) 107 CLR

466 at 481) the conduct relied upon must, in Lord Atkin's words from Southern Foundries, bring about "the impossibility of performance".

'Performance of what? The answer must surely be: The obligations of a party under the contract. These obligations depend on the application of rules of enforceability and construction concerning written instruments. ... The "implication" of a term implied in law depends upon the demonstration of "necessity" ... It follows that, leaving aside fiduciary obligations (which are not involved here), there cannot be a duty to co-operate in bringing about something which the contract does not require to happen. An "implication, arising as it does from necessity, must be limited by the extent of the need"'

The scope of the co-operation obligation was considered in the landmark decision of the High Court in *Secured Income Real Estate (Australia) Limited v St Martins Investments Proprietary Limited.*[99] Mason J observed at 607:

'But it is common ground that the contract imposed an implied obligation on each party to do all that was reasonably necessary to secure performance of the contract. As Lord Blackburn said in *Mackay v Dick* (1881) 6 App Cas 251 at 263: "... as a general rule ... where in a written contract it appears that both parties have agreed that something shall be done, which cannot effectually be done unless both concur in doing it, the construction of the contract is that each agrees to do all that is necessary to be done on his part for the carrying out of that thing, though there may be no express words to that effect".

'It is not to be thought that this rule of construction is confined to the imposition of an obligation on one contracting party to co-operate in doing all that is necessary to be done for the performance by the other party of his obligations under the contract. As Griffith CJ said in *Butt v M'Donald* (1896) 7 QU 68 at 70-1: "it is a general rule applicable to every contract that each party agrees, by implication, to do all such things as are necessary on his part to enable the other party to have the benefit of the contract".

'It is easy to imply a duty to co-operate in the doing of acts which are necessary to the performance by the parties or by one of the parties of fundamental obligations under the contract. It is not quite so easy to make the implication when the acts in question are necessary to entitle the other contacting party to a benefit under the contract but are not essential to the performance of that party's obligations and are not fundamental to the contract. Then the question arises whether the contract imposes a duty to co-operate on the first party or whether it leaves him at liberty to decide for himself whether the acts shall be done, even if the consequence of his decision is to disentitle the other party to a benefit. In such a case, the correct interpretation of the contract depends, as it seems to me, not so much on the application of the general rule of construction as on the intention of the parties as manifested by the contract itself.'

There has been a discussion as to whether the duty to co-operate is a rule of construction or an implied term. Thus in Byrne, McHugh and Gummow JJ in their joint reasons said at 448:

'Some implied terms are perhaps more usefully identified as rules of construction applied to the express terms of the contract, particularly to the written terms thereof. Thus, in *Secured Income Real Estate,* Mason J described as a "rule of construction" the proposition of Lord Blackburn in *Mackay v Dick.'*

Then, most recently in *Commonwealth Bank of Australia v Barker*[100] the plurality noted:

'[25] It has been accepted in this court that some rules treated as implications of terms in law in particular classes of contract, or contracts generally, can also be characterised as rules of construction. Mason J, in *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd,* so characterised the principle enunciated by Lord Blackburn in *Mackay v Dick* ... The language of Lord Blackburn was indicative of a rule of construction rather than of implication. Nevertheless, Mason J also referred to the rule as defining an implied "duty to co-operate".' (footnotes omitted)

In *Jackson Nominees Pty Ltd v Hanson Building Products Pty Ltd,*[101] McMurdo J noted that the *Mackay v Dick* principle formed part of a wider duty formulated by Griffith CJ in *Butt v M'Donald.*

A number of supplementary points arise out of Mason J's judgment in *Secured Income.*

First, Mason J referred to Lord Blackburn's formulation as a rule of construction. Subsequently in *Byrne,* McHugh and Gummow JJ in their joint reasons considered the legal characterisation of this so called rule of construction and noted at 449:

'However, the more modern and better view is that these rules of construction are not rules of law so much as terms implied, in the sense of attributed to the contractual intent of the parties, unless the contrary appears on a proper construction of their bargain.'

The High Court in *Barker* did not refer to this passage in the joint reasons of McHugh and Gummow JJ in *Byrne.*

Secondly, Mason J drew a distinction between a duty to co-operate in the doing of acts which are necessary to the performance by the parties, or by one of the parties, of fundamental obligations and acts which are necessary to entitle the other party to a benefit under the contract but are not essential to the performance of that other party's obligations and are not fundamental to the contract. In the former case Mason J suggested that it would be easy to imply the relevant duty, whereas in the latter case the existence of the duty would depend on the intention of the parties as manifested by the contract itself.

Relevantly, in *Australis Media Holdings Pty Ltd v Telstra Corporation Ltd.*[102] the New South Wales Court of Appeal noted:

'[124] Many terms now said to be implied by law in various categories of contract reflect the concern of the courts that, unless such a term be implied, the enjoyment of the rights conferred by the contract would or could be rendered nugatory,

worthless, or, perhaps, be seriously undermined. It would be, however, fallacious to elide the purpose of implying such terms with the terms themselves. To do so would replace necessity with desirability. The passages cited from *Nullagine Investments Pty Ltd v WA Club Inc* (1993) 177 CLR 635 at 647-648, 659, *Byrne* and *Breen,* show the High Court as drawing a clear distinction between the term implied and its rationale. A contract may "contemplate" many benefits for the respective parties, but each can only call on the other to provide, or co-operate in the providing of, benefits promised by that party. For example, in the absence of an express covenant, a landlord is not bound in contract to repair the demised premises.'

In *Commonwealth Bank of Australia v Barker*[103] the High Court rejected the implication into employment contracts, as a matter of law, a duty of mutual trust and confidence. The Court also rejected the alternative approach based on an implied duty of co-operation which was discussed and endorsed by a majority Full Federal Court. However, Jessup J dissented on this point. His Honour said:

'[307] In Australia, the duty of co-operation was stated by Griffith CJ in *Butt v M'Donald* (1896) 7 QLJ 68 , 70-71 and confirmed in the High Court in *Secured Income Real Estate (Aust) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596 , 607 (per Mason J, Gibbs, Stephen and Aickin JJ concurring):

"It is a general rule applicable to every contract that each party agrees, by implication, to do all such things as are necessary on his part to enable the other party to have the benefit of the contract."

'Clearly, in the application of this rule, one commences with the contractual benefits to which the presumptively innocent party is entitled under the contract. What are the benefits which make the imposition of duties of trust and confidence upon the employer a step towards the achievement of contractual co-operation? If the argument is not to become circular, the benefits cannot be those that would derive from observance of the implied term itself. It is necessary to locate within the contract some other benefit for the employee, the enjoyment of which makes it necessary for the employer to act consistently with the implied term.'

In agreeing with Jessup J's analysis, French CJ, Bell and Keane JJ in their joint reasons said:

'[26] The majority in the Full Court of the Federal Court referred to the implied duty of co-operation as providing an 'alternative approach' to the application of the implied duty of mutual trust and confidence. Their Honours relied upon its formulation in *Secured Income* as one which 'requires a party to a contract to do all things necessary to enable the other party to have the benefit of the contract.' That obligation of co-operation required the Bank to take the positive steps necessary to enable Mr Barker to have the benefit of cl 8, which contemplated the possibility of redeployment within the Bank as an alternative to termination. In opening that alternative approach, their Honours adverted to the suggestion by Lord Steyn in *Malik* that the implied duty of mutual trust and confidence propounded in that case "probably has its origin in the duty of co-operation between contracting parties". As appears below, whatever the historical basis in the United Kingdom for the implied duty of mutual trust and confidence, it cannot be supported in this country as an expression or development of the implied duty of co-operation.

'[27] As to the direct application of the implied duty of co-operation, the Bank submitted in this court, as Jessup J had reasoned in his dissent, that there was no relevant contractual benefit with which the implied term could engage. Clause 8 conferred a benefit by way of a termination payment but did not confer a contractual entitlement to the benefit of the Redeployment Policy. The submission made on behalf of Mr Barker that 'the prospect of ... redeployment was a benefit in the relevant sense' should not be accepted.'

Relevantly, the redundancy clause in Mr Barker's employment contract with the Commonwealth Bank provided:

'[8] This Clause applies only where the Employee was already employed by the Bank immediately preceding the date of this Agreement. In the case where the position occupied by the Employee becomes redundant and the Bank is unable to place the Employee in an alternative position with the Bank or one of its related bodies, in keeping with the Employee's skills and experience, the compensation payment for the Employee will be calculated on the basis of the greater of ...'

Earlier in *Council of the City of Sydney v Goldspar Australia Pty Limited,*[104] Gyles J in dealing with the implied duty of co-operation noted:

'[162] The difficulty lies in giving content to that obligation. It is not a mechanism for alleviating the consequences of hard, even harsh or unconscionable, contractual provisions. The duty of co-operation does not extend to being nice or even reasonable to the other party.'

A useful illustration of the limits on the implied duty of co-operation is provided by the decision of the Queensland Court of Appeal in *Jackson Nominees Pty Ltd v Hanson Building Products Pty Ltd.*[105]

I turn to the facts.

The appellant (defendant) entered into an agreement described as a 'Carrier's Agreement' with the respondent (plaintiff), under which the respondent agreed to deliver the appellant's plasterboard products to its various customers. The express terms of the agreement did not provide for any minimum number of hours or rates of cartage of either plasterboard or other carrying work.

The appellant subsequently sold its business but made no arrangements for the purchaser to continue with the Carrier's Agreement.

The respondent commenced proceedings alleging that, by selling its business, the appellant breached or repudiated the Carrier's Agreement. The appellant's appeal was allowed.

McMurdo J referred to Mason J's judgment in *Secured Income* and continued at 15:

'Mason J thereby distinguished between acts according to whether they are necessary to the performance of a party's fundamental obligations under the contract. There is a duty to co-operate in the doing of acts which are necessary to the performance of such obligations. But a duty to co-operate in the doing of acts which are not necessary to the performance of fundamental obligations has to be found in 'the intention of the parties as manifested by the contract itself', that is by a term implied in fact.

'In the same way, the duty to do what is necessary to enable the other party to have the benefit of the contract is limited to acts which are necessary to the performance of obligations under the contract. To assess the scope of the duty in a particular case, it is first necessary to define the relevant obligations, and in particular, to define the circumstances in which the parties have agreed that a certain obligation must be performed. It is not a duty upon one party to act so as to enhance the commercial value to the other party of the contract.'

In dealing with the scope of the duty to co-operate McMurdo J cited the following passage in the reasons for judgment of McHugh JA in *Elders IXL Ltd v National Employers Mutual General Insurance Association Ltd*[106] at 75-299:

'In terms (the duty of co-operation) applied only to a case where the parties have agreed to do something which required their joint co-operation. It does not apply to a case where one party has promised to pay money or confer benefit in exchange for the other party's act or forbearance. When a person promises that it will pay money or confer a benefit the fulfilment of which is dependent upon the existence of a state of affairs or condition, a term that the promisor will do nothing to put an end to the state of affairs or condition will only be implied where the promisee has already given consideration for the promise and the promisor has a present obligation to fulfil the promise.'

In dealing with the circumstances in *Jackson Nominees* McMurdo J concluded at 53:

'There are then two reasons, why the duty of co-operation does not assist the respondent's case. The first is that the continuation of the appellant's business was not something which could be achieved only by the joint co-operation of these parties. The second is that the terms of his contract does not oblige the appellant to continue the business.

'That second reason is also why the respondent cannot rely upon the more general duty that a party must do all things necessary to enable the other to have the benefit of the contract.'

His Honour cited the passage in the judgment of the Court of Appeal in *Australis Media* set out above.

In the Western Australia Supreme Court decision in *Wright Prospecting Pty Ltd v Hancock Prospecting Pty Ltd (No 9)* [2010] WASC 44, Murray J examined the scope and legal basis of the duty to co-operate in the context of a partnership variation agreement. As set out in the recital to that agreement the partners agreed that each would assume individual control over certain of the assets and interests of the Partnership to the exclusion of the other partner. Each partner had an option to require the division of such assets between the partners. The relevant assets were identified in attached schedules as the WPPL interests and the HPPL interests. Clause 4 of the agreement provided:

'4. Each Partner shall have the option exercisable at any time during the continuation of the Partnership to require the transfer of the HPPL interests to HPPL and the transfer of the WPPL interests to WPPL.'

WPPL contended that the agreement was subject to an implied term that HPPL would do all things necessary, including executing documents and joining in the seeking of the consent of any Minister or joint venture party, which may be necessary to enable WPPL to have the benefit of the transfer.

Murray J, in concluding that such a term was to be implied, made the following observations at 166 to 170:

I do not propose to immerse myself in a debate about whether the implication of such a term should be seen to be a matter of an implication in fact, necessary to give effect to the presumed intention of the parties, or whether the implication sought arises as a matter of law, not because the contract is one of a particular kind where such a term will be implied, eg, the covenant of quiet enjoyment in a lease, but because, as a matter of law, the parties are presumed to have intended that such a provision would apply.

'There is little in the voluminous submissions provided which debates para 20 of the statement of claim, but it seems to me that what is referred to in the pleading is what is usually known as the duty of co-operation, which will be implied in respect of every contractual term which may not be effective without the co-operation of the other side, or where it is necessary for the parties to seek the co-operation of a third party before the party entitled to the benefit of a contractual provision may have that benefit secured to it.

'The way in which the provision to be implied, as a matter of law, is often expressed, is known as the Butt formula, after the decision of Griffith CJ in *Butt v M'Donald* (1896) 7 QU 68 at 70-71. It is a formulation which is often said to have been adopted by the High Court first in *Secured Income Real Estate (Aust) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 597, per Mason J, the other members of the court agreeing, at 607. Put shortly, the law will imply a term in relation to a contractual provision that each party will do all that is necessary and reasonably within that party's power to secure to the other contracting party the benefit of the particular contractual provision under consideration: see also *Fitzgerald v FJ Leonhardt Pty Ltd* (1997) 189 CLR 215 at 219; *Campbell v Backoffice Investments Pty Ltd* [2009] HCA 25; (2009) 83 AUR 903, 936 [166]-[168].

'In my opinion, cl 4 requires the addendum of the implication of such a term. There may be, or have been, property identified in Sch 1 or Sch 2 capable of transfer from one partner to the other in compliance with a notice exercising the option, without more. However, it is abundantly clear, from the evidence to which I have already referred, that, particularly where the property was an interest in a joint venture or was otherwise held under a mining tenement, the party to whom notice was given would be required to provide its co-operative endeavour to enter into an agreement or other process by which the transfer was to be effected and, to the extent that it became necessary, that party would be required to give its co-operation and support to securing any third party consent, whether of a joint venture partner or the Minister, and whether that was required by some applicable contractual provision or because the person required to give consent wished to have the assurance that both HPPL and WPPL wanted the transaction proposed to it to occur.

'The question sustains no great debate. For the reasons given, I would imply the term sought in para 20(b) of the statement of claim. I am fortified in the conclusion to which I have come by the fact that that course was taken in a not dissimilar factual situation in the case *Anaconda Nickel Ltd v Tarmoola Aust Pty Ltd* (2000) 22 WAR 101; [2000] WASCA 27. See at 106-107 [10]-[11] per Ipp J, Pidgeon J agreeing.'

And in *IW & CA Price Constructions Pty Ltd v Australian Building Insurance Services Pty Ltd*[107] A Lyons J said:

'[54] The most recent endorsement by a Queensland Court of a duty to co-operate being implied into every contract was by Philip McMurdo J in *Baldwin v Icon Energy Ltd,* who noted that a term requiring a party to do all things necessary to enable the other party to have the benefit of his contract was "implied in every contract". The authorities relied upon by Philip McMurdo J commence with the acknowledgment of *Butt v M'Donald,* which contains the articulation of the fundamental principle by Griffith CJ that:

"It is a general rule applicable to every contract that each party agrees, by implication, to do all such things as are necessary on his part to enable the other party to have the benefit of the contract."

'[55] Philip McMurdo J also made reference to *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* and *Peters (WA) Ltd v Petersville Ltd* and then noted that the next question would be what constituted the benefit of the contract. His Honour stated that "implied duty is different from a duty on one party to act so as to enhance the commercial value to the other party of the contract, as I said, with the agreement of Jerrard JA, in *Jackson Nominees Pty Ltd v Hanson Building Products Pty Ltd*" (footnotes omitted).

'[56] The cases outlined above accurately summarise the current state of the law and indeed establish that there is an implied duty to co-operate incorporated into every contract. It is the scope of that duty which is really the subject of controversy. Accordingly to the extent that the submissions of the plaintiff contend that there is no such implied duty, those submissions are incorrect. The submissions do however accurately indicate that there are limitations of the affirmative duty to co-operate and that it is the scope of the duty which is critical. Accordingly whilst the plaintiff has an implied duty to co-operate in this case, the real issues relate to the following questions: "what is the benefit of the contract here?"; "what is the scope of the duty here?" and then "has been a breach of such a duty?".

'[57] The defendants also claim that the Contract contained an implied term that each party will not do anything to hinder or prevent the fulfilment of the benefit of the Contract. It is argued by the defendants that not only do the Courts imply an affirmative duty to co-operate into every contract but similarly the law implies a negative covenant not to hinder or prevent the fulfilment of the promises made. Reliance is placed on the decision of Griffith CJ in *WL Marshall v The Colonial Bank of Australasia* where Griffith CJ stated, "Now, all contractual relations impose upon the parties a mutual obligation that neither shall do anything which is calculated to hamper the other in the performance of the contract on his part". Counsel for the defendants argues that it is in this regard only that the counterclaim refers to an implied duty of good faith, and does not contend for the implication of a term that extends beyond the negative covenant that the High Court has held to be implied into all contracts, as discussed in *Peters (WA) Limited v Petersville Limited.* Counsel also argues that such a duty was acknowledged by Applegarth J in *Kosho Pty Ltd v Trilogy Funds Management Ltd.'*

5 OVERALL SUMMARY

(1) The courts support the implication of a term (as a matter of law) that each contracting party co-operate with the other to ensure that each receive their respective contracted for benefits.

(2) The duty of co-operation only extends to achieving contracted benefits and does not require that either party take steps to enhance the general commercial value of the contract for the benefit of the other party.

(3) Mason CJ (extra judicially in his Cambridge lecture) and Allsop CJ have identified the duty to co-operate as a key component of the concept of good faith in its application to contract performance.

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* Jeffrey Goldberger is a Special Counsel at Norton Rose Fulbright. This paper formed the basis of his Master Class for the CLA that was delivered in March, 2019. Part 1 of the paper was published in

the previous issue of CLQ. Part 3 of the paper can be found in this issue.

50 [2001] NSWCA 61

51 (1988) 5 BPR 11,110

52 Referred to by the Court of Appeal of Western Australia in *Fazio v Fazio* [2012] WASCA 72 and by the Supreme Court of Victoria in *Ambridge Investments Pty Ltd (in liquidation) v Baker* [2010] VSC 59

53 (2001) 117 FCR 424

54 [2009] NSWCA 44

55 *SDR Australia Pty Ltd v Leighton Contractors Pty Ltd* [2012] WASC 434 at [352]

56 Ibid at [352]

57 *R J Baker Nominees Pty Ltd v Parsons Management Group Pty Ltd* [2010] WASCA 128 at paragraph 97

58 [2017] NSWCA 121

59 [2001] EWCA Civ 274

60 [2007] VSCA 310

61 [2011] NSWCA

62 ((1986) 7 IPR 581 at 605-6)

63 (1992) 26 NSWLR 234

64 (1982) 149 CLR 337

65 (1977) 52 ALJR 20 at 26

66 [2007] NSWSC 503

67 (2001) 208 CLR 516 at 573

68 [2002] NSWSC 178

69 [2008] WASCA 161

70 [2015] VSCA 286

71 (2014) 253 CLR 169

72 [2017] VSCA 88

73 (1995) 185 CLR 410

74 *Grocon Constructors (Victoria) Pty Ltd v APN DF 2 Project 2 Pty Ltd* [2015] VSCA 190 (191)

75 (1988) 164 CLR 539

76 (1996) 186 CLR 71

77 [2014] HCA 32

78 (1998) 44 NSWLR 349

79 [2001] NSWCA 187

80 [2012] NSWCA 184

81 2005] VSCA 228

82 [2012] VSC 175

83 [2008] NSWCA 257

84 [2009] NSWCA 407

85 [2009] 2 All ER 1127

86 [2015] UKSC 72

87 [2009] NSWSC 676

88 (2014) 253 CLR 16

89 [2004] NSWCA 15

90 [2017] NSWSC 390

91 [2006] FCA 472

92 [2015] VSCA 286

93 [2018] NSWCA 96

94 (1986) 160 CLR 226

95 (1881) 6 App Cas 251 at 263

96 (1896) 7 QLJ 68 at 70-71: noted with approval by the High Court in *Fitzgerald v F J Leonhardt Pty Ltd* (1997) CLR 215, 219

97 (1864) 122 *English Reports* 1043, 1047

98 (1998) 43 NSWLR 104

99 (1979) 144 CLR 596

100 [2014] HCA 32

101 [2006] QCA126

102 (1998) 43 NSWLR 104

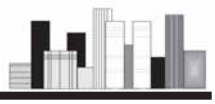
103 [2014] HCA 32

104 FCA 422

105 [2006] QCA126

106 (1988) 5 ANZ Ins Cas 60-847

107 [2017] QSC 39



Seminar paper

Incorporation by terms of reference or by a course of dealing Part 3 of 3

Jeffrey Goldberger*

1.1 Background and context

The identification of contractual terms may involve the application of two distinct sets of principles, namely, those which:

(1) determine the conditions for the incorporation of terms by reference or by a course of dealing;

(2) determine the conditions for the implication of terms.

Incorporation is concerned with establishing the express terms of a contract while the process of implication is concerned with the filling of gaps in an otherwise complete contract.

This section of the paper is concerned with incorporation.

The relevant principles have developed in response to a range of scenarios as follows:

(1) a party signs a contractual document without reading its provisions or without any understanding as to the meaning and effect of those provisions;

(2) a party enters into an oral contract the terms of which are said to be contained in an unsigned document;

(3) a party enters into an oral contract the terms of which are said to be established by a consistent course of dealing between the parties;

(4) a party asserts that a contract has been entered into on the basis of a set of terms and conditions put forward by that party while the other party asserts that the contract was entered into on the basis of terms put forward by that party, the so-called 'battle of terms'.

1.2 The status of a signed document

In *Toll (FGCT) Pty Ltd v Alphapharm*[108] the High Court having considered earlier authority noted the significance of a signature to a contractual document at 180-181:

'It should not be overlooked that to sign a document known and intended to affect legal relations is an act which itself ordinarily conveys a representation to a reasonable reader of the document. The representation is that the person who signs either has read and approved the contents of the document or is willing to take the chance of being bound by those contents, as Latham CJ put it, whatever they might be. That representation is even stronger where the signature appears below a perfectly legible written request to read the document before signing it.

'The statements in the above authorities accord with the well-known principle stated by Scrutton LJ in *L'Estrange v F Graucob Ltd* (*L'Estrange v Graucob*) that "[w]hen a document containing contractual terms is signed, then, in the absence of fraud, or, I will add, misrepresentation, the party signing it is bound, and it is wholly immaterial whether he has read the document or not". Scrutton LJ, in turn, was repeating the substance of what had been said by Mellish LJ in *Parker v South Eastern Railway Co.* The principle was applied in *Foreman v Great Western Railway Co.* A consignor of cattle sent them for transportation by a railway company. They were put in the charge of a drover, who could not read. The drover signed a contract of carriage which contained an exclusion clause. The drover's employer was held to be bound by the clause. The Exchequer Division said that"the plaintiff who sends the [illiterate] servant to sign the document is in no better or worse position than if he had signed it himself without reading it". In his lecture published as "Form and Substance in Legal Reasoning: The Case of Contract", Professor Atlyah posed, with reference to *L'Estrange v Graucob*, the question why signatures are, within established limits, regarded as conclusive. He answered:

"A signature is, and is widely recognised even by the general public as being a formal device, and its value would be greatly reduced if it could not be treated as a conclusive ground of contractual liability at least in all ordinary circumstances."

'Professor Atiyah added:

"However, what is, I think, less clear is what is the underlying reason of substance in this kind of situation. The usual explanation for holding a signature to be conclusively binding is that it must be taken to show that the party signing has agreed to the contents of the document; but another possible explanation is that the other party can be treated as having relied upon the signature. It thus may be a mistake to ask, as H L A Hart once asked, whether the signature is merely conclusive evidence of agreement, or whether it is itself a criterion of agreement."'

1.3 Incorporation by reference

The basis upon which an unsigned document (eg, a ticket or a brochure) may be imported into an oral contract was considered by the High Court in *Oceanic Sun Line Special Shipping Co Inc v Fay*.[109]

The plaintiff was injured while on a cruise in the Greek Islands. The cruise ship was owned by the defendant shipping company. The carriage contract was made in Sydney when the plaintiff paid the travel agent. Upon payment the plaintiff received a document described as an 'exchange order' which was a printed form. It had spaces for particulars of the intending passenger, the ship, the cruise which had been booked, fare and port taxes paid. The 'exchange order' was subsequently exchanged for a passenger ticket in Greece. The ticket contained terms and conditions of carriage including a submission to the exclusive jurisdiction of the Greek courts.

The plaintiff's wife received a brochure in Sydney before the booking was made. On the inside of the back cover of the brochure were the words:

'The attention of passengers is drawn to the General Conditions of Transportation set out in the Passage Contract.'

Under the heading 'Responsibility' was a statement that:

'The transportation of passengers and baggage ... is governed by the terms and conditions printed on the Passenger Ticket Contract which may be inspected at any Sun Line office.'

Passenger tickets were not available in Sydney. It was also unclear whether there was a Sun Line office in Australia.

The High Court held that the contents of the passenger ticket issued in Greece did not form part of the contract between the plaintiff and the defendant.

Brennan J having considered previous authority including the so-called 'ticket cases' said at 228:

'If a passenger signs and thereby binds himself to the terms of a contract of carriage containing a clause exempting the carrier from liability for loss arising out of the carriage, it is immaterial that the passenger did not trouble to discover the contents of the contract. But where an exemption clause is contained in a ticket or other document intended by the carrier to contain the terms of carriage, yet the other party is not in fact aware when the contract is made that an exemption clause is intended to be a term of the contract, the carrier cannot rely on that clause unless, at the time of the contract, the carrier had done all that was reasonably necessary to bring the exemption clause to the passenger's notice: *Hood v Anchor Line (Henderson Brothers) Ltd* [1918] AC 837 at 842, 844; *McCutcheon v David MacBrayne Ltd* [1964] 1 WLR 125 at 129; [1964] 1 All ER 430 at 433; *Thornton v Shoe Lane Parking Ltd* [1971] 2 QB 163 at 169-70 per Lord Denning MR, and per Megaw LJ at 172-3. In differing circumstances, different steps may be needed to bring an exemption clause to a passenger's notice, especially if the clause is an unusual one. In the present case, the only step which the defendant took to bring the exclusive foreign jurisdiction clause to the plaintiff's notice before the fare was paid was the note in the brochure that the conditions of carriage were printed in the (unavailable) passenger ticket contract. In *Hollingworth v Southern Ferries Ltd ('The Eagle')* [1977] 2 Lloyd's Rep 70, it was held that a mere statement in a carrier's brochure that the carrier contracted on its conditions of carriage was not enough to make those conditions terms of a contract of carriage subsequently made with an intending passenger who had read the brochure.'

And at 229 his Honour continued:

'As the contract of carriage was made when the exchange order was issued and as the exclusive jurisdiction clause contained in cl 13 of the ticket was not then known to Dr Fay and as insufficient was done to bring such a clause to his attention, that clause was not incorporated into the contract of carriage and could not subsequently be incorporated by insertion in the ticket issued pursuant to the original contract. This conclusion differs from the conclusion at which their Honours arrived in the courts below. It will not, I hope, be thought discourteous if I refrain from analysing the differing reasons advanced by their Honours and merely point out that the two factors which lead me to reject the application to this case of the "conventional analysis" of the ticket cases is that the ticket in this case was issued in performance of an antecedent contract and that, if the ticket were a mere offer, a passenger's election to decline carriage subject to an exemption clause could be exercised only after travelling to Greece and only if the fare were forfeited.'

The importance of establishing that an unsigned document is contractual is illustrated by the decision of the New South Wales Court of Appeal in *National Australia Bank Limited v Dionys as Trustee for the Angel Family Trust*.[110]

I turn to the facts.

On 14 March 2011, Ms Dionys visited the Marrickville branch of NAB and spoke to a bank officer, Mr Ahmad. On that day she signed an Account Authority Card (Card) for an account to be opened in the name of 'Ms Samantha Dionys as Trustee for Angel Family Trust'. Ms Dioyns signed the Card which recorded that she was on the only person who could authorise transactions on the account. The Card was signed on behalf of NAB by a Mr Melisi who was recorded on the document as the 'checking officer'.

Mr Ahmad gave evidence that was his invariable practice to provide a customer with a printed booklet entitled 'NAB Business Products Terms and Conditions' (NAB Conditions).

This document contained cl 5.18, which read as follows:

You must check your statements

Without limiting any part of these terms and conditions for your account, you must promptly review your statement of account to check for and tell NAB of any transaction recorded on your statement that you suspect for any reason that you did not authorise or for which the information recorded is incorrect. If you do not, then subject to any applicable law, you do not

have any right to make a claim against NAB in respect of such a matter (for example, a forged cheque).

On 18 March 2011 two cheques totalling some $493,000 were paid into the account and, subsequently, on 21 March 2011 NAB debited $492,000 from the account. This amount was transferred to the account of another company with NAB.

In late April 2011 Ms Dionys received a bank statement for the period 11 March to 19 April 2011. It showed the deposits and withdrawals. In October 2011 Ms Dionys claimed that the withdrawals were unauthorised and claimed proceedings against NAB.

The relied upon clause 5.18 of the NAB Conditions.

In the delivering the principal judgment of the Court, Sackville AJA said:

'[49] NAB clearly appreciated that it had to show that cl 5.18 had been incorporated into the agreement with Ms Dionys that governed conduct of the Account. The factual foundation for NAB's case on cl 5.18 was Mr Ahmad's evidence that, in accordance with his usual practice, he handed Ms Dionys the Booklet containing the NAB Conditions when opening the Account on 14 March 2011. Ms Dionys denied that Mr Ahmad told her that there were terms and conditions applicable to the Account or that she had received the Booklet from Mr Ahmad. Both Mr Ahmad and Ms Dionys were cross-examined on their evidence. Ms Dionys adhered to her account, while Mr Ahmad was adamant that there was no possibility that he departed from his invariable practice when dealing with Ms Dionys. There was therefore a conflict in the evidence.'

The first issue to be considered was the burden of proof. As noted by Sackville AJA, the basic principle is that a defendant who denies liability on the basis of a 'limiting term' bears the onus of showing that the term was incorporated in the relevant contract. His Honour continued:

'[58] In my view, cl 5.18, although it does not purport to exclude NAB from liability in all circumstances, is a "limiting term" for the purposes of this principle. The relationship between a banker and a customer maintaining an account in credit is essentially that of debtor and creditor. Unless the customer authorises the bank to make payments in reduction of its undebtedness, or the customer is estopped from denying such authority, the debt remains. Broadly speaking, there are only two exceptions to this principle. First, a customer must exercise reasonable care in drawing cheques to avoid facilitating fraud and forgery and, secondly, a customer must notify the bank of a forgery as soon as the customer becomes aware of the forgery. Attempts by banks to persuade courts to expand the scope of the customer's duties, otherwise than through contractual provisions, have proved unsuccessful.

'[59] In imposing a duty on the customer to review a statement of account "promptly" and to inform NAB of any transaction that the customer "suspects" is unauthorised, cl 5.18 significantly expands the duties owed by a customer to a bank under the general law. A customer who fails to comply with clause 5.18 is at risk of losing the right to claim compensation from NAB for losses sustained in consequence of unauthorised transactions on his or her account. Clause 5.18 therefore goes beyond the general law by imposing substantially more onerous duties on customers and limiting the rights of customers to claim compensation in respect of unauthorised transactions facilitated by NAB. As such, cl 5.18 is properly characterised as a "limiting term" for the purpose of determining whether NAB bears the onus of proving that cl 5.18 was incorporated into the agreement between it and Ms Dionys.'

The second and critical issue was whether the booklet received by Ms Dionys was a contractual document which in term depended on when the agreement with NAB was concluded.

Relevantly, Sackville AJA, in finding against NAB, said:

'[77] In *Baltic Shipping Co v Dillon (Mikhail Lermentov),* Gleeson CJ observed that the question of whether a limitation clause is included in a contract and the question of when and by what means the contract was made are closely related. His Honour pointed out that a resolution of the first question is ordinarily assisted by an analysis of the second. In the present case, the question of whether cl 5.18 was incorporated into the agreement between NAB and Ms Dionys requires consideration of when that agreement was concluded.

'[78] The starting point is the Authority Card signed on 14 March 2011 by Ms Dionys and Mr Melisi, presumably not at the same time. Ms Dionys' evidence, unchallenged on this point, was that she was asked questions by Mr Ahmad, who then produced the Authority Card on the basis of her answers. Ms Dionys read through the document prepared by Mr Ahmad and signed it at the place he indicated.

'[82] Mr Ahmad did not suggest that it was part of his usual practice to inform customers that the NAB Conditions formed part of the agreement with the customer. He simply said that he told customers they could access the terms and conditions on NAB's website. Mr Ahmad's evidence is important for something else he did not say. His evidence was that his practice was to provide the Booklet to customers "when opening a business cheque account" and that, based on his usual practice, he believed that when the Account was opened he handed Ms Dionys the Booklet. Mr Ahmad's evidence does not address whether his practice was to hand the Booklet to the customer before the customer signed the Authority Card or after the document had been signed. Accordingly, his evidence was equivocal as to whether his practice was to hand the Booklet to the customer before or after the customer was asked to sign the Authority Card. If anything, Mr Ahmad's language tends to suggest that the Booklet was not usually given to the customer until after he or she signed the Authority Card. Mr Morrow's evidence is to the same effect.

'[83] Mr Ahmed cannot be expected to have any particular recollection of the circumstances in which the Account was opened. Nevertheless, NAB could have elicited further evidence

from him to clarify his standard practice. As I have pointed out, NAB bears the onus of proving that cl 5.18 of the NAB Conditions was incorporated into the agreement between NAB and Ms Dionys. NAB's failure to elicit more specific evidence from Mr Ahmad allows an inference to be drawn with greater confidence that his practice was not necessarily to give the Booklet (and the other documents to which he referred) to a customer before the customer had signed the Authority Card. *In my opinion, NAB has not established on the balance of probabilities that Mr Ahmad gave Ms Dionys the Booklet containing the NAB Conditions before she signed the Authority Card.*' (emphasis added)

1.4 The incorporation of unusual or onerous terms

Assuming that an unsigned document is contractual, a further question arises as to whether a party seeking to rely upon an unusual or onerous term is required to bring such term to the attention of the other party. This issue was considered in the important decision of the Victorian Court of Appeal in *Maxitherm Boilers Pty Ltd v Pacific Dunlop Ltd.*[111]

In short compass the sequence of events in this case was as follows.

The plaintiff Pacific Dunlop received a quotation for a new autoclave on 25 November 1988. It was expressed to be 'subject to conditions of tender attached'. No such conditions were attached.

On 22 March 1989 the defendant's representative sent to the plaintiff's representative what was referred to at the trial as the 'confirming fax'. The confirming fax contained the words:

'Our offer is based on our standard terms and conditions as per previous quotation V541-11-88 dated 25/11/88.'

Also, on 22 March 1989 Pacific Dunlop forwarded a purchase order number to Maxitherm.

On 23 March 1989 the representatives of the parties signed a specification which contained certain negotiated changes to an earlier specification and provided for payment of a 25% deposit with the order.

On 29 March 1989 Pacific Dunlop prepared a purchase order which on its reverse side contained a set of the plaintiff's standard purchasing terms.

On 31 March 1989 the defendants submitted a document to the plaintiffs containing nothing but the Maxitherm's standard terms and conditions. That document was accompanied by a 'with compliments' slip.

On 22 March 1990 the Autoclave exploded in the course of a production trial.

Maxitherm's terms contained a limitation of liability clause.

The trial judge held that Maxitherm's terms and conditions were not part of the contract.

The trial judge was reversed on appeal. In his reasons for judgement Buchanan JA made the following observations at 567-569:

'In my opinion Pacific Dunlop and Maxitherm did not reach a concluded agreement on 22 March 1989. On that day the parties were in the course of working out the terms upon which the autoclave would be supplied, and neither regarded the process as complete. In determining whether and when a contract is made in the course of an ongoing series of communications, it is necessary to consider the communications as a whole. As Earl Cairns LC said in *Hussey v Horne-Payne* (1879) 4 App Cas 311, at p316:

"... It is one of the first principles applicable to a case of the kind that where you have to find your contract, or your note or memorandum of the terms of the contract in letters, you must take into consideration the whole of the correspondence which has passed. You must not at one particular time draw a line and say, 'We will look at the letters up to this point and find in them a contract or not, but we will look at nothing beyond.' In order fairly to estimate what was arranged and agreed, if anything was agreed between the parties, you must look at the whole of that which took place and passed between them."

'The original quotation incorporated Maxitherm's standard terms. A reasonable reader of the quotation would have concluded that Maxitherm intended to contract in accordance with certain conditions, and that those conditions, which were not contained in the body of the quotation, could be identified. I do not think that the failure to attach the terms would be reasonably taken to countermand the words "subject to conditions of tender". However, even if the absence of attached terms might have been taken to mean that Maxitherm did not intend to contract according to any "conditions of tender", that impression could not have survived the confirming fax, for that document stated in type, not print, that the offer was "... based on our standard terms and conditions as per previous quotation ...". Accordingly, in my opinion Maxitherm's standard terms were made terms of the contract because they formed part of the offer which Pacific Dunlop accepted.

'...

'Once the conclusion has been reached that an express offer containing a party's standard terms has been accepted, there is no occasion to then consider whether sufficient steps have been taken to bring the standard terms to the attention of the other party. The ultimate question is whether the party relying upon the standard terms can properly assume that the other party has consented to those terms.

'I do not intend to convey that express acceptance of an offer which incorporates other terms by reference necessarily connotes acceptance of all those terms. In a case where the person expressing consent has not read the terms, his consent may be taken to be a consent to those terms which are appropriate to a contract of the type in question. If the terms include provisions which no one would anticipate in a contract of the type in question, it would not be appropriate to assume consent to those provisions. The basic enquiry remains whether it is reasonable to assume that a contracting party has assented to the terms put forward by the other party.

'...

'As I have said, in my opinion the inclusion of an unusual term, at least in an unsigned document, may require its proponent to take special steps to bring it to the attention of the other party, for otherwise it may not be reasonable to assume consent to the term. Whether special steps are required, and what those steps must be, will depend upon the circumstances of each case. Further, I think that a term may be unusual because it is more than ordinarily onerous. However, I do not consider that the mere fact that a provision is onerous entitles a court applying the common law to reject it as a term unless special steps have been taken to draw attention to it. The relevant question is whether a contracting party can be reasonably taken to have assented to a particular term, not whether a contracting party should be subject to an unreasonable term.

'In the present case I doubt that any of Maxitherm's standard terms was so exceptional that it was unreasonable to suppose that Pacific Dunlop was not assenting to it by expressly accepting the offer that incorporated the terms. However, whether or not cl15 and cl16, or parts of them, required special steps to be taken to bring them to the attention of Pacific Dunlop in order to incorporate them as terms of the contract, the point only emerged upon appeal. It was not pleaded that cl15 and cl16 or parts of them were not terms of the contract because they were unusual or onerous. In my view it is now too late to raise the point, for evidence may have been led as to whether the terms were unusual in contracts of this type. A point may not be raised for the first time on appeal when it could possibly have been met by calling evidence at trial. *Suttor v Gundowda Pty Ltd* (1950) 81 CLR 418, at p438; *Water Board v Moustakas* (1988)180 CLR 491, at p497-p498.'

Ormiston JA said at 561:

'Where terms are explicitly referred to by an offeror, it can be rare that an apparent acceptance by the offeree should not carry with it the offeree's assent to the whole of the terms described, but I would agree that, where a term is so onerous or is otherwise of a kind such as to suggest that it might not reasonably be expected to be part of the terms of the contract, the issue is whether the accepting party can reasonably be taken to have assented to the particular term. It has not been shown in this case that any of the terms contained in the appellant's general terms and conditions were of a kind which the respondent Pacific Dunlop ought not to be taken to have accepted.'

Maxitherm was considered and applied by the Queensland Court of Appeal in *Surfstone Pty Ltd v Morgan Consulting Engineers Pty Ltd.*[112]

I turn to the facts.

The owners of certain land retained an architect to design a distribution warehouse building. The architect, on behalf of the owners, invited Morgan Consulting Engineers (Morgan) to submit a fee proposal to perform civil and structural engineering services, including design and documentation of the building structure. The fee proposal was submitted on 27 August 2003 and contained the following statement:

'These fees will remain valid for a period of six months from the date of this letter. The commission would be generally in accordance with the ACEA Guideline Terms of Agreement, with terms of payment being 30 days from the date of invoice.'

The ACEA Guideline Terms of Agreement included clause 4.3 which provided:

'The Consulting Engineer shall be deemed to have been discharged from all liability in respect of the Services, whether under the law of contract, tort or otherwise, ... on the expiration of one year from the completion of the Services, and the Client ... shall not be entitled to commence any action or claim whatsoever against the Consulting Engineer ... in respect of the Services after that date.'

In April 2009 signs of problems with concrete floors became apparent. The owners commenced proceedings in 2014 claiming that Morgan was negligent in performing the services.

In response to Morgan's reliance on clause 4.3 of the ACEA Terms, the owners contended that the clause was unusual and onerous and, therefore, had to be specifically drawn to the attention of the owners.

Morrison JA, in delivering the principal judgment of the Court of Appeal, referred with manifest approval to the following observations of the primary judge.

'[51] The learned primary judge, having conducted a thorough review of the authorities in this area, adopted the following propositions for determining whether an offeree is bound by a term set out or incorporated in an unsigned document which the offeror has provided to the offeree in circumstances which show the offeror intends the document to identify terms of the contract:

(a) it is not always the case that the offeree is not bound by an exemption clause, unless the offeror directs attention to the clause;

(b) the fundamental question is whether the offeror is reasonably entitled to conclude that the offeree has accepted the terms in the document, including the exemption clause;

(c) that conclusion should be reached where the offeree has had a reasonable opportunity to consider the terms, including the exemption clause, and has behaved in a way which manifests acceptance of the document as recording contractual terms;

(d) in other cases, where the clause is one reasonably to be expected in contracts of the kind in question, acceptance of the document makes the clause binding, even if the offeree does not know its terms, or even that it is contained in the document; and

(e) if the clause is not one reasonably to be expected, then something more is required by way of provision of information about the clause to the offeree before the contract is formed; what information will be required will depend on the circumstances, but particularly on the terms of the clause.

'[52] His Honour then applied those principles to the present case, and concluded that it was unnecessary for Morgan to

have specifically drawn clause 4.3 to the owners' attention, nor were they required to do more in that regard ...'

In dismissing the owner's appeal, his Honour said:

'[65] Was clause 4.3 a clause that no one would anticipate in a contract of the type in question? That question is posed because of this passage from Buchanan JA in *Maxitherm*:

"If the terms include provisions which no one would anticipate in a contract of the type in question, it would not be appropriate to assume consent to those provisions."

'[66] The type of contract is one between a structural and civil engineer and the owners of land, whereby the engineer is retained to design the structural and civil elements of a building project, but is not responsible for the geotechnical analysis of the land conditions.

'[67] The evidence of Cox, Motto and Quigley provide ample evidence that this is a clause that might be expected in such a contract. Their evidence can be summarised this way:

(a) the ACEA Guideline Terms had been in existence for many years prior to the retainer of Morgan;

(b) the ACEA Guidelines were commonly used in Australia at the relevant time, in various engineering fields;

(c) many structural and civil engineering firms used the Guideline Terms in their fee proposals; and

(d) it was common for such fee proposals to simply refer to the ACEA Guidelines and not attach a copy.

'[68] However, there is more to the context of this particular contract. This contract was being made in circumstances where the owner's representative had highlighted matters of significance concerning geotechnical matters. They related to questions of the land's being susceptible to compressible clay leading to settlement issues. Further geotechnical work was to be done. They are matters which almost certainly would have had an impact on the engineer's exposure once the design services were rendered. In my view, those circumstances mean it would not be surprising at all to find that the design engineer wished to insert clauses in the contract, limiting the design engineer's liability and the scope of warranties.'

1.5 Incorporation of terms by reference in employment contracts

(a) Potential sources

In the employment context there are three potential sources of external documentary material which may potentially be incorporated by reference, namely:

(i) company policy documents including policies relating to redundancy, grievance and discipline, anti-discrimination and bullying and harassment and discretionary bonuses;

(ii) enterprise agreements;

(iii) awards.

(b) The case law

Modern Australian law governing the principles for the incorporation of terms by reference has developed from two decisions of the Full Federal Court, namely, *Riverwood International Australia Pty Ltd v McCormick*[113] and *Goldman Sachs JBWere Services Pty Ltd v Nikolich*.[114]

In *Riverwood* the question was whether the plaintiff, McCormick, was entitled to a redundancy payment referred to and described in the company's Policies and Procedures manual. McCormick's letter of appointment contained the following term:

Company Policies and Practices

You agree to abide by all Company Policies and Practices currently in place, any alterations made to them, and any new ones introduced.'

Riverwood contended that this provision only imposed obligations on McCormick and did not contractually bind Riverwood to comply with any of the provisions of the manual.

The primary Judge (Weinberg J) in finding for McCormick set out the applicable principles as follows:

'[74] In ascertaining the meaning of an expression contained in a contract such as the requirement that the applicant "abide" by all "Company Policies and Practices currently in place, any alterations made to them, and any new ones introduced", the approach to be adopted differs from that taken in statutory interpretation. It must rest on the premise that the contract was made in good faith with the object of at least potential mutual benefit by due performance.

'[75] The court approaches the task of ascertaining the meaning of the parties' expressions from an objective point of view. In the case of a disputed clause in a commercial agreement the essential question is what would reasonable business people in the position of the parties have taken the clause to mean?

'[76] The parties may be bound by the meaning reasonably to be inferred in the circumstances, even if it does not conform to the interpretation advanced by either. It is not necessary that a statement should be subjectively intended to be a term of a contract in order to be one; it is enough if it can reasonably be so understood.'

Riverwood's appeal to the Full Federal Court was dismissed. The Court endorsed Weinberg J's formulation of the relevant principles.

Specifically, North J said:

'[107] The association of the expression "abide by" with the reference to the Manual, essential characteristics of which have been analysed earlier in these reasons, suggest that the clause was intended to oblige Mr McCormick to comply with his obligations and also to signify that Mr McCormick had accepted an offer from Riverwood to the effect that it would comply with the obligations imposed on it by the Manual. Thus, the clause reflected the parties' intention to offer and accept mutual obligations in accordance with the provisions of the Manual. The fact that the clause refers only to "You" is consistent with this construction. While Mr McCormick

agreed to abide by the Manual, he was in part responding to Riverwood in that he agreed to accept its compliance with its obligations under the Manual. The phraseology of the clause was proffered by Riverwood. Mr McCormick's acceptance carried with it an acceptance of Riverwood's offer to abide by the Manual by conferring the benefits provided in the manual in favour of Mr McCormick.

'[108] Thus, in my view the natural meaning of the term under consideration, viewed in the context in which the contract of employment was made, imposed upon Riverwood an obligation to make the redundancy payments in accordance with the provision in the Manual.'

And Mansfield J said:

'[150] In the light of the factual matrix referred to, I share the conclusion of the learned trial judge that the letter incorporates by reference the terms set out in the Manual from time to time including the Redundancy Agreement. I further agree with the conclusion that the presumed intention of the appellant and the respondent, by reason of the policy clause in the letter, was that the respondent would receive the benefits of the policies of the appellant in the Manual as they applied to him, including under the Redundancy Agreement (subject to that policy being changed by the appellant). The agreement "to abide by" those policies, in the circumstances, means that the respondent would receive or enjoy the benefits provided for by those policies but only according to their terms, and would himself comply with the terms of those policies as they applied to him.'

Turning next to *Nikolich*.

Nikolich was offered employment by Goldman Sachs. His letter of offer was accompanied by several documents including a substantial document entitled 'Working with us' ('WWU'). This document contained the following statement:

'JBWere will take every practicable step to provide and maintain a safe and healthy work environment for all people.'

Relevantly, Nikolich was provided with a copy of the document with his letter of offer. He was also required to sign some forms within the document including Goldman's Health and Safety statement. Further the letter of offer contained the following:

General Instructions

From time to time the Company has issued and will in the future issue office memoranda and instructions with which it will expect you to comply as applicable ...

The primary Judge (Wilcox J) held that Nikolich's contract of employment contained a term that Goldman would take every practicable step to provide and maintain a safe and healthy work environment for all people and that Goldman was in breach of this term. Relevantly, Wilcox J said:

'[246] In *Riverwood,* the relevant term of the employment agreement was that the employee would "abide by" the policies and practices contained in a secondary document. In the present case, the relevant term of the employment agreement was that [Goldman] "will expect" Mr Nikolich to "comply as applicable" with presently-existing and future "office memoranda and instructions". There is not much difference between the wording of the two terms. Also, in both cases, the relevant secondary document clearly purported to impose obligations on the employer, some, at least, of which are obligations customarily found in employment contracts and which would otherwise be absent from the employment contract. Accordingly, it seems to me that the approach taken in *Riverwood* has application to this case.'

In dismissing Goldman's appeal Black CJ said:

'[28] In contending that the trial judge was wrong in finding that there was a term of this nature the appellant argued that the language was not contractual and that the statement was merely aspirational. It was said that to construe these statements in WWU as contractual terms involved giving a meaning to them that could not have been reasonably intended.

'[29] As I have noted, the test is objective. What matters is what the language used, in context, would have led a reasonable person in the position of Mr Nikolich to believe. Context is very relevant. Here, it is plain that in WWU the firm was holding itself out as having a commitment, which it regarded as very important, to provide a caring and safe working environment based upon mutual respect and concern. To repeat examples referred to earlier: 'The JBWere culture and "family" approach means each person is able to work positively and is treated with "respect and courtesy" and "Although we are aggressive in the market place, we are not aggressive with each other".

'[30] The difficulty is that the statement in issue is not explicitly contractual in its language and could be seen as merely aspirational. It appears in a document of mixed content and purposes and, although these include contractual purposes, at least the primary repository of the employment contract is unambiguously elsewhere. The context is, however, decisive. In the context of WWU as a whole, if the statement that the firm "will take every practicable step to provide and maintain a safe and healthy work environment for all people" were no more than an aspirational representation, imposing no obligation on the maker, it would be seen as an exercise in hypocrisy. The statement is a reflection of, and is central to, WWU's expression of the "culture" of the firm and its approach to its staff, and its aspirations about the approach its employees will take to each other. The language used, taken in the context as a whole, points to the statement embodying a contractual obligation and the trial judge was correct in holding that it was a term of the contract.'

And Marshall J said:

'[119] The central question on this aspect of the appeal is whether the parties intended to incorporate into their contract some or all of the matters dealt with in WWU.

'[120] The conclusion of Wilcox J on the topic of express incorporation of WWU into the contract is compelling, for the following reasons:

• WWU formed part of the 'office memoranda and instructions' which Mr Nikolich's letter of offer of employment said would be issued and with which he would be expected to comply as applicable. Goldman gave him no other document which may be described as "General Instructions" within the context of the letter of offer;

• Mr Nikolich was required to read WWU and sign some forms contained within it, some of which covered the topics on which Wilcox J made findings, such as the Health and Safety Statement; and

• WWU provided entitlements to employees in addition to setting out directions to them. It sets out what each of the parties could expect the other to do, during its subsistence, in respect of a broad range of matters.'

Jessup J dissented. Importantly, his Honour noted:

'[286] ... the trial Judge considered that there was "not much difference" between the wording in the contract in *Riverwood* and the wording in the respondent's letter of offer in the present case and that the secondary document in both cases purported to impose obligations on the employer, some of which were of a kind customarily found in employment contracts. Thus his Honour held that the "approach" taken in *Riverwood* was applicable in the present case.

'[287] With respect to his Honour, I would have no difficulty following the approach which was taken in *Riverwood*. That approach was to consider all the facts and circumstances surrounding the making of the contract in question, including the content of the documents which were controversial, for the purpose of considering whether the term contended for by the respondent had been established as a matter of inference. Beyond that, I read *Riverwood* as a judgment which turned entirely on its own facts. Little is to be gained, I consider, by picking apart the factual matrix in *Riverwood* with a view to lining up selected elements thereof with individual elements of the matrix in the present case thought to be corresponding in some sense. *Riverwood* was decided the way it was because their Honours in the majority agreed with the trial Judge that the parties intended a particular provision to be a term of the contract of employment. Necessarily, they arrived at that conclusion after considering every fact and circumstance that had the potential to assist in the process of inference. It would be quite inappropriate, I consider, for a later court to seize upon individual elements of their Honours' fact-finding reasoning as though, somehow, they would have some binding or even persuasive impact upon the fact-finding process in which it was itself engaged.

'[288] A significant respect in which the facts of the present case differ from those in *Riverwood* is that, here, the secondary document upon which the respondent relies was given to him at the time he was offered employment, whereas there the appellant's manual was not, at least specifically, given to the respondent employee. Necessarily, in *Riverwood* the "abide by" term was not only important: it was critical. Without it, the respondent's case for express incorporation would have been very different. In the present case, the respondent has the benefit of the circumstance that the appellant provided him with a copy of WWU at the very time it was offering him employment on stated terms.'

The next decision is *Romero v Farstad Shipping (Indian Pacific) Pty Ltd.*[115]

Ms Romero was employed as a deck officer on vessels owned by Farstad under the terms of a letter dated 10 January 2011. Relevantly that letter contained the following:

'You will be expected, if required, to serve on any vessel owned or operated by Farstad Shipping and be flexible in regards to availability. Whilst every attempt is made to accommodate individual requests in allocation to vessels, the decision of the Ship Manager and HR department will be final. In addition, all Farstad Shipping Policies are to be observed at all times.'

The Full Federal Court held that Farstad's workplace discrimination and harassment policy formed part of the contract of employment with Ms Farstad.

Relevantly the Court said:

'[55] In situations where clear language is used and sufficient emphasis is placed upon the need for compliance (implicitly by both parties) with the terms of a company policy, then especially where that goes to fundamental conditions of employment, such as payment and the method of compliance with external statutory obligations, objectively viewed, the parties would be expected to regard such terms as contractually binding.

'[56] The language used in this instance, taking the Policy a as a whole, makes it clear that there is an expectation by the company that there will be mutual obligations. In return for the employee complying with the terms of the Policy, the employer gives a responsive assurance that complaints of non-compliance by other employees will be treated in a certain way.

'[57] While counsel for Farstad suggested that these elements of the Policy were merely directive, that is, directing the employee as to how to go about making a complaint, on proper analysis they are more in the nature of a bargain with an exchange of undertakings and assurances or promises.

'[60] It is relevant that the Policy was the subject of an education program at, or contemporaneously with, the offer of employment and was provided to the employee and that the employee was required to sign the Policy. It is also relevant that the benefit provided is consistent with the nature of the benefit which would be expected to be provided by statute and, therefore, a benefit ordinarily conferred in employment contracts. Further, it is relevant that there was regular reinforcement of policies on an ongoing basis. None of those matters, taken alone, may be decisive, but the cumulative effect of those features of this relationship point towards the incorporation of the Policy into the contract of employment.

'[61] The actual employment context is also particularly pertinent. There would be features of the activity involved in Ms

Romero's employment which could readily lead to particularly problematic situations if bullying and discrimination were not precluded. In the context of operating ships, a calm environment is of particular importance, from a safety perspective, not only for the particular employee, but for many who may be affected by departure from such standards.

'[62] The Policy in this instance was part of the employment contract. The wording of the letter of offer taken with the importance of the Policy terms, the education of employees to reinforce the terms of the Policy are all factors leading to that conclusion. While some parts of the Policy may have been aspirational and some parts directive, Farstad's obligations in relation to dealing with serious complaints of sex discrimination and bullying were contractual promises given in exchange for employees being obliged to comply with the behavioural requirements imposed on employees by the Policy.'

Following *Romero,* the New South Wales Court of Appeal in *McKeith v Royal Bank of Scotland Group PLC; Royal Bank of Scotland Group PLC v James*[116] considered each of *Riverwood, Goldman Sachs,* and *Romero* in the context of an employment contract which contained the following provision:

ABN AMRO Policies:

You agree to be bound by the policies of ABN AMRO as may exist from time to time. You acknowledge and accept that it is the prerogative of ABN AMRO to vary change or terminate existing policies as well as to devise and introduce new policies.

One of the features of this case was that the redundancy policy operated by the company was closed in the sense that an employee did not have access to the policy itself.

The primary Judge applying *Riverwood* considered that the redundancy policy formed part of the contract. Relevantly his Honour said:

'Although the language was not the same, the decision of the Full Court of the Federal Court of Australia in *Riverwood International Australia Pty Ltd v McCormick* [2000] FCA 889; 177 ALR 193 and, in particular, the judgment of Mansfield J provided some support for the construction adopted. The expression "to be bound" in the relevant part of Mr James' contract of employment needed to be construed in the context in which it is to be found being the letter of 1 January 2007. The letter should be regarded as containing an offer by AAAS of the terms on which Mr James would continue to be employed in the position of Chief Executive Officer of AAAH, which terms and conditions included those which Mr James was obliged to perform and those which AAAS was obliged to perform. Although the letter dealt with the "subject of termination" and with the obligations on termination, it was clear from the Policy which both existed and was known to exist at the time the letter was proffered and accepted by Mr James, that what was said under the heading "Termination" did not exhaust the topic and, specifically, did not deal with the question of what might happen over and above the limited provision set out should Mr James become redundant.'

Tobias AJA having considered *Riverwood, Goldman Sachs, Romero* and *Foggo v O'Sullivan Partners*[117] said:

'[125] A number of conclusions may be drawn from the foregoing. First, *Riverwood* was a case decided purely on its own facts. Secondly, the relevant part of the Manual which was found to be critical to the conclusion of the majority in that case was the strong predominance of provisions beneficial only to the employee. Thirdly, in *Goldman Sachs* some of the provisions of the WWU which the respondent sought to have incorporated into his contract of employment were clearly contractual in nature but not the complaints process on which the respondent relied. The case turned on its own facts. Fourthly, the same observation may be made about *Romero* and *Foggo.* The nature of the relevant policy provisions in these cases is quite different from that relied on by Mr James. No principle can be derived from the authorities called in aid by Mr James of his claim that the Policy was incorporated into his contract of employment so that AAAS was bound to give effect when it terminated his employment on the ground of redundancy.

'[126] Accordingly, the secret terms of the Policy and the relevant text of Mr James' contract of employment when properly construed, would not lead a reasonable person in the position of Mr James to conclude that AAAS intended to be contractually bound by the Policy upon the basis that it was expressly incorporated as a term of Mr James' contract of employment.

'[127] Accordingly, I am unable to agree with the primary judge's conclusion at [76] of his reasons that the Policy, as it stood at the time Mr James' employment was terminated, was incorporated into his Contract of Employment and was thus binding upon both Mr James and AAAS. It follows that the judgment entered by his Honour in favour of Mr James based upon breach of the Policy as a term of his Contract of Employment must be set aside unless it can be justified on other grounds.'

1.6 Overview of key conclusions

(a) Each case is highly fact sensitive.

(b) The fundamental governing principle is that whether an external policy document forms part of an employment contract turns upon the intention of the parties to be objectively determined having regard to all surrounding facts and circumstances.

(c) The ability of an employer to unilaterally vary the contents of a company policy does not prevent that policy from forming part of the relevant employment contract.

1.7 A possible new approach in employment contracts

In *Westpac Banking Corporation v Wittenberg*[118] Buchanan J in the Full Federal Court proposed a different analysis in relation to the potential application of company policies. His Honour said:

'[109] I note that, in *McKeith v Royal Bank of Scotland Group PLC* [2016] NSWCA 36, the New South Wales Court of Appeal (Tobias AJA, with whom Macfarlan JA and Emmett AJA agreed) considered each of *Riverwood, Goldman Sachs* and *Romero* and distinguished each of them on various grounds. Tobias AJA concluded in that case that an employer's redundancy policy had not been incorporated in contracts of employment. For separate and different reasons it was found that a promise, which was later made to apply the policy in particular circumstances, was contractually effective. The analysis does not appear to me to provide specific support for the approach to questions of incorporation which I wish to call into question.

'[110] It may have been sufficient in each of *Riverwood, Goldman Sachs* and *Romero* to imply a term as a matter of fact that, in light of the formal imposition of its policies, the employer would honour so much of those policies as, at any particular time, operated for the real and practical benefit of an employee (eg, assured payments, distinct procedural protections) and would not arbitrarily or capriciously withdraw them. An evaluation would need to be made on the facts of particular cases, but I see no reason in principle why an implication of that kind would not in many cases meet the usual tests — certainty, necessary to give business efficacy, so obvious it goes without saying, consistency with express terms, etc (see *BP Refinery (Westernport) Pty Ltd v President, Councillors and Ratepayers of the Shire of Hastings* (1977) 180 CLR 266; 16 ALR 363). The approach would be consistent with authority concerning a contractual right to participate in discretionary bonus systems, which I discuss hereunder.

'[111] One thing that would be avoided by such an approach would be the artificiality of proposing contractual force to obviously discretionary procedures, or vision statements or general aspirations. It may avoid the tedious complexity which attends attempts to use the notion of incorporation. Any suggestion that less than a full statement of policy is contractually incorporated necessarily operates upon an assumption that such matters must be excluded from the incorporation but, in my respectful view, that approaches the matter from the wrong direction and loads the assessment in favour of contractual obligation. The great strength of the law of contract is its identification of certainty of obligations and corresponding rights — at the time the contract is made. Any incorporation must be no less certain — at that time. Implication of terms may produce a more flexible outcome. To take only one example — an implication (whether as a matter of law or fact) of reasonable notice on termination poses a test which is, in practical terms, to be evaluated for its operative content on termination, not on commencement. An implied term of observance of real and practical benefits under policies and of no arbitrary or capricious withdrawal permits evaluation according to the circumstances and practical realities of the time.

'[112] Whatever might be the correct view about such an approach, in my respectful view it is an error of analysis to argue from the language of a policy to a conclusion that the terms of the policy are contractual. The analysis must begin with the terms of the contract itself. Then, if it is suggested that a requirement for obedience to the terms of a policy (or any other instruction) by an employee is an aspect of some mutual or reciprocal obligation to obey the policy a further enquiry is warranted and necessary. It is whether the employer is free, at its own discretion and without any form of consultation with an individual employee, nevertheless to unilaterally alter the policy — ie, its own policy. If it is, I do not readily see how the terms of the policy can be seen as a mutual statement of contractual rights and obligations. It is generally not suggested in cases of this kind that any contractual obligation represented by the policy remains fixed as at the date of contract. It is generally accepted that an employee must comply with the terms of the policy as set by the employer from time to time. That feature, in my view, denies the necessary quality of mutuality. That mutuality is not supplied by what is, in truth, an acknowledgement by an employee in a contract of employment that the policies of the employer are relevant instructions or directions which must be complied with.

'[113] A possible exception to this concern, and one which in fact arises on the facts of the present case, is where an adjustment to duties is made for a defined period by reference to published criteria. In the present case, for example, a number of the employees were seconded to Westpac in a context where SGB had a published policy that secondment could not exceed 12 months. It was accepted that there could be no forced secondment; agreement was necessary. Agreement was clearly given in each case upon the basis of the 12-month limitation which was thereby incorporated. Despite a change to the policy in that period, rewording the limitation, I accept that any extension of secondment would require explicit consent. But such is not a case of agreement to abide by policies as stated from time to time. It is a more classic case of incorporation of a known term by reference, in a collateral contract or variation for a fixed term.'

1.8 Incorporation by a course of dealing

The principles governing the incorporation of terms by a course of dealing were recently considered by the Western Australia Court of Appeal in *La Rosa v Nudrill Pty Ltd.*[119]

However, before considering that decision it is appropriate to turn to the earlier case law, both English and Australian.

The starting point is the decision of the Full Court of the Supreme Court of Victoria in *D J Hill & Co Pty Ltd v Walter H Wright Pty Ltd.*[120]

The defendant, in accordance with an oral contract made in September 1966, carried certain machinery for the plaintiff. The machinery was damaged in transit. The evidence was that upon delivery of the machinery, two documents, one relating to a crane used by the defendant in the removal and the other

relating to the machinery, were signed by an employee of the plaintiff. The latter document contained an exclusion clause. Evidence was adduced that between February and September 1966 the defendant had carried goods for the plaintiff on about 10 occasions and on each such occasion a document containing conditions similar to the conditions in the document under consideration had been signed by the plaintiff's employee on delivery of the goods. The defendants contended that by a course of dealing the exclusion clause was incorporated in the carriage contract which provided the defendant with a complete defence.

Winneke CJ delivering the judgment of the full court said at 753:

'On the occasion of the first dealing between the appellant and the respondent in the month of February 1966 it is clear that the contract was oral, that the contract was made before the form was presented, and moreover, that performance of the contract by the appellant was complete by that time. On that occasion the form, in our opinion, was plainly not a contractual document between the parties.

'...

'On each subsequent occasion the dealing between the appellant and the respondent followed precisely the same course as on the first occasion. The contract was made orally, the appellant performed its part of the contract by delivering the goods, and it was only at that stage that the form was presented to the respondent for signature. In these circumstances, disclosed by the evidence, we can see no justification for holding that any of the subsequent contracts was in any different position from the first, or that in any of them the form became a contractual document. It is true that by the time second and subsequent contracts were made the respondent had knowledge of the existence of the form, but it was unaware of the content of the terms and conditions on the back of it and regarded it, being presented when it was, as nothing more than an acknowledgment by it of delivery of the goods. These circumstances, in our view, afford no basis for regarding the form as a contractual document in any of the subsequent contracts or for importing the terms and conditions endorsed thereon as terms of the subsequent contract. It is, we think, impossible to conclude on the facts evidenced in this case that at any point of time in the earlier dealings between the parties the form became a contractual document or was mutually treated by them as such. There was, we think, no evidence of any course of prior dealing in which the parties mutually regarded the terms and conditions endorsed on the back of the form as part of the contract between them.'

Hill v Wright was followed by the Full Court of the Supreme Court of Western Australia in *Rinaldi & Patroni Pty Limited v Precision Mouldings Pty Ltd.*[121] The facts were on all fours with *Hill*.

An oral contract was made in November 1980 for the transportation by the defendant of the plaintiff's 42-foot fishing boat from Perth to Melbourne. On the outskirts of Melbourne the prime mover and trailer carrying the boat went under a bridge in the incorrect lane where the bridge had a reduced clearance. The boat struck the underside of the bridge and was badly damaged.

Evidence was adduced that between April 1980 and November 1980 the defendant had carried goods for the plaintiff on 10 or perhaps nine occasions. The practice on these occasions was that the defendant would supply the driver with a book of 'Cart Notes'. The notes were produced in triplicate. One of the notes was attached to an invoice after completion of the carriage and sent to the plaintiff. On the face of each Cart Note were the words 'All goods are accepted subject to conditions on the reverse'.

One of the conditions exempted the defendant for liability for negligence.

The defendant sought to rely on the exemption clause contending that it was incorporated by a course of dealing. Burt CJ rejected the defendant's contention noting at 135:

'In argument it was conceded that there was no basis upon which the term could be implied in the contract of carriage first entered into which on the facts would appear to be a contract entered into on 30 April 1980 — cart note 13385. The submission is that at some unspecified time thereafter, the oral agreements should be held to have been made upon the terms of the "conditions" and it should be so held by reason of "a course of dealing" between the parties. The proposition expressed in general terms is that if it should appear that the parties had over a period of time been conducting business upon terms excluding liability then it should be held that on the occasion in question they contracted upon that basis. The difficulty in making good that proposition upon the facts of this case is evident enough. Once it is conceded that the use of the cart notes in the way in which they were used could not sustain a finding that the contract first entered into contained as a term cI 5 of the conditions, how does one then establish the relevant course of business which leads to the conclusion that without the respondent being fixed with actual knowledge of that term it is to be implied in subsequent contracts.'

And in reference to *Hill's* case his Honour said at 138:

'What is there being said is that in every case, as in the instant case, the document containing the exemption clause was presented for signature after the contract had been performed and that it was not a contractual document in that the respondent reasonably regarded it, being presented as it was, as being nothing more than an acknowledgment by it of the delivery of the goods. In that respect, I think that that case is on all fours with the present case.'

The central point in both of these cases appears to be that the documents sought to be relied upon had never been treated by the parties in their prior dealings as contractual documents. Importantly, in each case the documents were signed after the oral contract was made.

In *La Rosa v Nudrill Pty Ltd*[122] the Western Australia Court of Appeal revisited the case law.

Although the Court did not question the correctness of the decisions in *Hill* or *Rinaldi,* the Court formulated the test for incorporation in a somewhat different way.

McLure P cited with evident approval the approach of Lord Pearce in *Henry Kendall & Sons v William Lillico & Sons Ltd.*[123] His Lordship said at 113:

'In the present case SAPPA had regularly received more than a hundred similar contract notes from Grimsdale in the course of dealing over three years. They knew of the existence of the conditions on the back of the contract note. They never raised any query or objection (Havers J. [1964] 2 Lloyd's Rep. 227, 267). The court's task is to decide what each party to an alleged contract would reasonably conclude from the utterances, writings or conduct of the other. The question, therefore, is not what SAPPA themselves thought or knew about the matter but what they should be taken as representing to Grimsdale about it or leading Grimsdale to believe. The only reasonable inference from the regular course of dealing over so long a period is that SAPPA were evincing an acceptance of, and a readiness to be bound by, the printed conditions of whose existence they were well aware although they had not troubled to read them. Thus the general conditions became part of the oral contract.'

McLure P then noted at 43:

'A review of all the cases reveals that there is no single test for the incorporation of a term into a contract based on prior dealings. However, it is clear that we are not here talking about implied terms in fact (which must satisfy the test in *Codelfa Construction etv Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 at 347) or a term implied as a matter of trade custom or usage. The question is whether an express term is incorporated into a contract as a result of an inference arising from the prior conduct of the parties as a whole. Moreover, it is not essential in a prior dealing case that the term in issue must have been incorporated in a previous contract between the parties, whether by a contractual document or otherwise. The trial judge erred in that regard.'

And her Honour concluded at 45 to 47:

'In the ticket cases, notice of the terms is given on or around the time of entry into the relevant contract and constructive knowledge of the content of the term(s) is sufficient: *MacRobertson Miller Airline Services v Cmr of State Taxation* (WA) (1975) 133 CLR 125. Moreover, in the ticket cases the expression "contractual document" is used to refer to the sort of document in which a reasonable person would expect to find contractual terms. However, in the prior dealing cases it has a wider meaning to include documents which the parties have by their conduct accepted or treated as a contractual document. Kendall falls within this category.

'Anderson J in *Brambles* adopted and applied Lord Pearce's test in *Kendall* for the incorporation of terms by prior dealings. That test seems more appropriately adapted to the circumstances in which prior dealings are relied on. On that test, actual knowledge of the content of the relevant term(s) may be sufficient to justify an inference of an acceptance of, and readiness to be bound by, the conditions in the document, but is not essential.

'However, regardless of which test is applied, the facts in this case do not support an inference that the exclusion clause was incorporated in the cartage contract as a result of the prior dealings between the parties. I will assume for present purposes that the dealings between all the various entities can be taken into account. The invoices were not a "contractual document" within either the narrow or wider meaning of the expression. In each case the invoice was provided to the respondent for services already supplied pursuant to a prior contract. The purpose of the invoices was to secure payment for those services. The receipt of the invoices by the respondent in all the circumstances is not sufficient to justify an inference of an acceptance by the respondent of, and readiness to be bound by, the terms on the reverse of the invoices. Nor is it sufficient notice to the respondent of the terms on which the appellant would do business in the future. I would dismiss this ground of appeal.'

Buss JA noted at 68:

'It will be a question of fact and degree whether, in a particular case, the parties, by their conduct, have incorporated a term into their contract by a previous course of dealings. Each case turns on its own facts and circumstances. Factors of relevance in determining whether the alleged term was incorporated include the number of prior dealings, how recent they were, and the consistency in the prior dealings and the dealing in question (for example, the similarity between the subject matter of the dealings and the manner in which the dealings were entered into or concluded). This is not, of course, an exhaustive statement of relevant factors.'

And his Honour Buss JA continued at 71:

'It is not an essential pre-condition to the incorporation of a term by a previous course of dealings that:

(a) any document containing the relevant term have been sent or given to the party sought to be bound at or prior to the formation of each of the contracts (or one or more of them) constituting the previous course of dealings; or

(b) the relevant term have been incorporated in at least one of the contracts constituting the previous course of dealings.'

With respect to the need to find that the relevant terms formed part of an earlier contract, his Honour said at 73:

'In the present case, the trial judge was of the view that the Full Court of the Supreme Court of Victoria (Winneke CJ, Starke & Anderson JJ) in *DJ Hill & Co Pty Ltd v Walter H Wright Pty Ltd* (1971] VR 749, and Burt CJ in *Rinaldi & Patroni,* held that a term could not be incorporated into a contract by a previous course of dealings unless the term was contained in an earlier contract or contracts between the parties [120], [169]. This view was, with respect, erroneous.'

The significance of *La Rosa* is the finding by the Western Australia Court of Appeal that incorporation of a term by a course of dealing may be established without evidence that the term ever formed part of an earlier contract between the parties. It is not clear that this finding correctly reflects earlier Australian case law.

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108 (2004) 219 CLR 165
109 (1988) 165 CLR 197
110 [2016] NSWCA 242
111 [1998] 4 VR 559
112 [2016] QCA 213
113 (2000) 117 ALR 193.
114 (2007) 163 FCR 62.
115 [2014] FCAFC 177
116 [2016] NSWCA 36
117 [2011] NSWSC 501
118 [2016] FCAFC 33
119 [2013] WASCA 16
120 [1971] VR 749
121 [1986] WAR 131
122 [2013] WASCA 18
123 [1969] 2 AC 31

What are the rules of construction that apply to 'reverse indemnity' clauses?

William John Potts*

ABSTRACT

Few clauses attract as much attention throughout contract negotiation as indemnities, which are a severe but effective means of allocating risk and apportioning liability. Indemnities are often rejected in the first instance by the party being asked to provide the indemnity or otherwise restricted by applying a monetary cap or carving out certain categories of loss. Parties likewise often seek to limit or exclude liability attributable to the counterparty's negligence. However, some parties continue to agree to uncapped and unlimited indemnities and even 'reverse indemnities', where one party indemnifies the counterparty in respect of loss or damage attributable to that counterparty's own acts or omissions. This paper will explore the case law on reverse indemnity clauses, with the aim of ascertaining how indemnities are interpreted as a matter of contract construction, particularly in the context of negligence.

INTRODUCTION

Indemnities are one of the key contractual devices for allocating risk and limiting liability. While it is generally accepted that indemnities are designed to hold a party harmless from loss or damage, there is much debate over the nature and categorisation of indemnities and a view that 'wide usage has not generated a common understanding or approach'.[1]

This paper is not concerned with the various forms an indemnity can take, or why the indemnity is not well understood and has evaded attempts to be defined. It will focus on the 'reverse indemnity', as judicial consideration of such provisions appropriately informs the different rules of construction used to interpret indemnities. The reverse indemnity (or 'reflexive indemnity') is where one party indemnifies the counterparty in respect of loss or damage arising as a result of that counterparty's own acts or omissions. In other words, a contractual device to protect against the consequences of one's own negligence.

The paper will comprise three parts. Part I will consider key principles and concepts relating to contract construction and indemnities in general, before making some more specific comments about reverse indemnities. Case law will be examined in Part II, which will reveal different methods of construction and at times, inconsistent approaches. Part III will attempt to resolve some of the apparent ambiguity in this area and establish the relevant rules and principles that apply to the interpretation of reverse indemnities.

The conflict between commercial construction and strict construction will be a principal theme in this paper. Despite a resurgence in strict construction, commercial construction is or at least *should* remain relevant in determining the intention of the parties.

Another theme which will be explored is the tension between concern over the apparent incongruity of allowing a party to be indemnified for the consequences of their own negligence and an economic liberty perspective in which parties should be free to agree to terms and allocate risk as they choose. Finally, some brief comments will be made on drafting reverse indemnities.

I: PRINCIPLES AND CONCEPTS

Contract construction

'Construction' is the process by which the meaning, legal effect or application of a contract is determined and given effect to. It describes the method employed to ascertain or 'construct' the intention of the parties through legally available material. It is said to be an objective exercise, in which the focus is on how contractual rights and obligations would be reasonably understood, rather than the actual beliefs or intention of the parties.[2] This was expounded in *Codelfa Construction v State Rail Authority of New South Wales* (*Codelfa*), where the High Court endorsed the approach to construction adopted by Lord Wilberforce. That approach was concerned with 'the surrounding circumstances' and 'commercial purposes of the contract', which could be gleaned from looking at the 'genesis of the transaction, the background, the context, the market in which the parties are operating'.[3] This is an illustration of 'com-

mercial construction', which applies the standard of interpretation of a reasonable commercial person.

Commercial construction can be contrasted with 'strict construction'. Strict construction is typically associated with a literal and narrow reading of relevant words, or a 'black letter law' interpretation. In the context of indemnity clauses it generally involves a reading down process such that the indemnifier is favoured over the indemnified party.[4] An example is *Davis v Pearce,* where the High Court accepted 'an exempting clause must be construed strictly, and that clear words are necessary to exclude liability for negligence'.[5]

While the emergence of commercial construction has been traced back to the 18th century,[6] the classic authorities derive from the latter half of the 20th century. Lord Wilberforce's judgements were pivotal.[7] Another frequently cited authority is *Photo Production v Securicor Transport* (*Photo Production*), where the House of Lords rejected the doctrine of fundamental breach in favour of natural construction. Lord Diplock found that it was 'wrong to place a strained construction upon words in an exclusion clause which are clear and fairly susceptible of one meaning only'.[8] This approach was endorsed and developed by Lord Hoffman, who set out the key principles that replaced the 'old intellectual baggage of "legal" interpretation' in *Investors Compensation Scheme v West Bromwich Building Society*.[9] Lord Steyn described the modern approach as 'commercially sensible construction', while Judge Bowsher referred to it as a 'business common sense' approach.[10] The key cases in this area reveal the guiding characteristics of commercial construction to be the surrounding circumstances or factual matrix of the contract, practical consideration of internal context, a common sense approach to commercially sensible construction, uniformity in construction, and avoiding construction that ensures the contract will fail for uncertainty.[11]

Over time, commercial construction became the dominant or preferred method of construction, as modern courts regarded it as being more likely to give effect to the intention of the parties than strict construction.[12] However, the earlier methods of application are not redundant. An evolution from formalism to literal construction to commercial construction has occurred rather than those earlier methods of application being replaced or superseded.[13] Commercial construction has been hailed as 'arguably the most significant development in the modern law of contract'.[14] Nevertheless, as we shall see, strict construction has enjoyed a revival in the context of indemnity clauses following the High Court decision in *Andar Transport v Brambles* (*Andar*) in 2004.[15]

Indemnities

An indemnity can take numerous forms, but in general terms they are designed to hold a party harmless from loss or damage or shift responsibility for such loss from one party to another. In *Sunbird Plaza v Maloney,* Mason CJ described an indemnity as 'a promise by the promisor that he will keep the promisee harmless against loss as a result of entering into a transaction with a third party.'[16] In *Andar,* Kirby J described them as 'provisions that purport to exempt one party from civil liability which the law would otherwise impose upon it. They are provisions that shift to another party the civil liability otherwise attached by law to the first party.'[17] Judicially, disputes over indemnities usually come down to whether the relevant loss falls within the scope of the indemnity.

Historically, indemnities were often determined by reference to risk allocation clauses such as exclusion or insurance clauses.[18] In modern times, indemnities are common place in commercial contracts. For example, standard bank facility agreements (whether with retail or wholesale clients) include indemnities to ensure the bank will be able to recover losses, liabilities, costs and expenses attributable to the client or loan. In large-scale infrastructure projects, the client (typically the State) will normally seek an indemnity from the principal contractor and consultants, who in turn will seek indemnities from their sub-contractors and advisors.[19] As indemnities will effectively run through the contractual chain, they should ultimately be supported by insurance or professional indemnity cover.[20]

Availability of reverse indemnities

As a general principle of Australian law, a party may be indemnified for the consequences of its own negligence. While there are exceptions,[21] the availability of such indemnities can be contrasted with jurisdictions in other parts of the world which have legislated against them.[22] Accordingly, the question of whether an indemnity can apply to protect a party from the consequences of their own negligence is ultimately a question of construction.[23]

'*Canada Steamship* Rules'

The traditional approach to the construction of indemnity clauses in this area was expounded by Lord Morton of the Privy Council in *Canada Steamship v The King* (*Canada Steamship*) in what came to be known as the '*Canada Steamship* Rules':[24]

1. If the clause contains language which expressly exempts the person in whose favour it is made (hereafter called 'the proferens') from the consequence of the negligence of his own servants, effect must be given to that provision ...

2. If there is no express reference to negligence, the court must consider whether the words used are wide enough, in their ordinary meaning, to cover negligence on the part of the servants of the proferens ...

3. If the words used are wide enough for the above purpose, the court must then consider whether 'the head of damage may be based on some ground other than that of negligence,' to quote again Lord Greene in the *Alderslade* case.[25] The 'other ground' must not be so fanciful or remote that the proferens cannot be supposed to have desired protection against it; but

subject to this qualification, which is no doubt to be implied from Lord Greene's words, the existence of a possible head of damage other than that of negligence is fatal to the proferens even if the words used are *prima facie* wide enough to cover negligence on the part of his servants.

Issues and interpretation

Reverse indemnity clauses which explicitly cover negligence have been upheld on numerous occasions. One such case is *Qantas Airways v Aravco* (*Qantas*), where Qantas sought an indemnity from Aravco for damage caused to an aircraft as a result of its own negligence. The relevant clause stated that Aravco 'agrees regardless of any negligence on the part of Qantas to release, hold harmless and indemnify Qantas from and against all liabilities, claims damages, losses, costs and expenses ...'. The High Court had no difficulty in finding that negligence was covered by the clause and thus upheld Qantas' claim.[26] Likewise, in *Leighton Contractors v Smith* (*Leighton*), the New South Wales Court of Appeal (NSW CA) found Leighton was entitled to full recovery in respect of loss arising from its own negligence, as the relevant clause provided that the subcontractor indemnify Leighton in respect of 'any act, error, or omission or neglect'.[27] It appears clear that an indemnity of the sort encountered in these cases (both of which fit within the first *Canada Steamship* Rule) would be enforced in favour of the indemnified party.

However, indemnity clauses do not always specifically address negligence, as the second and third *Canada Steamship* Rules reveal. Case law generally indicates that where there is no mention of the word 'negligence', clauses designed to exclude 'all liability' or 'any loss' will not be wide enough to cover negligence, unless accompanied by words such as 'whatever its cause' or 'however caused'.[28] Reflecting on this issue in *Smith v South Wales Switchgear* (*Switchgear*) (a case which applied the *Canada Steamship* Rules), Lord Fraser of Tullybelton said 'I do not see how a clause can "expressly" exempt or indemnify the proferens against his negligence unless it contains the word "negligence" or some synonym for it'.[29] Nevertheless, he accepted that the words 'any liability, loss, claim or proceedings whatsoever' were wide enough to cover negligence on the part of the respondents. Likewise, Viscount Dilhorne stressed the importance of 'very clear words' for such an indemnity. The same approach is evident in Australian case law,[30] with some judgements suggesting an undisputed acceptance of the first two *Canada Steamship* Rules.[31]

It is the third rule that has been the subject of much scrutiny and debate. In effect it requires that if there are two possible bases of liability, negligence will not be covered by the clause. This principle was not controversial at the time of the *Canada Steamship* case, being a restatement of the law applicable then.[32] However, much has changed since then and on balance, it appears this rule no longer applies in Australia.

The case law on reverse indemnities reveals competing tensions. Broadly, the issue is one of construction and what the correct approach is. Does the general or ordinary approach to construction apply, or are there 'special' rules that apply? Should a strict or commercial approach be adopted in construing a reverse indemnity?

II: CASE LAW AND INTERPRETATION

Pre-*Andar*: Commercial construction

Prior to *Andar,* the classic Australian authority in this area was *Darlington Futures v Delco* (*Delco*). In *Delco,* the High Court looked to a series of cases, beginning with *Photo Production,* as grounds for rejecting the principle that exclusion clauses should be construed strictly. It set out a commercial approach to construction, stating that the interpretation of an exclusion clause is to be determined by:[33]

'... construing the clause according to its natural and ordinary meaning, read in the light of the contract as a whole, thereby giving due weight to the context in which the clause appears including the nature and object of the context, and, where appropriate, construing the clause *contra proferentem* in the case of ambiguity.'

Delco concerned an exclusion clause, not an indemnity, but the principles were later said to apply to indemnities. *Delco* encapsulates 'commercially sensible construction'. It has been followed in numerous cases.

In *Schenker v Maplas* (*Schenker*), when faced with the question of whether a reverse indemnity covered negligence, the Victoria Court of Appeal considered the *Canada Steamship* Rules but found them to be inconsistent with the principles adopted in earlier Australian cases, culminating in *Delco.* The leading judgement was given by McGarvie J, who said that since *Delco,* 'strained constructions' are no longer available under Australian law in the construction of commercial contracts between business people.[34]

Schenker was followed in *Valkonen v Jennings Construction* (*Valkonen*), where the Supreme Court of South Australia recognised that the first two *Canada Steamship* Rules 'provide acceptable working rules' but that the third rule 'imposes an artificial and inflexible rule of interpretation that is as likely as not to frustrate the intention of the parties'. The Court found that 'modern commercial conditions' may warrant that a party be indemnified for all liability, even that which is its own fault.[35]

Schenker was also followed in *Glebe Island Terminals v Continental Seagram* (*Glebe Island*). Sheller JA stressed that the words of Lord Diplock in *Photo Production* approved in *Delco* 'can and should be applied to indemnity clauses'. In rejecting the strained construction of an indemnity, Sheller JA reflected 'businessman are capable of looking after their own interests and of deciding how risks inherent in the performance of various kinds of contracts can be most economically borne.'[36]

These cases are synonymous with commercial construction. They indicate a divergence from the older approach of strict

interpretation and a presumption against the indemnified party, an approach which some justices clearly associated with the *Canada Steamship* Rules. Nevertheless, it is questionable whether the principles adopted in these cases also necessitated a divergence from or rejection of the third *Canada Steamship* Rule. J W Carter has argued that the notion that commercial construction amounts to the demise of the *Canada Steamship* Rules is a 'gross oversimplification'.[37] A related issue is whether *Delco* should apply to indemnities at all. Meagher JA of the NSW CA considered it should and that *Delco* was incompatible with the *Canada Steamship* Rules and confirmed as much in *NSW v Tempo Services*.[38] Shortly after that case, the High Court handed down a decision which altered the development of the law in this area.

Andar: Strict construction

In *Andar,* the High Court held that 'a strict construction should be adopted' to indemnity clauses.[39] The dispute arose in relation to an employee/director of Andar suffering an injury while providing services to Brambles, which was held to be negligent. The relevant clause required Andar to indemnify Brambles for any 'loss, damage, injury or accidental death from any cause to property or person occasioned or contributed by any act, omission, neglect or breach or default of [Andar]'. The High Court held that the liability of the indemnifier was *strictissimi juris* (a rule which had previously no application to indemnities) and found that because the clause did not expressly refer to Brambles' liability concerning Andar's employees, it could not construe it to cover such damages. It applied the contra proferentem rule to the clause, so that any ambiguity was resolved in favour of the indemnifier, Andar. Consequently, Brambles was liable for the damages, with the High Court holding that the indemnity was limited to any vicarious liability Brambles might incur to third parties. The decision in *Andar* is troubling for several reasons.

Firstly, it is not clear why the indemnity was ambiguous or why it was necessary to apply the *contra proferentem* rule. This aspect of the decision was dissected in the dissenting judgement of Callinan J. Referring to *Delco,* his honour said that clauses should be given their natural and ordinary meaning. The case was not one of 'an ambiguity of language in a contract' and nor did the ordinary meaning of the words in question produce any absurdity. As such, there was no reason to rely on the contra proferentem rule, a rule that was generally regarded as a remedy of last resort, as Kirby J had explained in an earlier judgement.[40] It seems that the ambiguity in *Andar* was artificially created by application of the *strictissimi juris* rule.[41] This was unnecessary and unwarranted, both as a matter of principle and in terms of doing justice to the parties in dispute.

Secondly, the High Court's decision to equate guarantees with indemnities is bewildering. It served as the basis for it applying the *contra proferentem* rule, but it is not clear why indemnities were treated like guarantees in the first place. In considering the principles of construction applicable to contractual indemnities, the High Court began, as 'the starting-point', with the decision in *Ankar v National Westminster Finance* (*Ankar*).[42] *Ankar* did not concern an indemnity, but rather, guarantees and the question of whether breach was sufficient to discharge the surety from liability. Nevertheless, the principles adopted in *Ankar* and applied in *Chan v Cresdon*[43] were found to be 'relevant to the construction of indemnity clauses' and being ambiguous, the clause was read down.[44] The High Court knowingly diverged from its earlier formulation of an indemnity as a promise to hold a party harmless[45] in favour of a guarantee infused satisfaction of liability (or 'make good') construction. This approach has been heavily criticised for ignoring established authority that indemnities and guarantees are different creatures of law.[46]

The strict construction principles for guarantees set out in *Coghlan v SH Lock* were also cited with approval.[47] In that case however, Lord Oliver of Aylmerton held that in cases of ambiguity, the surrounding circumstances remain pivotal and were not to be displaced by strict construction.[48] Such reasoning was not evident in *Andar*, where the High Court arguably applied a stricter approach than some of the authorities it relied upon. Moreover, reading *Andar* in isolation, one could be forgiven for assuming that a lack of relevant case law on indemnities forced the High Court to look elsewhere for guidance. It is perplexing that the High Court embarked on a lengthy investigation into guarantees, yet declined to state its position on the *Canada Steamship* Rules or other related authorities.

Finally, the decision can be criticised for undermining commercial construction by applying a special rule for interpreting indemnities. Commercial construction is central to modern commercial law. As commercial parties have come to assume and expect this, any apparent departure or deviation will inevitably create uncertainty, particularly when endorsed by the High Court in the absence of justifications for such approach. The High Court's reference to the principles of construction 'applicable to contractual indemnities'[49] may indicate that it sees indemnities as having their own particular or 'special' rules for construction. Unsurprisingly, the High Court has been criticised for 'undermining its own decision in *Delco*' and 'commercial construction in general'.[50] Predictions that the application of a special rule would create 'anomalies'[51] have arguably borne true, as shown in subsequent case law.

Post-*Andar*: Strict construction, commercial construction or something else?

Pacific Carriers v BNP Paribas (*Paribas*) was the next case the High Court heard after *Andar.* In *Paribas,* the High Court said that the construction of an indemnity is to be determined by 'what a reasonable person' in the position of the indemnified party 'would have understood [it] to mean', which requires con-

sideration of the contract, as well as 'the surrounding circumstances' known to the parties and the 'purpose and object of the transaction'.[52] It cited the aforementioned statement of Lord Wilberforce approved in *Codelfa* in support of this proposition. *Paribas,* which has been described as a 'triumph' for commercial construction,[53] appears to be at odds with the strict construction approach adopted in *Andar.* Given *Paribas* and *Andar* were decided consecutively, it would seem unlikely that the judgements are incompatible. Beyond both cases involving disputes over indemnities, the cases have little in common. The issue in *Paribas* was whether an indemnity was available for losses suffered for delivering a cargo of goods in the absence of bills of lading. Consequently, the different approaches to construction can presumably be put down to factual differences between the cases. This strengthens the view that commercial construction still has a role to play in the interpretation of indemnities generally, even if it does not for reverse indemnities of the sort seen in *Andar.* Conversely, it may signal that special rules are emerging for such indemnities.

Normoyle v Transfield (*Normoyle*) was decided shortly after *Andar.* In *Normoyle,* the NSW CA had to determine whether injuries suffered by a worker were covered by a clause which required the subcontractor to provide an indemnity in circumstances 'arising as a result of any act, neglect or default of the subcontractor ... relating to the execution of the works'. The majority rejected the operation of the indemnity to the injuries in question, finding they had not been caused by any act, neglect or default on the part of the subcontractor. Ipp JA referred to *Andar* as authority for the proposition that an ambiguous indemnity clause is 'to be construed in favour of the person providing the indemnity'.[54] Ipp JA also dismissed an interpretation based on an earlier decision of the same Court in *Leighton,* where Meagher JA had applied *Delco* as grounds for interpreting commercial contracts according to their natural and ordinary meaning. Ipp JA found that *Delco* no longer applied for indemnity clauses and stated the *Leighton* approach must now 'yield to what was stated in *Andar*'.[55] Unfortunately, Ipp JA made no attempt to clarify the significance of the new approach, but it has been interpreted as an endorsement of strict construction, over commercial construction.[56]

A strong dissenting judgment was handed down by Bryson JA in *Normoyle,* who lamented that despite indicating the approach to be adopted when construing ambiguous indemnity clauses, *Andar* failed to establish how to detect whether such clauses are actually ambiguous. As he said, 'there is no special rule for contracts of indemnity about what constitutes an ambiguity, or about how ambiguity is discovered '.[57] Bryson JA dismissed the notion that there was any ambiguity regarding the indemnity or any 'ground for the operation of the principles of construction referred to in *Ankar* and approved in *Andar*.'[58] He considered that *Delco* should still apply and that an indemnity clause 'like any other contractual provision, should be construed according to its natural and ordinary meaning read in the light of the contract as a whole.'[59] Bryson JA's observations reinforce the problems with *Andar* and the absurdity of finding ambiguity to serve as the basis for applying the *contra proferentem* rule.

Decisions made by Campbell JA of the NSW CA favouring 'commercially realistic' construction appear to endorse the pre-*Andar* position. In *Rava v Logan Wines* (*Rava*) he referred to *Schenker* and noted that the *contra proferentem* rule adopted in *Andar* 'is just one rule of construction' and that the 'fundamental purpose of construction' remains ascertaining the intention of the parties 'arising from the document as a whole and reading the document with such background information as was known by all the parties to it'.[60] The same approach is evident in *NRMA v Whitlam* (*NRMA*), his honour reflecting that the *contra proferentem* rule was not required in the absence of ambiguity.[61] Although neither case concerned a reverse indemnity, like *Paribas,* they indicate that commercial construction still has a role to play in interpreting contractual indemnities generally.

A similar approach was taken by Spigelman CJ in *Gardiner v Agricultural and Rural Finance* (*Gardiner*). In attempting to make sense of inconsistent authorities he stated 'there is more than one principle involved in the task of contractual interpretation'. He found that the correct approach is 'the general approach ... as applicable to commercial contracts'.[62] An approach which he considered was best summed up by Gleeson CJ in *McCann v Switzerland Insurance* as giving a 'business like interpretation' to a commercial contract which focuses on the 'language used by the parties', 'commercial circumstances' and the 'objects' of the contact.[63] *Gardiner* went before the High Court,[64] which agreed with Spigelman CJ's reasoning, stating that the indemnities 'must be construed in their commercial context' and given meanings according to 'the meaning ordinarily conveyed by the words used'.[65]

In *BI (Contracting) v AW Baulderstone* (*Baulderstone*), the NSW CA reaffirmed the *Andar* approach. Baulderstone sought a complete contractual indemnity against BIC in respect of injury to one of its employees, which Baulderstone was liable for. The relevant clause required BIC to 'indemnify [Baulderstone] against all liability relating to the subcontract works'. The NSW CA confirmed the resurrection of strict construction and inapplicability of *Delco* for indemnities following *Andar,* meaning BIC was liable to indemnify Baulderstone.[66] It did so, despite there being no reference to negligence in the clause in question. The decision is surprising in this regard, as it is arguably at odds with the strict construction approach it purportedly applied. It has been suggested that the decision turned more on the broad, ordinary meaning of the words than a narrow or strict construction and in this sense, resembles the sort of decision which might have been made under *Delco*.[67]

Another puzzling aspect of *Baulderstone* is its explicit rejection of the third *Canada Steamship* Rule in favour of the *Andar* approach.[68] By drawing such a link, not only did the NSW CA

suggest that the two approaches were incompatible, it went further than the High Court, which decided *Andar* without reference to the *Canada Steamship* Rules.

In rejecting the third *Canada Steamship* Rule in *Baulderstone,* Beazley JA was careful to emphasise that the three rules are not legally binding. *HIH v Chase Manhattan Bank* (*HIH*) was cited as authority for the proposition that they are 'broad guidelines to assist in the court's ascertainment of the intention of the parties' rather than 'inflexible rules'.[69]

Erect Safe Scaffolding v Sutton (*Erect Safe*) is another relevant NSW CA decision. A clause requiring a subcontractor to indemnify the head contractor against all damage suffered by the head contractor 'arising out of the performance of the subcontract works and its other obligations under the subcontract' was held too narrowly worded to cover loss suffered from injuries arising as a result of the head contractor's negligence. The NSW CA questioned the extent to which *Andar* represented a departure from *Delco.* Basten JA stressed that 'it is far from clear that [*Delco*] is no longer good law' and that 'the Court is not bound by the outcome in another case involving a similar but not identical contract', although it must 'apply principles established in such cases' in construing a contractual provision.[70] He noted that the absence of any reference to *Delco* in *Andar* and the fact that the High Court heard *Ankar* (the decision upon which *Andar* was based) within one month of it hearing *Delco,* without any reference to the principles set down in *Delco,* made it unlikely that the 'relevant High Court authorities, including *Andar* ... should be read as inconsistent with [*Delco*]'.[71]

Elsewhere, the point has been made that if the High Court had intended to 'disapprove — and overrule — all the cases on secondary construction rules it would have said so'.[72] It is preferable to reconcile *Andar* with earlier authorities than to treat it as signifying the demise of principles from those earlier cases.

Basten JA's judgement is illuminating for another reason. In explaining why there is not necessarily a discordance between the *contra proferentem* rule and construing contractual words according to their natural and ordinary meaning, he stressed 'the *contra proferentem* rule is designed to resolve ambiguities, not to create them.'[73] Basten JA takes this as self-evident. Since *Andar* however, the *contra proferentem* rule has being applied at times without adequate consideration of whether the words in question are actually ambiguous. In effect, ambiguities are arising somewhat artificially or being found simply to allow the rule to operate. Bryson JA touched on this dilemma in *Normoyle*.[74] In construing an indemnity, investigation should begin with the meaning of the clause, not whether there are grounds for reading it down. Commercial construction still has a role to play in this context, or at least should. Unfortunately, its pre-eminence may have diminished somewhat following *Andar*.

Bofinger v Kingsway Group (*Bofinger*) involved a dispute over certain mortgages, one of which was described on the coversheet as a 'deed of guarantee and indemnity'. The High Court cited *Andar* as authority for interpreting guarantees and indemnities in favour of the surety or indemnifier where there is any doubt as to the construction of a provision. Relevantly, the High Court reflected that it is 'implicit' that the doubt may stem from not just the 'meaning of a particular expression but from its apparent width of possible application.'[75]

Westina Corporation v BGC Contracting (*Westina*) concerned a reverse indemnity. Westina brought a damages claim against BGC, which BGC successfully absolved itself from in the first instance as the indemnity provided by Westina included acts of BGC's own negligence. The decision was overturned however, with the Supreme Court of Western Australia citing *Paribas* to construe the indemnity on the basis of the agreement 'as a whole, the surrounding circumstances known to the parties, and the purpose and object of the transaction.'[76] *Andar* and *Bofinger* were then applied and the indemnity was read down in favour of Westina due to apparent doubt arising from the breadth of application of the clause.[77]

Samways v WorkCover Queensland (*Samways*) is another relevant case. Although the indemnity in question did not expressly refer to negligence, the Court construed the clause in the context of the contract as a whole and found it not improbable that the principal contractor, Lynsha 'would seek to be indemnified against claims for damages caused by its own negligence'.[78] In reaching this verdict, Applegarth J considered *Andar* and *Erect Safe* and purportedly resolved ambiguities between the different approaches by stating:[79]

'The authorities that require ambiguity to be resolved in favour of the indemnifier do not require that ambiguity be detected where the natural and ordinary meaning of the language, taken in its contractual context, requires no such conclusion.'

An indemnity covering a personal injury claim arising in connection with the plaintiff's negligence was upheld in *CSR v Adecco* (*CSR*). The appeal focused on whether a valid contract was in place (albeit an implied contract as the express term had expired) and if so, how the relevant indemnity provision, which was poorly drafted, should be constructed. The NSW CA cited *Andar* as grounds for applying the principle of strictissimi juris regarding ambiguous contractual provisions.[80] However, Adecco failed to establish that the breadth of the relevant clause and the grammatical errors therein required it to be construed strictly against CSR on grounds of ambiguity. The NSW CA looked to the contract as a whole to find there was no doubt that it was intended to 'cover all claims, whether caused or contributed to by CSR's own fault'.[81] Adecco was thus liable to indemnify CSR for damages arising from the personal injury claim. CSR supports and develops the approach evident in *NRMA, Rava* and *Samways,* further signalling that *Andar* and the *strictissimi juris* rule are not necessarily incompatible with commercial construction.

A broadly drafted indemnity provision was one of a number of allegedly 'unfair' clauses considered in *ACCC v JJ Richards,* a case brought under the recent Australian laws on unfair contract

terms for small businesses.[82] The clause was read down, the ACCC successfully arguing it amounted to an 'unlimited indemnity' that caused a 'significant imbalance' between the parties.[83] This is an example of statutory interpretation.

Finally, the recent case of *XL Insurance v BNY Trust* (*BNY*) provides useful guidance. At issue was the proper construction of an exclusion clause in the context of a professional indemnity insurance policy.[84] The NSW CA rejected the primary judge finding that the relevant provision be read down on the basis of ambiguity, when no such ambiguity actually existed.[85] Relevantly, the NSW CA approved Bathurst CJ's statement that the *contra proferentem* rule should only apply where 'ambiguity remains after all other avenues of construction have been exhausted'.[86] The measured approach taken to upholding an indemnity in this case is commendable.

III: OBSERVATIONS AND RESOLUTIONS

What are the rules of construction that apply?

Given the varying and at times conflicting judicial decisions, there is a genuine issue as to what the rules of construction are regarding the interpretation of indemnities. However, it appears that the state of flux following *Andar* has subsided somewhat, with recent case law indicating a measured approach to the construction of indemnities. *Andar* is not necessarily inconsistent with earlier case law, but regardless, it does not mean those cases are no longer good law. Other rules and principles besides strict construction may still apply, depending on the facts of the case. *Paribas,* Bryson JA's dissenting judgement in *Normoyle, Rava, NRMA, Gardiner, Erect Safe, Westina, Samways, CSR* and *BNY* all indicate judicial support of this view, suggesting commercial construction remains pertinent. Moreover, divergence between strict and commercial construction may have been overstated, with suggestions some rules associated with strict construction may be applied in commercial construction. For example, the *contra proferentem* rule may serve as a 'logical concomitant of commercial construction'.[87]

A final point on the issue of strict construction versus commercial construction concerns the reason for applying the contra proferentem rule in favour of the indemnifier (or the surety in a guarantee). It appears that the law generally considers that the party who is promising to take the initial risk, either to hold harmless or to guarantee, is more worthy of protection than the beneficiary of that promise. There is no discernible justification for the pre-eminence of this approach. As Spigelman CJ reflected in *Gardiner,* the indemnifier should not have ambiguities construed in its favour simply because it drafted the provision in question.[88]

'Common sense' considerations

Courts have often found it difficult to accept that contracting parties would intend that an indemnity be available for negligence. Several judgements reflect that it is counterintuitive to allow a party to be liable for the consequences of the other party's negligence, over which it has no control. One such case is *Ellington v Heinrich Constructions Pty Ltd,* which involved a dispute over the scope of an indemnity given by a subcontractor in favour of a builder. In finding that the clause did not cover the builder for the consequences of its own negligence, Chesterman J noted that it was 'inherently improbable' or 'impossible to suppose' that the parties to a contract would intend that a party should be indemnified and absolved for the consequences of its own negligence.[89]

Similar comments were made by Buckley LJ in *Gillespie Brothers v Roy Bowles* and Kitto J in *Davis v The Commissioner for Main Roads*.[90] Likewise, the same authorities were cited in the aforementioned *Westina* case, where the provision was read down in favour of the indemnifier, distinguishing it from cases such as *Qantas,* where there was no doubt that the indemnity covered 'all liabilities ... of whatever nature, howsoever occurring'.[91] Judicially, the 'insistence on explicitness' arguably reflects an 'inherent hostility' to reverse indemnities.[92] Indeed, the *Canada Steamship* Rules can be seen as giving effect to a policy function by restricting the operation of indemnities in the context of negligence.[93] Such considerations reflect what can be described as a 'common sense' approach to reverse indemnities. Perhaps this also helps explain the basis of the law's bias towards the indemnifier.

This position can be contrasted with Lord Hoffman's judgement in *HIH*. He considered the issue from the opposite angle, finding that there was 'nothing in the language or context' of the clauses in question to 'suggest that the parties did not intend them to cover negligence'. He stressed 'negligence is a risk which the parties could reasonably have been expected to allocate to one party or the other, so as best to achieve the commercial objectives of the contract.'[94] Elsewhere, Lord Hoffman reflected that reading exclusion clauses down on the basis of ambiguity or 'in the absence of clear words' amounted to the judicial creation of 'artificial rule[s] of construction'.[95] On this view, freedom of contract is being undermined by judicial intervention.

An economic liberal perspective is also discernible in *Valkonen* and *Glebe Island*.[96] Likewise, in *Normoyle,* after considering the 'common sense' approach, Bryson JA said that there is 'nothing unusual' about allocating risk in such a way and that it is simply the 'exercise of ... economic liberty'.[97] Freedom of contract is of course a cornerstone of laissez-faire economics and the free-market. Nevertheless, its application in this area and the shifting of liability from the responsible party to the counterparty is arguably at odds with a fundamental tenet of modern commerce; that risk should be borne by the party best able to control and mange that risk. It is difficult to envisage a scenario in which a party other than the responsible party would be in a better position to manage and control risk associated with that party's own acts and omissions.[98] Does ignoring a key principle of risk allocation paradoxically undermine the doctrine of economic liberalism upon which freedom of contract is purportedly based?

The question of whether a party should be exonerated for the consequences of its negligence is a controversial one, but if that is the intention of the parties, the courts should enforce such agreement. As Basten JA said in *Erect Safe,* 'absent statutory authority', a court 'has no mandate to rewrite a provision to avoid what it retrospectively perceives as commercial unfairness or lack of 'balance' when construing a contract.[99] That is as it should be. Granted, there are issues relating to inequality of bargaining power that make arguments in favour of banning such indemnities more compelling.[100] However, inequality in bargaining power can exist in virtually every contract imaginable. Legislation is not the answer to all such problems. Sophisticated commercial parties should be free to agree to terms relating to indemnities without a muddling and cumbersome legislature getting involved. The position in Australia can be contrasted with other jurisdictions that have legislated in this area.

In the United States, approximately two-thirds of the States have enacted statue that prohibits the enforcement of clauses which allow an indemnity for loss or damage for personal injury or property damage caused by the indemnified party.[101] Some require the indemnified party to be solely negligent for the indemnity to be voided, while others apply irrespective of whether the indemnified party was solely or concurrently negligent. The latter kind are more common. A typical example is New York General Obligations Law § 5-322.1, which prohibits, as against public policy, a construction contract under which a party would be required to indemnify the other party for bodily injury or property damage caused, in whole or in part, by that party's own negligence.

Lessons

As with any contract, the best way to limit the likelihood of a dispute is by careful consideration in drafting. It has been suggested that if something as 'intuitively unusual' as a reverse indemnity has been agreed by the parties, one could reasonably expect this to be clear in the drafting.[102] The drafting should be precise as to whether losses arising from the indemnified party's negligence are covered by the indemnity or not. It is particularly important from the indemnified party's perspective, lest the clause be deemed ambiguous and construed in favour of the indemnifier. That said, *CSR* indicates that 'clumsy draftsmanship' and ambiguity will not necessarily lead to the clause being read down if such a construction would be inconsistent with the intention of the parties as ascertained from the contract as a whole.[103] Still, it is imperative that an indemnity clause be capable of one interpretation only.

CONCLUSION

The decision in *Andar* has had a profound effect on the development of the law relating to indemnities. Prior to *Andar,* there was some evidence suggesting that the classic approach set down by the Privy Council in *Canada Steamship* (or at least the third rule) was yielding to a more commercial approach, but it was generally accepted that indemnities were no different to other contractual clauses.

Andar suggests that there are special rules for interpreting indemnities and confirmed that an ambiguous indemnity clause will be construed strictly in favour of the indemnifier. Since then, the judicial inclination to read indemnities down has at times appeared to outweigh interest in the corresponding question of ambiguity. Nevertheless, despite the *Andar* strict construction approach being followed in several cases and further clarified in *Bofinger,* an emerging body of case law indicates that an indemnity clause will be interpreted in the broader context of the contract as a whole, instead of simply construing it strictly against the indemnified party without any question or investigation. Accordingly, the relevant principles of construction depend on the facts of the case. Provided the contract is outside the unfair contract regime, Australian courts should give effect to its express terms, having regard to commercial purpose, meaning an indemnity between sophisticated commercial parties will be given its natural and ordinary meaning. In cases of ambiguity, a strict interpretation will be given.

Notwithstanding differences between strict and commercial construction, the two methods are not necessarily mutually exclusive. Strict construction rules may be adopted in interpreting an indemnity provision within the broader commercial context in which the relevant contract was negotiated and agreed.

From a practical perspective, the main lesson is that most, if not all the issues considered in this paper can be avoided through careful consideration and precise drafting of indemnity clauses.

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1 Nunico D'Angelo, 'The indemnity: it's all in the drafting' (2007) 35 *Australian Business Law Review* 93.

2 J W Carter, *Carter on Contract* (looseleaf) (2002), [15-150], Elisabeth Peden and J W Carter, 'Taking Stock: The High Court and Contract Construction' (2005) 21 *Journal of Contract Law* 179, Nunico D'Angelo, above n1, 96.

3 *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337 [19]-[20] citing *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* (1976) 3 A11 ER 237.

4 See J W Carter, *The Construction of Commercial Contracts* (2013) [15-12], [15-34], [17-10], Wayne Courtney, *Contractual Indemnities* (2009) 43.

5 *Davis v Pearce Parking Station Pty Ltd* (1954) 91 CLR 642 [9].

6 Elisabeth Peden and J W Carter, above n2, 178, citing *Hotham v East India Co* (1779) 99 ER 178.

7 *Prenn v Simmonds* [1971] 1 WLR 1361, *L Schuler AG . Wickman Machine Tool Sales Ltd* (1974) AC 235 and *Reardon Smith Line Ltd v Yngvar Hansen-Tangen* (1976) 3 A11 ER 237.

8 *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827 [851].

9 *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] WLR 896 [912]-[913]

10 As cited in J W Carter and D Yates, 'Perspectives on Commercial Construction and the *Canada SS* Case' (2004) 20 *Journal of Contract Law* 242-43, referring to *Lord Napier and Ettrick v R F Kershaw Ltd* [1999] WLR 756 and *Ellis Tylin Ltd v Co-Operative Retail Services Ltd* [1999] BLR 205, *British Fermentation Products Ltd v Compare Reavell Ltd* [1999] BLR 352 respectively.

11 Elisabeth Peden and J W Carter, above n2, 179.

12 *Mannai Investment Co Ltd v Eagle Star Life Insurance Co Ltd* [1997] AC 749 (Lord Steyn).

13 J W Carter, above n4, [15-20], Wayne Courtney, above n4, 49.

14 Elisabeth Peden and J W Carter, above n2, 178.

15 *Andar Transport Pty Ltd v Brambles Ltd* (2004) 217 CLR 424.

16 *Sunbird Plaza Pty Ltd v Maloney* (1988) 166 CLR 245 [3].

17 *Andar Transport Pty Ltd v Brambles Ltd* (2004) 217 CLR 424 [71].

18 Wayne Courtney, above n4, 42 suggests the ordinary principles of commercial construction apply to contracts of insurance, citing *Australian Casualty Co Ltd v Federico* (1986) 160 CLR 513 [520] (Gibbs CJ); *McCann v Switzerland Insurance Australia Ltd* [2000] HCA 65; (2000) 203 CLR 579, [22] (Gleeson CJ); *Wilkie v Gordian Runoff Ltd* [2005] HCA 17; (2005) 221 CLR 522 [15] (Gleeson CJ, McHugh, Gummow and Kirby JJ); *Selected Seeds Pty v QBEMM Pty Ltd* [2010] HCA 37; (2010) 242 CLR 336 [29], [34].

19 Such indemnities may for example cover claims for losses arising from contractual breach or defaults, liability for negligence, claims for loss of profit, taxes, statutory payments, legal costs, and compensation for injuries or property damage.

20 For discussion of indemnities in the context of indemnity insurance, see Wayne Courtney, above n4, 30-33, 42.

21 Note that in Australia the unfair contract terms regime contained in the Australian Consumer Law was expanded in 2017 (via amendments to the Australian Securities and Investments Commission Act 2010 (Cth) and the Competition and Consumer Law Act 2010 (Cth)) to include indemnities and limitation of liability clauses. However, this reform concerns small business contracts, which is outside the scope of this paper, notwithstanding comments on *ACCC v JJ Richards and Sons Pty* below.

22 See comments below on position in the United States.

23 See generally, J W Carter, above n2, [15-150], Nunico D'Angelo, 'Indemnities, gross negligence and the "accidental insurer"' (2009) 37 *Australian Business Law Review* 11.

24 *Canada Steamship Lines Limited v The King* [1952] AC 192 [208].

25 *Alderslade v Hendon Laundry Ltd* [1945] 1 KB 189.

26 *Qantas Airways Ltd v Aravco Ltd* (1996) 185 CLR 43.

27 *Leighton Contractors Pty Ltd v Smith* [2000] NSWCA 55.

28 J W Carter, above n2, [15-150].

29 *Smith & Ors v South Wales Switchgear Ltd* [1977] 1 All ER 18 [25].

30 *Davis v Pearce Parking Station Pty Ltd* (1954) 91 CLR 642.

31 *Valkonen and J A Ceilfix Pty Ltd v Jennings Construction Ltd and Ors* (1995) 184 LSJS 87, *BI (Contracting) Pty Ltd v AW Baulderstone Holdings Pty Ltd* [2007] NSWCA 173.

32 See for example *Alderslade v Hendon Laundry Ltd* [1945] 1 KB 189. See J W Carter, '"Commercial" Construction and the *Canada SS* Rules' (1995) 9 *Journal of Contract Law* 83.

33 *Darlington Futures Ltd v Delco Australia Pty Ltd* [1986] HCA 82 [16].

34 *Schenker and Co (Aus) Pty Ltd v Maplas Equipment and Services Pty Ltd* [1990] VR 834 [846] McGarvie J also referred to observations made by Barwick CJ in *Council of the Upper Hunter County District v Australian Chilling and Freezing Co Ltd* [1968] HCA 8 and Lord Diplock in *Antaios Compania Naviera SA v Salen Rederierna A B* (1985) AC 191 as supporting this interpretation.

35 *Debra Valkonen and J A Ceilfix Pty Ltd v Jennings Construction Ltd and Ors* [1995] SASC 5344 [34].

36 *Glebe Island Terminals Pty Ltd v Continental Seagram Pty Ltd* (1993) 40 NSWLR 206.

37 See J W Carter, above n33, 100.

38 *NSW v Tempo Services Ltd* [2004] NSWCA 4.

39 *Andar Transport Pty Ltd v Brambles Ltd* (2004) 217 CLR 424 [73].

40 *Andar Transport Pty Ltd v Brambles Ltd* (2004) 217 CLR 424 [126]-[127], citing *McCann v Switzerland Insurance Australia Ltd* [2000] HCA 65.

41 See J W Carter and D Yates, above n10, 244.

42 *Ankar Pty Ltd v National Westminster Finance (Australia) Ltd* [1987] CLR 549.

43 *Chan v Cresdon Pty Ltd* [1989] CLR 242.

44 *Andar Transport Pty Ltd v Brambles Ltd* (2004) 217 CLR 424 [26].

45 *Andar Transport Pty Ltd v Brambles Ltd* (2004) 217 CLR 424 [22] citing *Sunbird Plaza Pty Ltd v Maloney* (1988) 166 CLR 245 [254].

46 J W Carter and D Yates, above n10, 236, Nunico D'Angelo, above n1, 99.

47 *Andar Transport Pty Ltd v Brambles Ltd* (2004) 217 CLR 424 [22] citing *Coghlan v SH Lock (Australia) Ltd* [1987] 8 NSWLR 88 (PC).

48 *Coghlan v SH Lock (Australia) Ltd* 1987 8 NSWLR 88 (PC), 92, as cited in Wayne Courtney, above n4, 37.

49 *Andar Transport Pty Ltd v Brambles Ltd* (2004) 217 CLR 424 [22].

50 J W Carter and D Yates, above n10, 244.

51 J W Carter and D Yates, above n10, 245.

52 *Pacific Carriers Ltd v BNP Paribas* [2004] HCA 35 [22].

53 Elisabeth Peden and J W Carter, above n2, 180.

54 *F & D Normoyle Pty Ltd v Transfield Pty Ltd* (2005) NSW CA 193 [6].

55 *F & D Normoyle Pty Ltd v Transfield Pty Ltd* (2005) NSW

CA 193 [60], [64]-[66].

56 Wayne Courtney, 'Construction of Contractual Indemnities — Out with the old, in with the new?' (2011) 27 *Journal of Contract Law* 190.

57 *F & D Normoyle Pty Ltd v Transfield Pty Ltd* (2005) NSW CA 193 [141].

58 *F & D Normoyle Pty Ltd v Transfield Pty Ltd* (2005) NSW CA 193 [149].

59 *F & D Normoyle Pty Ltd v Transfield Pty Ltd* (2005) NSW CA 193 [142].

60 *Rava v Logan Wines* [2007] NSWCA 62 [53].

61 *NRMA v Whitlam* [2007] NSWCA 81. On *Rava* and *NRMA* see Wayne Courtney, above n59, 191-92.

62 *Gardiner v Agricultural and Rural Finance Pty Ltd* [2007] NSWCA 235 [19].

63 *Gardiner v Agricultural and Rural Finance Pty Ltd* [2007] NSWCA 235 [9], [100], citing *McCann v Switzerland Insurance Australia Limited* [2000] HCA 65.

64 *Agricultural and Rural Finance Pty Limited v Gardiner* [2008] HCA 57.

65 *Agricultural and Rural Finance Pty Limited v Gardiner* [2008] HCA 57 [38].

66 *BI (Contracting) Pty Limited v AW Baulderstone Holdings Pty Limited* [2007] NSWCA 173 [94], [95].

67 Wayne Courtney, above n59, 192, 195.

68 *BI (Contracting) Pty Limited v AW Baulderstone Holdings Pty Limited* [2007] NSWCA 173 [94], [95].

69 *BI (Contracting) Pty Limited v AW Baulderstone Holdings Pty Limited* [2007] NSWCA 173 [90], citing *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] 2 Lloyds Rep 61 [116] (Lord Scott) Similar comments were made by Lord Keith of *Kinkel in Smith & Ors v South Wales Switchgear Ltd* [1977] 1 All ER 18, citing *North of Scotland Hydro-Electric Board v D & R Taylor* 1956 SC 1 26 Digest (Repl) 255. See also J W Carter, above n2, [15-150].

70 *Erect Safe Scaffolding (Australia) Pty Ltd v Sutton* [2008] NSWCA 114 [89].

71 *Erect Safe Scaffolding (Australia) Pty Ltd v Sutton* [2008] NSWCA 114 [82].

72 J W Carter and D Yates, above n10, 241.

73 *Erect Safe Scaffolding (Australia) Pty Ltd v Sutton* [2008] NSWCA 114 [82].

74 See comments above.

75 *Bofinger v Kingsway Group Ltd* [2009] HCA 44 [53].

76 *Westina Corporation Pty Ltd v BGC Contracting Pty Ltd* [2009] WASCA 213 [48].

77 *Westina Corporation Pty Ltd v BGC Contracting Pty Ltd* [2009] WASCA 213 [49]-[50], [52].

78 *Samways v WorkCover Queensland & Ors* [2010] QSC 127 [74].

79 *Samways v WorkCover Queensland & Ors* [2010] QSC 127 [67].

80 *CSR Limited v Adecco (Australia) Pty Limited* [2017] NSWCA 121 [160]-[161].

81 *CSR Limited v Adecco (Australia) Pty Limited* [2017] NSWCA 121 [205].

82 The Treasury Legislation Amendment (Small Business and Unfair Contract Terms) Act 2015 (Cth) commenced on 12 November 2016.

83 *ACCC v JJ Richards and Sons Pty* [2017] FCA 1224 [56], [58].

84 The construction of insurance contracts is outside the scope of this paper.

85 *XL Insurance Co SE v BNY Trust Company of Australia Limited* [2019] NSWCA 215 [107]-[108]

86 *XL Insurance Co SE v BNY Trust Company of Australia Limited* [2019] NSWCA 215 [104]-[106], citing *Zhang v ROC Services (NSW) Pty Ltd* [2016] NSWCA 370 [140], which approved the remarks of Bathurst CJ from *Beefeater Sales International Pty Ltd v MIS Funding No 1 Pty Ltd* [2016] NSWCA 217 [66].

87 Wayne Courtney, above n4, 39, 55-56.

88 *Gardiner v Agricultural and Rural Finance Pty Ltd* [2007] NSWCA 235 [21].

89 *Ellington v Heinrich Constructions Pty Ltd* [2004] QCA 475 [57], [60]-[61].

90 *Gillespie Brothers & Co Ltd v Roy Bowles Transport Ltd* [1973] 1 QB 400 [419]; *Davis v The Commissioner for Main Roads* (1968) 117 CLR 529 [534].

91 *Westina Corporation Pty Ltd v BGC Contracting Pty Ltd* [2009] WASCA 213 [66], citing *Qantas Airways Ltd v Aravco Ltd* (1996) 185 CLR 43 [46]-[47].

92 See Wayne Courtney, above n4, 45, who also cites *Smith & Ors v South Wales Switchgear Ltd* [1977] 1 WLR 165 (HL), [168] (Lord Dilhorne), [178] (Lord Keith) in support of this view.

93 See J W Carter, above n33, 78, Wayne Courtney, above n4, 49-50.

94 *HIH Casualty and General Insurance Ltd v Chase Manhattan Bank* [2003] 2 Lloyds Rep 61 [67].

95 *Bank of Credit and Commerce International SA v Munawar Ali, Sultana Runi Khan and Others* [2001] UKHL 8; [2001] 1 All ER 961, [62].

96 See comments above.

97 *F & D Normoyle Pty Ltd v Transfield Pty Ltd* (2005) NSW CA 193 [150].

98 Exceptions may arise, for example for insurance purposes or where one party is able to absorb those risks at a lower cost. For further details on this principle in the context of large scale infrastructure projects and public private partnerships, see Timothy Irwin, *Government Guarantees: Allocating and Valuing Risk in Privately Financed Infrastructure Projects* (2007) 56 – 62.

99 *Erect Safe Scaffolding (Australia) Pty Ltd v Sutton* [2008] NSWCA 114 [88]. This approach was endorsed by the *Supreme Court of Queensland in Samways v WorkCover Queensland & Ors* [2010] QSC 127 [67], see comments above.

100 Inequality of bargaining power is the primary concern of the aforementioned reform to the unfair contract terms regime contained in the Australian Consumer Law. See footnote 22 above.

101 See Howard Smith, 'Closing the Loophole: Anti-indemnity

Statutes Should Apply to Additional Insured Provisions', Honours Scholar Paper, 11-13, available https://www.kentlaw.iit.edu/sites/ck/files/public/academics/jd/honors-scholars/2010/Howard-Smith-paper.pdf (accessed 5 October 2018).

102 Nunico D'Angelo, above n1, 101.

103 *CSR Limited v Adecco (Australia) Pty Limited* [2017] NSWCA 121 [204-205].

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