Contract Law Masterclass

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2. Nature of a contractual indemnity

A contractual indemnity has been defined in various ways. The following are examples of some of the definitions.

> *An indemnity is 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 ...* (Mason CJ in *Sunbird Plaza Pty Ltd v Maloney* (1987) 166 CLR 245)

> *However, notwithstanding the differences in the operation of guarantees and indemnities, both are designed to satisfy a liability owed by someone other than the guarantor or indemnifier to a third person. The principles adopted in Ankar, and applied in Chan, are therefore relevant to the construction of indemnity clauses.* (Gleeson CJ, McHugh, Gummow, Hayne and Heydon JJ in *Andar Transport Pty Ltd v Brambles Ltd* (2004) 317 CLR 424, at 437)

> *Indemnity clauses are 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. Self-evidently this is a serious thing to do or to attempt to do.* (Kirby J in *Andar Transport Pty Ltd v Brambles Ltd* (2004) 317 CLR 424, at 452)

> *A contract of indemnity is "a contract by one party to keep the other harmless against loss" and is not dependent on the continuing liability of the principal debtor* (Gleeson JA in *Canty v Paperlinx Australia Pty Ltd* [2014] NSWCA 309)

In *Westina Corporation Pty Ltd v BGC Contracting Pty Ltd*[1], Buss JA identified a class of indemnity which his Honour described as a reflexive indemnity:

> *[51] A contractual indemnity is the obverse of an exemption clause. See Smith v South Wales Switchgear Co Ltd [1978] 1 WLR 165 at 168 (Viscount Dilhorne). An indemnity usually operates "where one contracting party, A, may become liable to a third party, X, and the other contracting party, B, promises to indemnify A": Halsbury's Laws of England (4th ed reissue, Vol 9(1)), [797] fn (2). See also Adams JN and Brownsword R, Key Issues in Contract (1995) 270, who point out that in addition to this kind of "bare indemnity clause", there is a "reflexive indemnity clause" which requires one contracting party, B, who has successfully sued another (but defaulting) contracting party, A, to indemnify A. A "reflexive indemnity" is distinguishable from a "bare indemnity" in that a reflexive indemnity is intended by the parties to apply to a liability which arises, as between them, from the indemnified party's own default (for example, a breach of duty or breach of contract). As noted in Gosewisch D, "Difficulties with Indemnities between Business Entities" (2006) 34 Australian Business Law Review 89, in these circumstances a reflexive indemnity operates in relation to a liability stemming from the indemnified party's own default as both an indemnity and a release (90).*

In *Todd v Alterra at Lloyds Ltd (on behalf of underwriting members of Syndicate 1400)*[2], Allsop CJ and Gleeson J in their joint reasons referred to the different purposes respectively served by guarantees, indemnities and contracts of insurance and the process for determining whether a contract falls into one or other of those categories. Their Honours said:

> *[36] The categorisation or characterisation of contracts of guarantee, of indemnity and of insurance, requires, above all, an understanding of their purpose and nature. All, at one level, contain an element of indemnity; all can be said at one level of abstraction to be contracts of indemnity (subject to the qualification expressed earlier as to different types of insurance). But each has a relevant difference from the other; and contracts of guarantee and indemnity, for the operation of the principle in Ankar, are to be categorised and characterised as quite different from contracts of insurance.*

[1] [2009] WASCA 213.
[2] [2016] FCAFC 15.

[37] Each of a guarantee and an indemnity has the object or purpose of making good the financial position of a creditor of someone other than the guarantor or indemnifier. The two categories do this by different means: the guarantor as surety assumes a secondary obligation to the primary obligation of the principal debtor. In a contract of indemnity the indemnifier is primarily liable to the creditor, not collaterally. This difference in character, ascertained by construction, is important in the identification of the parties' mutual rights and obligations. But both are a species of financial accommodation to support the credit risk of the principal debtor and to hold the creditor harmless.
[38] A contract of insurance has the object or purpose of sharing the risk of, or spreading loss from, a contingency. Relevant to its character as insurance will be how the contract came to be effected, its nature and purpose and how it is to be performed: see generally Seaton v Heath; Seaton v Burnand [1899] 1 QB 782 at 792-793 (Romer LJ).

3. Indemnities and guarantees: the difference

The distinction between an indemnity and a guarantee was explained by Gleeson JA in *Canty v Paperlinx Australia Pty Ltd*[3]. His Honour said:

[37] Fundamental to the determination of the construction question is the distinction between a guarantee and an indemnity. The general nature of a contract of guarantee was described by Jordan CJ in Jowitt v Callaghan (1938) 38 SR (NSW) 512 at 516 in the following terms:
The contract of guarantee or suretyship is a contract between two persons which is intended by them to secure the performance of the obligation of a third person to one of them.
[38] Simply stated a guarantee is a binding promise of one person to be answerable for the debt or obligation of another if that other defaults: Sunbird Plaza Pty Ltd v Maloney [1988] HCA 11; 166 CLR 245 at [3]-[10]. The distinctive feature of a contract of guarantee is the secondary nature of the obligation which is assumed by the guarantor. There must be another person who is primarily liable: Turner Manufacturing Co Pty Ltd v Senes [1964] NSWR 692. See also Phillips and O'Donovan, The Modern Contract of Guarantee (loose-leaf, Thomson Reuters) at [1.1100].
[39] In contrast, under an indemnity, a person assumes a primary liability. A contract of indemnity is "a contract by one party to keep the other harmless against loss" and is not dependent on the continuing liability of the principal debtor: Yeoman Credit Ltd v Latter [1961] 1 WLR 828 at 830-831; Total Oil Products (Aust) Pty Ltd v Robinson (Total Oil Products) [1970] 1 NSWR 701 at 703. An indemnity is an independent obligation to make good a loss: Sutton v Grey [1894] 1 QB 285 at 288-289 (Lord Esher MR). As Davey LJ said in Guild & Co v Conrad [1894] 2 QB 885 at 896:
... there is a plain distinction between a promise to pay the creditor if the principal debtor makes default in payment, and a promise to keep a person who has entered, or is about to enter, into a contract of liability indemnified against that liability independently of the question whether a third person makes default or not.

4. Indemnities and suretyship

In certain circumstances an indemnity may exhibit the indicia of suretyship. This point and its significance was addressed in the decision of the New South Wales Court of Appeal in *Caltex Australia Petroleum Pty Ltd v Troost*[4]. Relevantly, Emmett JA (Meagher and Barrett JJA agreeing) said:

[50] While in many circumstances a guarantee and an indemnity are designed to achieve the same purpose, they create different obligations. A guarantee gives rise to a secondary liability, whereas an indemnity gives rise to a primary liability. That is to say, for the most part, the liability of a guarantor depends upon the non-performance by a principal debtor of an obligation owed by the principal debtor to a principal creditor. In the case of an indemnity, however, there is no such dependence. That distinction has important consequences.
[51] The essence of the difference is that, under an indemnity, the indemnifier promises to make good loss or damage suffered by the other party (usually the principal creditor) as a consequence of some specified event or circumstance. An indemnity need not relate to a failure by another party (such as the principal debtor) to perform a contractual obligation. Where, however, the loss or damage indemnified is that flowing from the failure by the principal debtor to perform a contractual obligation, the object of the indemnity is clearly enough to achieve the same object as a guarantee of that obligation. Nevertheless, an indemnity creates a principal obligation, rather than a secondary obligation (see generally, Canty v PaperlinX Australia Pty Ltd [2014] NSWCA 309 at [37]-[40]; Sunbird Plaza Pty Ltd v Maloney [1988] HCA 11; 166 CLR 245 at 254-6). (emphasis added)

5. Forms of indemnity

[3] [2014] NSWCA 309.
[4] [2015] NSWCA 64.

There are three basic categories of indemnity as follows:

1. in respect of losses arising out of a breach by the indemnifying party of a contract with the indemnified party;
2. for claims made by or liabilities to third parties including claims for infringement of IP rights; and
3. a reflexive indemnity operating both as an indemnity and a release in respect of the legal liability of the indemnified party to the indemnifying party

6. Construction and interpretation of indemnities

It is critically important that the scope of an indemnity is drafted in clear and precise terms and unambiguously captures the categories of loss and liability intended to be the subject of indemnification.

In *Bofinger v Kingsway Group Ltd*[5] the High Court set out the approach which the Australian Courts must follow when interpreting a contractual indemnity. The Court said:

> *The settled principle in Australia governing the interpretation of contracts of guarantee and indemnity has been stated by this Court in authorities the most recent of which is found in the joint reasons in Andar Transport Pty Ltd v Brambles Ltd. The principle is that a doubt as to the construction of a provision in such a contract should be resolved in favour of the surety or indemnifier. It is implicit in this that the doubt may arise not only from the uncertain meaning of a particular expression but from its apparent width of possible application.*

Importantly, in *Erect Safe Scaffolding (Australia) Pty Limited v Sutton*[6], Giles JA said:

> *[5] The operation of any contractual indemnity must be found in the application to the facts of the words of the relevant clause, construed as part of the contract as a whole. Decisions on the operation of contractual indemnities in different words in different contracts are likely to be of limited assistance.* Several decisions of the Australian courts illustrate the importance of clear drafting and how judgments on interpretation can be finely balanced turning on punctuation and the inclusion or placement of individual words.

Example 1: *F & D Normoyle Pty Ltd v Transfield Pty Ltd [2005] NSWCA 193*

A Transfield joint venture was the head contractor and occupier of the construction site for the Sydney Airport domestic railway station project. An employee of one of the subcontractors (Chadwick) claimed damages against Transfield in respect of Injuries sustained as a result of falling over some pipes. Another subcontractor (F & D Normoyle) had brought the pipes on to the site and had stored them in an allocated storage area. Transfield sought indemnification from Normoyle in respect of damages payable to the employee.

The relevant indemnity provided as follows:

> *The sub-contractor shall indemnify and keep indemnified [the Joint Venture] and their respective officers, employees and agents against all claims. demands, proceedings, liabilities, costs, charges and expenses arising as a result of any act, neglect or default of the sub-contractor, its employees or agents relating to its execution of the Works.*

The court found that Normoyle was not negligent, did not commit a breach of contract and was not guilty of any breach of statutory duty. The issue before the Court of Appeal was whether as a matter of construction the indemnity relied upon by Transfield was triggered by Normoyle's storage of the pipes in circumstances where that act did not in itself attract any legal liability. The case turned upon the proper construction of the words "*act, neglect or default*" in the indemnity.

Transfield submitted that the word "act" was not to be qualified or read down by the words "neglect or default" and therefore allowed the indemnity to be triggered in the absence of any fault on the part of Normoyle. The Court of Appeal rejected this submission. Ipp JA (McColl JA agreeing) noted as follows:

[5] (2009) 239 CLR 269.
[6] [2008] NSWCA 114.

When "neglect" and "default" (to be understood as meaning omissions involving breaches of legal duties) are used in juxtaposition with "act" (in a contractual clause imposing an obligation to indemnify in respect of a certain kind of "act" or "neglect" or "default"), the word "act", in my view, should similarly be understood as meaning an act involving a breach of a legal duty. In my view, the words "any act" in the phrase "any act, neglect or default" are not used entirely separately and independently from the words "neglect or default". For example, "any" governs "act" and "neglect" and "default". The meaning of each word in the phrase has a bearing on the others.

Bryson JA dissented.

Example 2: *Shamrock Civil Engineering Pty Ltd v Honan Insurance Group Pty Ltd* [2024] QSC 313

In this case, Cleanaway Pty Ltd entered into a contract with Shamrock under which Shamrock agreed to construct a cell at a waste dump owned and operated by Cleanaway. A cell is an open area where waste can be placed. The agreement was in the form of a work order which was placed under an existing master construction agreement between the parties.

In February 2022 there was major flooding at the cell site, which resulted from sustained heavy rainfall. This flooding created a lake like conditions which became putrid as materials stored at the dump leeched out into the water. An environmental order was made against Cleanaway, resulting in Cleanaway incurring costs of $31 million to drain the resulting swamp.

The master agreement contained an indemnity by Shamrock in favour of Cleanaway which relevantly provided as follows:

10. Contractor's Indemnity

The Contractor shall be liable for and shall indemnify the Principal against:

(a) any liability, loss claim or proceeding whatsoever in respect of loss, destruction or damage to any property, real or personal, arising out of or in the course of or by reason of the execution of the Works; and

(b) any liability, loss, claim or proceeding whatsoever arising at common law or under statute in respect of personal injury to or the death of any person whomsoever arising out of or in the course of or by reason of the execution of the Works, but the Contractor's liability under this Clause shall be reduced proportionately to the extent that an act or omission of the Principal, or its employees or agents contributed to the loss, damage, death or injury.

In the course of proceedings involving Cleanaway's insurers, Cleanaway filed a cross claim on the indemnity against Shamrock seeking recovery of their costs.

In these proceedings, Shamrock applied for summary judgment, arguing that Cleanaway had no real prospect of succeeding on its indemnity claim, and that that claim should be dismissed.

A key issue was the proper construction of the words "arising out of or in the course of or by reason of the execution of the Works" in clause 10 (a) of the indemnity.

Shamrock argued that it was improbable that the parties intended to give Cleanaway a right to an indemnity, even if the work was done brilliantly by Shamrock. It was argued that a reasonable businessperson would recoil at such an interpretation.

Freeburn J, in holding in favour of Cleanaway, made the following observations.

[34] The expression "arising out of or in the course of or by reason of the execution of the Works" has three components. The damage can arise: (a) out of the execution of the work; or (b) in the course of the execution of the work; or (c) by reason of the execution of the work.

[35] Component (c) certainly involves what could be described as a causal nexus between the damage and the execution of the work. Component (a) requires that the damage arise from the actual execution of the work. Component (b) is the least stringent of the alternatives. It merely requires that the damage arise during the course of the work. Understandably, the argument focussed on component (b).

[36] The ordinary and literal meaning of component (b) does not require a causal nexus with the execution of the works. All it requires is that the damage arise in the course of the work. As counsel for Cleanaway described it, the requirement is for some proximity to the work in time and place.

[37] Comparing components (a) and (b) is instructive. Component (a) does require some connection with the work. Presumably the draftsperson's intention with component (b) was not to duplicate component (a). But that may well be the effect of Shamrock's contention:

> *It is submitted that these words require that the property damage or personal injury for which indemnity is granted, has some nexus with the actual performance of the Work. It is not enough that the damage occurs, or the injury is suffered, during the term of the Master Agreement.*

[38] Shamrock submits that components (a) and (c) both involve a causative link between the damage and the execution of the works and, because component (b) sits between those two components, those two components give content to or colour the words in the middle.

In his conclusion, Freeburn J said:

[39] Applying the principle that the relevant meaning is that which the text conveys, I would think there is more than a reasonable prospect that the court will ultimately prefer the literal view of component (b).

7. The nature of a claim under an indemnity

The Australian and English case law support two disparate views as to the nature of a claim under an indemnity. Determining which view prevails has important implications for the way in which a claim under an indemnity is pleaded and for the operation of the Statute of Limitations in respect of such claims.

The first view referred to as the "prevent loss" analysis postulates that upon the indemnified party suffering loss within the scope of the indemnity a claim for unliquidated damages for breach of contract becomes immediately available to the indemnified party. However, such a claim would be subject to the law of contractual damages including the principles of remoteness and mitigation. An indicator that an indemnity is of this nature is a promise by the indemnifying party to hold harmless the indemnified party. The other view referred to as the "compensate loss" analysis postulates that a claim under an indemnity is a claim in debt. On this analysis an indemnity is characterised as an agreement to pay compensation for loss incurred by the indemnified party. Upon quantification of that loss a claim in debt becomes available to the indemnified party for the recovery of that loss.

The "prevent loss" analysis is principally sourced in the speech of Lord Goff in *Firma C-Trade SA v Newcastle Protection and Indemnity Association; The Fanti*[7]. His Lordship said:

First of all, I am unable to accept the submission that a condition of prior payment is, at common law, implicit in a contract of indemnity. I accept that, at common law, a contract of indemnity gives rise to an action for unliquidated damages, arising from the failure of the indemnifier to prevent the indemnified person from suffering damage, for example by having to pay a third party. I also accept that, at common law, the cause of action does not (unless the contract provides otherwise) arise until the indemnified person can show actual loss: see Collinge v Heywood (1839) 9 Ad & El 633, 112 ER 1352. This is, as I understand it, because a promise of indemnity is simply a promise to hold the indemnified person harmless against a specified loss or expense. On this basis, no debt can arise before the loss is suffered or the expense incurred; however, once the loss is suffered or the expense incurred, the indemnifier is in breach of contract for having failed to hold the indemnified person harmless against the relevant loss or expense. There is no condition of prior payment but the remedies available at law (assumpsit for damages, or possibly in certain circumstances the common count for money paid) were not efficacious to give full effect to the contract of indemnity. It is for this reason that equity felt that it could, and should, intervene. If there had been a clear implied condition of prior payment, operable in the relevant circumstances, equity would not have intervened to enforce the contract in a manner inconsistent with that term. Equity does not mend men's bargains; but it may grant specific performance of a contract, consistently with its terms, where the remedies at law are inadequate. This is what has happened in the case of contracts of indemnity. As a general rule, 'indemnity requires that the party to be indemnified shall never be called upon to pay' (see Re Richardson, ex p Governors of St Thomas's Hospital [1911] 2 KB 705 at 716 per Buckley LJ) and it is to give effect to that underlying purpose of the contract that equity intervenes, the common law remedies being incapable of achieving that result.

[7] [1990] 2 All ER 705 at 717.

Subsequently in *Callaghan v Dominion Insurance Co. Ltd*, Sir Peter Webster sitting as a judge of the High Court supported the defendants' submission in that case that "*a contract of indemnity gives rise to an action for unliquidated damages arising from the failure of the indemnifier to prevent the indemnified person from suffering a loss, and that once the loss is suffered the indemnifier is in breach of contract for having failed to hold the indemnified person harmless against the relevant loss or expense*".

In her article *The Limitations of Contractual Indemnities*[8], Felicity Maher identified some of the deficiencies in the prevent loss analysis noting as follows:

> *The principal objection to the prevent loss analysis is that an obligation to prevent the indemnified party from suffering loss is one that will often be incapable of performance by the indemnifier. For example, a property indemnity insurer cannot prevent a property from being ravaged by fire, or engulfed by flood waters. Moreover, it will often be the case that both parties know this, at the time of contracting. On the prevent loss analysis, the indemnifier is in breach as soon as loss within the scope of the indemnity is suffered, before the indemnifier has had an opportunity to proffer any kind of a performance. The analysis is therefore inconsistent with the reasonable expectations of the parties, common sense and commercial reality.*

The compensate loss analysis has its principal source in the speech of Lord Hoffmann in *Caledonia North Sea Ltd v London Bridge Engineering Ltd (the Piper Alpha)* His Lordship said:

> *My Lords, I would wish to reserve the question of whether, in the context of the contracts in the Hotel Services and similar cases, the construction adopted by the Court of Appeal was correct. But I do not think that they have any application to this case. Clause 21 limits the liability of the parties for losses caused by breach of contract. Certain kinds of loss are excluded. But this is not a claim for breach of contract. It is a claim to an indemnity for a liability incurred by the operator outside the contract. In my opinion cl. 21 has no application to such a claim. The liability either falls within the scope of the indemnity or it does not. The kind of loss for which indemnity was claimed fell within the indemnity simply because it was loss arising out of liability for death or injury in respect of the contractor's employees. As for quantum, the Lord Ordinary's finding that it was reasonable to settle at the agreed level is sufficient to make the sums which were paid recoverable.*

In *Codemasters Software Company Limited v Automobile Club De L'Ouest*[9], Warren J in discussing an earlier Court of Appeal decision[10] said:

> *The first ground of appeal was that since the agreement in question was a contract of indemnity, the sums were payable as a debt and there was, as a matter of principle, no need in law to mitigate losses under such an agreement. As to that, counsel submitted that a claim under a contract of indemnity such as that in the instant case was not a claim in damages at all but was a claim for a specific sum due on the happening of a specific event. Accordingly, it should not be open to a person providing an indemnity to challenge his obligation to pay by reference to the principles relating to the assessment of damages for breach of contract which have no application to debts. The Court of Appeal agreed with that submission.*
> *The law, so far as I am concerned, is therefore that questions of mitigation do not arise under contracts of indemnity so as to give the indemnifier a defence to any part of a claim for which he would otherwise be liable under his indemnity. The line of authority considered is concerned with contractual indemnities.*

Turning to Australian case law.

In the early decision of the New South Wales Court of Appeal in *McIntosh v Dalwood (No 4)*[10], Street CJ recognised the availability of equitable relief in respect of the enforcement of indemnities. His Honour said at 418:

> *"The test is always the same. In every case the contractual obligation must first be ascertained in order that it may be seen whether an adequate remedy exists at law in the event of a breach. If the obligation is merely an obligation to indemnify a person, in the sense of repaying to him a sum of money after he has paid it, no equitable relief is needed. Damages will provide an adequate remedy. If, however, the obligation on its true construction is an obligation to relieve a debtor by preventing him from having to pay his debt, equity will in such a case give relief in the nature of quia timet relief, and, instead of compelling the party indemnified first to*

[8] (2020) 31 Insurance Law Journal 1.
[9] [2009] EWHC 3194 (Ch).
[10] (1930) 30 SR (NSW).

pay the debt, and perhaps to ruin himself in doing so, will specifically enforce the obligation by ordering the indemnifying party to pay the debt. …."

In *Paterson v Pongrass Group Operations Pty Ltd*[11], White J considered whether an indemnified party must suffer loss before being entitled to make a claim on an indemnity.

Turning to the facts.

On 17 January 2003 Mr Paterson was appointed the sole director of seventeen subsidiaries of Pongrass Group. His role was to place selected subsidiaries into voluntary administration and then manage the process of administration.

Between 2003 and 2005 the Australian Taxation Office (ATO) made demands on Pongrass for unpaid taxes. In connection with these demands Mr Paterson in his capacity as sole director of the subsidiaries received a director penalty notice. He then sought to negotiate an indemnity from Pongrass Group in respect of his potential tax liabilities as a sole director of the Pongrass Group subsidiaries.

On 17 May 2005 a deed of indemnity was made between Mr Paterson as the indemnified and Pongrass as the indemnifier. The key provision of the deed was as follows:

> *3. INDEMNITY*
> *The Indemnifiers will indemnify, and pay to the Indemnified monies to compensate for, and be in respect of, any loss suffered by the Indemnified arising out of any claim connected to, or directly or indirectly related to, any act committed or omitted to be done by the Indemnified in his capacity as such a director, including such acts or omissions that are offences against any laws, including but limited to taxation laws. For the purposes of this clause 'loss' includes, any amount payable in respect of a claim against the Indemnified, and includes but is not limited to damages, judgments, settlements, interest, costs and defence costs, and includes any fines or penalties imposed by law, punitive, exemplary or aggravated or multiple damages, income tax, customs duties, excise duty, transaction duty, Goods and Services Tax, or any other State or Federal tax or duty.*

On 11 October 2010 the Deputy Commissioner of Taxation served a payment demand on Mr Paterson for $2m and advised that legal action for recovery was an option open to the Australian Taxation office.

Mr Paterson made a claim on the indemnity submitting that he was entitled to be indemnified either by receipt of the amount of the demand or by Pongrass paying the amount directly to the ATO. Mr Pongrass submitted that the indemnity responded even though he had not made any payment to the ATO. Pongrass Group rejected the claim.

White J held that the indemnity responded without prior payment by Mr Paterson to the ATO. His Honour said:

> *54 An obligation to indemnify can arise in a variety of circumstances. The obligation might arise under an express contract, as in this case. It may be implied as in the case of a guarantor and principal debtor. Without any express contract, it is implied that the principal debtor will indemnify the guarantor against the guarantor's liability to the creditor. In such cases equity may grant quia timet relief requiring the principal debtor to satisfy the debt where there is an accrued and fixed liability so as to relieve the guarantor from that liability, it being unreasonable that the guarantor should always have such a cloud hanging over him.*
> *57 The proper construction of any contract of indemnity must depend upon the terms of the individual contract, considered, where appropriate, in the objective matrix of facts in which the contract was entered into. There can be no rule of law that a particular form of words is necessary in order to conclude that the indemnity is to prevent the indemnified party from suffering loss rather than to compensate the indemnified party for loss he or she has suffered. In every case the proper meaning of a contract of indemnity must be taken from the words the parties have used and the context in which the agreement is made in order to ascertain objectively their intention.* [Emphasis added]

In reaching his conclusion in favour of Mr Paterson His Honour noted:

> *63 The punctuation of the first paragraph of the indemnity is important. PGO's promise was not merely to pay to Mr Paterson moneys to compensate for any loss suffered by him arising out of such a claim. If that were the extent of the indemnity then even given the extended meaning of " loss " as including*

[11] [2011] NSWSC 1588.

> *amounts payable in respect of a claim (and not merely amounts paid in respect of a claim), there would be force in the submission that to require PGO to pay the Commissioner of Taxation or Mr Paterson the amount of the penalties for which Mr Paterson is admittedly liable would go beyond compensating him, where no step has been taken to require him to pay those moneys beyond the service of a demand.*
> *64 But the opening paragraph of the indemnity is wider. PGO's promise to pay Mr Paterson moneys to compensate for any loss suffered by him arising out of a claim as described is additional to its promise to indemnify Mr Paterson in respect of any loss suffered by him arising out of any such claim. When the word "loss" is read in its defined sense as including an amount payable in respect of the claim and not merely an amount paid in respect of a claim, that indemnity, being additional to the promise to pay moneys as compensation, amounts to a promise to relieve Mr Paterson by preventing his having to pay his debt.*
> *65 In my view, the draftsman of the indemnity took a belts and braces approach by providing both a promise to prevent Mr Paterson from suffering loss arising out of a described claim and a promise to compensate him in respect of any such loss. It is true that the promise to compensate for such loss should be unnecessary if PGO fulfilled its promise to prevent the loss from being suffered. But the draftsman dealt with both contingencies. The promise of PGO was not only to indemnify Mr Paterson by paying money to compensate him for loss suffered.*

White J's formulation of principle underlined above was cited with manifest approval by Rees J in *Evagelakos v UPG 318 Pty Ltd*[12]

The other important recent Australian decision is *Globe Church Incorporated v Allianz Australia Ltd*[13]. Turning to the facts.

Globe Church held an industrial special risks insurance policy with Allianz for the year ending 31 March 2008. The policy provided insurance against loss or damage to buildings and property and for consequential loss of profits. Between June 2007 and 31 March 2008 a church hall and carpark in which Globe Church held an equitable interest were damaged by flooding.

Globe made a claim on the policy on 29 September 2009. Liability on the policy was denied by Allianz on 30 September 2011.

Globe commenced proceedings against Allianz on 4 November 2016. Thus, for the purpose of Section 14 of the Limitation Act 1969 (NSW), 4 November 2010 was a critical date.

Allianz submitted that the claim was statute barred as Globe's cause of action arose no later than 31 March 2008 when the policy period expired. Conversely, Globe submitted that its cause of action arose after the lapse of a reasonable time following notification of its claim to Allianz. Globe further submitted that the best evidence of the lapse of a reasonable time was the date that Allianz rejected the claim, namely, 30 September 2011. Accordingly, the claim was not statute barred. The majority (Bathurst CJ, Beazley P and Ward JA) held in favour of Allianz. Their Honours reasoned as follows:

> *209 Absent a provision in an indemnity insurance policy that makes lodgement of a claim a condition precedent to liability, the concept of a promise to indemnify (to make good the loss or to hold harmless against loss) in the context of a property damage insurance policy is such that the promise is enlivened when the property damage is suffered. Unless it be necessary for there to be a claim made on the insurer to give rise to the liability, it is at the point of property damage that the insured has not been held harmless against the loss and (leaving aside any defences that might be raised on such a claim) would be entitled to sue to enforce the promise to indemnify. Such a claim is recognised as being a claim for unliquidated damages (albeit that the amount necessary to make good the loss is to be calculated in accordance with the basis of settlement clause in the policy).*
> *210 Thus, unless the making of a demand is a condition precedent to liability, all the essential facts required to be established by the insured to enforce the indemnity will by then have occurred and accordingly the cause of action for unliquidated damages will be complete. It follows that the cause of action accrues on the happening of the property damage (the insured event).*

The core of the insurer's submission was that a property insurance policy should be viewed as a promise to prevent loss and, accordingly, once the insured suffered loss the insurer became immediately liable for unliquidated damages for breach of contract. Meagher JA (in dissent) noted as follows:

> *222 The fundamental issue raised by the separate questions is whether, as the insurers contend, any cause of action for breach of their contractual obligation to indemnify arose on the happening of the*

[12] [2024] NSWSC 1179 at [50].
[13] [2019] NSWCA 27.

claimed Damage. The insurers submit that their contractual obligation to "indemnify" required them to hold the insured "harmless" against physical loss, damage or destruction, with the necessary consequence that they were in breach of that obligation immediately upon the happening of any property Damage. In support of that meaning of their promise to indemnify, the insurers rely on the statement of Lord Goff in Firma C-Trade SA v Newcastle Protection and Indemnity Association (The Fanti) [1991] 2 AC 1 at 35-36 that "once the loss is suffered or the expense incurred, the indemnifier is in breach of contract for having failed to hold the indemnified person harmless against the relevant loss or expense"; and the dictum of Lord Sumption JSC in Versloot Dredging BV v HDI Gerling Industrie Versicherung AG [2017] AC 1 at 18 that an "insured's right to indemnity arises as soon as the loss is suffered.

However, His Honour noted that consistently with English authority the expression "unliquidated damages" was used in a somewhat unusual sense in reference to a claim under an insurance indemnity as the only wrong admitted by the insurer is a failure to pay a sum due under a contract, the amount of which is to be ascertained.

His Honour continued:

229 Thus the construction of an indemnity as including a promise to hold harmless and the characterisation of the action to enforce an indemnity as being for unliquidated damages for breach of contract have been taken under English law to support a general conception of promises to indemnify in contracts of insurance as undertakings to prevent the insured from suffering loss or damage, the happening of which constitutes a breach of that undertaking giving rise to an immediate action for unliquidated damages against the insurer…This conception has been applied to property insurance, notwithstanding the almost certain expectation of the parties to such insurance that the insurer will not pay without first being given notice of any damage to enable the adjustment of the insured's claim and computation of the amount payable.

In holding in favour of Globe Church His Honour said:

236 For the reasons which follow, the insurers' argument should be rejected. First, it does not give effect to the language of the insuring clause, or take account of the nature of the policy as one insuring against property damage and the sensible commercial expectations of the parties to such a contract. As Hirst J accepted in The Italia Express (No 2) (at 291, col 2) in relation to a marine hull insurance, it is "commercially inconceivable that in a large total loss case like the present, or in a complex claim for partial loss or damage, the underwriter would pay up in full by return post without any investigation".
In his dissenting judgment Leeming JA explained why an indemnified party may claim on an indemnity without actually suffering a loss. His Honour begins his analysis with the following observations:
296 At common law, a contract of indemnity was understood to involve a promise which was broken only when the beneficiary had been damnified by actually paying: Collinge v Heywood (1839) 9 A & E 633; 112 ER 1352; Zaccardi v Caunt [2008] NSWCA 202 at [34]. Only at that point did an entitlement to sue at law arise. Equity intervened. Equity recognised the inadequacy of the position at law and would compel the indemnifier to pay the third party directly, or pay the beneficiary so as to enable the third party to be paid. Such an order was in the nature of specific performance. Lindley LJ said in Johnston v The Salvage Association (1887) 19 QBD 458 at 460-461 that:
"In equity a contract to indemnify can be specifically enforced before there has been any such breach of the contract as would sustain an action at law. In equity the plaintiff need not pay and perhaps ruin himself before seeking relief. He is entitled to be relieved from liability."
Following the enactment of Lord Cairns' Act, chancery could order statutory damages in lieu of specific performance.

Having referred to the effect of the Judicature legislation in England and how equity enabled the indemnified party to enforce the indemnity without prior payment, his Honour said:

299 The result achieved was that, through the intervention of equity, and with the supplementation of statute, the defect of the common law was ameliorated, so that the beneficiary did not first have to pay. One way of describing the net effect was that the beneficiary was "held harmless". But it did not follow that the contract was breached immediately upon the occurrence which caused damage to the insured. Nor did it follow that a court was ordering contractual damages (as opposed to an equitable or statutory remedy) prior to any actual payment by the indemnified party. This may be one reason why Brennan CJ, Dawson, Toohey and Gummow JJ referred to the term "damages" being used "loosely" to describe the moneys payable to an insured. It was suggested in argument, of the fact that "damages" was sometimes said to be used in a particular sense, that it was "not always immediately apparent" why there was any difficulty with the term. It seems to me that part of the awkwardness in describing the remedy as one of damages simpliciter is an appreciation of the different responses of common law, equity and statute.

So far the analysis has been concerned with claims by the indemnified party. However, in *Wardley Australia Limited v The State of Western Australia*[14] the High Court considered a claim for compensation by an indemnifying party for misleading and deceptive conduct based upon a fraudulent inducement by a third party to grant the inducement.

Turning to the facts.

The state of Western Australia provided an indemnity to National Australia Bank (NAB) in respect of an advance that the bank made to Rothwells. The indemnity was provided on the basis of a false representation by Wardley that Rothwells was a sound financial institution with substantial assets. Subsequently Rothwells was placed in liquidation and the State was required to pay some $22m to NAB under the indemnity.

The State claimed compensation under section 82 (section 236 of the Australian Consumer Law) for misleading and deceptive conduct in contravention of section 52 (section 18 of the ACL).
The short point of the High Court was whether the action was statute barred.

Relatively, the cause of action under section 82 accrue when the loss is suffered. Wardley submitted that the State suffered loss when the indemnity was provided so that the action was statute barred.
In holding that the State's action was not statute barred, the plurality said at 524:

> *The indemnity was not one of a kind which generates an immediate non-contingent liability to pay upon execution of the instrument. It was neither a promise to meet a liability of the promisee to make a payment nor a promise to pay a debt owing by a third party to the promisee. In our view, the indemnity, on its true construction, was one which created a liability on the part of the respondent to the Bank to make payment if and when the Bank's relevant "net loss" was ascertained and quantified, subject to the making of a demand for payment by the Bank. The liability was, therefore, in conformity with the opinion of the Full Court, contingent and executory. The likelihood, perhaps the virtual certainty, that there would be a loss, in the light of Rothwell's actual financial position as it stood when the indemnity was executed, did not transform the liability into an actual or present liability at that time. However, the appellants do not accept that this conclusion means that the respondent suffered no loss or damage unless and until the Bank's "net loss" was ascertained and quantified because the appellants' case is that, as the respondent's liability under the indemnity was greater than it would have been had the representations been correct, loss or damage was sustained on entry into the indemnity.*

Brennan J said at 535:

> *The question in this case is not how much worse off is the State than it would have been had the alleged misrepresentation been true, but how much worse off is the State than it would have been had it not relied on the alleged misrepresentation and entered into the transaction. The tortious measure, not the contractual measure, is in question. The State alleges that it is $22.5 million worse off as the result of giving the National Australia Bank the indemnity which Wardleys allegedly induced the State to give by misrepresenting that Rothwells Ltd was a sound financial institution. When did the State suffer that loss? Four dates are offered for consideration: the date when the indemnity was given (26 October 1987), a date occurring between November 1988 and May 1989 when the Bank claimed payment under the indemnity, the date when the State agreed to a compromise with the Bank and the liquidator of Rothwells whereby the State was to pay the liquidator $33 million and the State was entitled to receive from the Bank $10.5 million (3 May 1989) and the date on which the State paid the liquidator $33 million (30 May 1989). The first - but only the first - of those dates is more than three years prior to the date on which the State delivered an amended statement of claim (14 January 1991) in which the State first pleaded a misrepresentation allegedly made by Wardleys on Sunday 25 October 1987 (the Sunday representation) which induced the State to give the indemnity.*

A final note.

Nuncio D'Angelo in his article, *The Indemnity: It's all in the drafting*[15] Nuncio D'Angelo made the following concluding remarks on the drafting of an indemnity:

> *There are benefits in drafting an indemnity as a "compensatory" rather than a "prevent loss" indemnity. The indemnified party achieves greater certainty of cover and ease of enforcement, while the indemnifier is spared being put into breach of contract by events he or she might not be able to control. Neither party is exposed to the damages rules. A well-advised indemnifier would be conscious of the potential for open-ended liability and would seek to negotiate built-in limitations. The ensuing negotiations would*

[14] (1992) 175 CLR 514.
[15] [2007] 35 ABLR 93.

generate the collateral benefit of forcing the parties to focus on exactly which losses are to be shifted and which are not.
This would achieve greater clarity, to both parties' benefit. An indemnity that makes clear at the outset what is likely to be the indemnifier's liability allocates risks in a more certain way, allowing both parties to assess whether they need complementary or extraneous protection via (say) insurance.
As always with indemnities, it's all in the drafting.

Chapter 2

Settlement deeds, releases and covenants not to sue: key principles and drafting issues

1. Releases

The principal Australian authority on the construction and application of releases is *Grant v John Grant & Sons Proprietary Limited* (1954) 91 CLR 112 (*Grant*), in which the High Court identified two common law principles, and one equitable principle. Conveniently, the Full Federal Court in *Wardman v Macquarie Bank Ltd* [2023] FCAFC 13 explained the common law principles emerging from *Grant.* Relevantly, Wheelahan J (Bromberg and Snaden JJ agreeing) said:

> *[206] In relation to the construction of releases, in Grant v John Grant & Sons Pty Ltd [1954] HCA 23; 91 CLR 112, Dixon CJ, Fullagar, Kitto and Taylor JJ referred at 123-124 to two related common law principles of construction. The first was that general words of a release are to be restrained by any particular occasion referred to in the recitals –*
>
> > *The principle relied upon is that adopted by the common law long ago for the restriction of wide general words in a release of obligations, viz. that the general words of a release should be restrained by the particular occasion: Knight v Cole (1690) 3 Lev 273 [83 ER 686]. Thus the general words of a release are to be restrained by the particular recital: Payler v Homersham (1815) 4 M & S 423 [105 ER 890]. As it is concisely expressed by Best J in Lampon v Corke (1822) 5 B & Ald 606 at 611 [106 ER 1312 at 1314] "If there be introductory matter, that will qualify the general words of the release."*
> > *(Citations added in place of the footnotes.)*
>
> *[207] This first principle may be seen as an emanation of the more general principle that the words of a contract are to be construed as a whole having regard to the purpose or objects to be secured by the contract. The first principle operates on the premise that there are express objects evident from recitals.*
>
> *[208] The second and differently expressed common law principle of construction referred to in the joint judgment in Grant v John Grant Sons Pty Ltd is that the general words in a release are limited to those things which were in the contemplation of the parties at the time when the release was given –*
>
> > *The principle which it is thus sought to apply was expressed by Lord Westbury in London South Western Railway Co v Blackmore (1870) LR 4 HL 610 as follows: "The general words in a release are limited always to that thing or those things which were specially in the contemplation of the parties at the time when the release was given" [at 623]. It was expressed by Taunton J in Upton v Upton (1832) Dow PC 400; 36 RR 817 in this way: " ... the general words of a release may be limited by the particular matter out of which the release springs and the particular intent of the parties by whom the release is executed" [at 406; 821].*
> > *(Citations added in place of the footnotes.)*
>
> *[209] The second principle may also be seen as an emanation of the more general principle that in the construction process regard be had to the purpose to be secured by a contract, objectively ascertained.*

The difference between the two common law principles of construction was captured by the plurality in *Grant* as follows (at 123):

> *The difference between the two replications lies in the difference between controlling the general words by reference to the express recital and controlling them by reference to the disputes which existed between the actual releasor (in this case the plaintiff) and the releasee (the defendant).*

These common law principles were most recently invoked by the New South Wales Court of Appeal in *Pharmacy Platform Pty Ltd v Millichamp* [2025] NSWCA 213.

Turning to the facts.

- Mr Millichamp commenced employment with Apotex Pty Ltd (*Apotex*) in 2006 as managing director.
- His contract of employment was terminated by notice on 26 September 2019, and his employment came to an end on 30 June 2020.
- On 25 August 2020, Mr Millichamp commenced employment with Pharmacy Platform Pty Ltd (*Pharmacy Platform*). Under this contract, he was entitled to a long-term incentive bonus (LTI) on the occurrence of certain defined exit events.
- In November 2020, Mr Millichamp served a letter of demand on Apotex. His claim was for unpaid employment entitlements. This dispute was mediated without success.
- In July 2021, Mr Millichamp commenced proceedings against Apotex and Apotex Inc (as guarantor).
- In December 2021, Pharmacy Platform's business was sold under a share purchase agreement to the Arrotex Group. Apotex was also part of that group. This sale triggered Mr Millichamp's entitlement to the LTI.
- Earlier, on 11 June 2021, Mr Millichamp's employment with Pharmacy Platform terminated.
- On 16 March 2022, the Apotex proceedings were settled, and a deed of settlement was entered into between Mr Millichamp and Apotex.

Turning to the contents of the deed of settlement.

By Clause 1, Apotex is the "Company", and "Group Companies" means relevantly all related bodies corporate (as defined in the *Corporations Act*) of Apotex and Apotex Inc, and "Proceedings" means the Apotex proceedings. Clause 4 contained the following release from Mr Millichamp:

> ***4. Mr Millichamp's acknowledgments and agreement***
>
> *4.1 Mr Millichamp releases and forever discharges the Company, Apotex Inc., the Group Companies and all officers, employees and agents of the Company, Apotex Inc. and of the Group Companies from all present and future claims, whether known or unknown, and however arising (including in contract, in tort or under statute) which Mr Millichamp has or may have against them or any of them:*
>
> *(a) relating to, arising out of or in any way connected with any or all of the events the subject of the Proceedings; or*
>
> *(b) otherwise relating to, arising out of or in any way connected with his employment by the Company, his role as a director of the Company and Apotex Australia Pty Ltd, the cessation of that employment, the Contract and the termination of the Contract* ***or any services provided to any Group Company or Sherfam (whether or not for reward)****, other than any claim arising out of rights of or to indemnification in favour of Mr Millichamp, which rights of or to indemnification subsisted as at the date of notice of termination of employment.* Emphasis added.

The constructional question was whether, as submitted by Pharmacy Platform, the release in Clause 4.1(b) extended to the LTI, so that Pharmacy Platform was no longer required to pay it. The primary Judge (Rothman J) held that the release did not extinguish Mr Millichamp's entitlement to the LTI.

The question turned on the construction of the 14 words highlighted in bold above. Pharmacy Platform made the following submissions:

1. Pharmacy Platform falls within the definition of "Group Companies" in the deed, such that Mr Millichamp's claim is against a Group Company.

2. The claim arises under the Pharmacy Platform Employment Agreement. Mr Millichamp provided services to Pharmacy Platform under that agreement. The claim is therefore one "relating to, arising out of or…connected with…any services provided to any Group Company".

The Court of Appeal dismissed Pharmacy Platform's appeal.

McHugh JA (Kirk JA and Price AJA agreeing) summarised the constructional point as follows,

> *[57] To the extent that Pharmacy Platform's submission is that the words "any services" cannot be read down by any proper process of interpretation, the submission should not be accepted. The question is then whether those words should be read down in light of the operative text of the Deed, the recitals and what the parties had in contemplation at the time of execution. Although the question remains always the construction of the operative text, it is convenient to address the contextual matters first.*

Turning to the application of the first common law principle (the recitals), his Honour said,

> *[61] On the face of the recitals, the main object of the Deed was thus to settle the Apotex Proceedings and "to finalise all matters between" the parties (in the language of recital E), in particular with respect to Mr Millichamp's employment with Apotex (as referred to in recitals A to D). The recitals thus make clear that the main purpose of the Deed is to address claims arising out of Mr Millichamp's relationship with Apotex and to bring the legal consequences of the relationship to an end. That relationship was largely one of employer and employee, but also one of director and company. It is unnecessary for present purposes to do more than refer to the relationship generally, which favours Pharmacy Platform.*
> *[62] Applying the principles that "the general words of a release are to be restrained by the particular recital"; that "introductory matter…will qualify the general words of the release"; and that "the words of a contract are to be construed as a whole having regard to the purpose or objects to be secured by the contract … [including] express objects evident from recitals", the recitals provide strong reasons to construe the words "any services provided to any Group Company" in clause 4.1(b) as meaning services the provision of which arose out of Mr Millichamp's relationship with Apotex.*

In respect of the second common law principle (things specifically in contemplation), his Honour said,

> *[63] Nothing in the "genesis of the transaction" suggests a wider purpose of the Deed than that apparent from the recitals. To the contrary, the circumstances leading to the Deed confirm that purpose. Those circumstances began with Mr Millichamp's claims against Apotex under the Apotex Employment Agreement, which led to the Apotex Proceedings, which resulted in the settlement of those proceedings.*

> *Settling the Apotex Proceedings and finalising all matters between the parties required a payment by Apotex to Mr Millichamp, and Apotex required releases from him in return.*

On commenting on the overall drafting of clause 4.1(b), his Honour noted,

> *[75] The clause may thus be seen as an example of "belts and braces" drafting. The words at the end of par (b) serve at least to make clear that the release is not confined to claims Mr Millichamp might have in his capacity as an employee of Apotex. The use of the word "services" is apt to capture any other role Mr Millichamp might have had or any other task he might have carried out for other group companies while an employee of Apotex, whether or not he was separately paid to do so.*

Turning to the equitable principle emerging from *Grant*.

The plurality, having reviewed the authorities dealing with the role of equity in restricting the scope of a release, said, at 129,

> *From the authorities which have already been cited it will be seen that equity proceeded upon the principle that a release must not use the general words of a release as a means of escaping the fulfilment of obligations falling outside the true purpose of the transaction as ascertained from the nature of the instrument and the surrounding circumstances including the state of knowledge of the respective parties concerning the existence, character and extent of the liability in question and the actual intention of the releasor.*

Recently, in *Protheroe v Protheroe* [2023] NSWCA 328, Meagher JA (Mitchelmore JA and Basten AJA agreeing) made the following observation on equitable doctrine:

> *[37] Equity may in its auxiliary jurisdiction relieve a releasor from unconscientious reliance by a releasee on the general words of a release. The underlying equitable doctrine was described by Pollock CB in Lyall v Edwards (1861) 6 H & N 337 at 347 [158 ER 139 at 143] as being "that a release cannot apply, or be intended to apply to circumstances of which a party had no knowledge at the time he executed it, and that if it is so general in its terms as to include matters never contemplated, the party will be entitled to relief" (emphasis added).*

The essence of the equity appears to be the unconscientious advantage taking of a releasor's lack of knowledge of potential claims against the releasee at the time of the release.

However, the most comprehensive examination of the role of equity in this area was undertaken by Leeming JA in *Reid v Commonwealth Bank of Australia* [2022] NSWCA 134.

Turning to the facts.

On 28 October 2003, Mr and Mrs Reid entered into separate guarantees in respect of loans made by the Commonwealth Bank (Bank) to three separate companies. On the same date, Mr and Mrs Reid executed a mortgage over a property they jointly owned in Menangle, New South Wales (Menangle Property). In January 2012 the Bank commenced proceedings seeking judgment against Mr and Mrs Reid as guarantors and also sought judgment for the possession of the Menangle Property. In May 2012 Mr Reid and the companies commenced proceedings against the Bank on the basis that the Bank's receivers sold the security for the loans at an undervalue.

Ultimately, the Bank's claims against Mr and Mrs Reid were compromised by separate deeds of settlements, one with Mrs Reid on 10 October 2013 and one with Mr Reid on 13 February 2013. The matter was complicated by Family Court proceedings between Mr and Mrs Reid to which the Bank became a party on 8 May 2012. Relevantly, the settlement deed with Mr Reid contained the following release in favour of the Bank:

> ***5. Release***
>
> *5.1 Mr Reid, the Companies and Dorgal release and discharge the Bank from all liability for damages or loss and from all sums of money, accounts, actions, proceedings, claims, demands, costs and expenses whatever which Mr Reid, the Companies and/or Dorgal or any or each of them has or had or at any time in the future may have against the Bank for or by reason or in respect of any act, cause, matter or thing arising out of or in connection with or incidental to the Loans, the Loan Agreement, the Property, the Sale, the Mortgage, the Guarantee, the Bank Proceedings, the Family Court Proceedings, the Companies' Proceedings, or in any way relating to the matters referred to in the recitals.*
>
> *5.2 Upon all other terms, conditions, representations, acknowledgments and warranties in this Document being complied with by Mr Reid, the Companies and Dorgal, the Bank covenants not to file the Judgment as against Mr Reid, the Companies or Dorgal or seek to recover the balance of the Secured Moneys against Mr Reid, the Companies and/or Dorgal after the settlement of the Sale of the Property."*

In June 2015, the Bank took control of the Menangle Property and exchanged contracts for its sale. However, after the Bank took possession the property was vandalised and because of the damage sustained the Bank allowed the purchaser a discount of $370,000.00, which Mr Reid only discovered three years later.

Mr Reid commenced proceedings against the Bank in the District Court seeking recovery of the $370,000.00 discount. Abadee DCJ ordered the summary dismissal of Mr Reid's claim relying on the wide terms of the release in clause 5.1 of the settlement agreement.

Mr Reid then appealed this ruling, on an interlocutory basis, to the New South Wales Court of Appeal.

Leeming JA, in identifying the issues raised by *Grant*, said:

> *[37] Two issues of some complexity emerge from the High Court's reasoning in Grant v John Grant & Sons Pty Ltd. One is whether equity would construe a release differently and more narrowly than the same words would be construed at law. The second is as to the circumstances when, including by reference to the releasor's subjective understanding, equity would prevent the releasee from relying on the release.*

On the first issue, his Honour observed:

> *[43] There is an attraction to the idea that the equitable aspect of Grant was confined to the unconscientious exercise of legal rights, which could be informed by the subjective intentions of the parties, and that the approach to construction of the document is the same at law and in equity. That accords with the emphatic endorsement of the objective theory of contract in decisions such as Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd (2004) 219 CLR 165; [2004] HCA 52. The same point was made by Lord Nicholls, when dealing with releases, in Bank of Credit and Commerce International SA v Ali [2002] 1 AC 251; [2001] UKHL 8 at [25]: "Today there is no question of a document having a legal interpretation as distinct from an equitable interpretation". See also at [17] (Lord Bingham) and [79] (Lord Clyde). Doubtless it seems to twenty-first century eyes a strong thing to conclude that the same document would be construed differently, according to different rules and by reference to different evidence, by a common law court and an equitable court.*

On the second issue, his Honour referred to the decision of the Victorian Court of Appeal in *Burness v Hill* [2019] VSCA 94, in which that Court held that the ignorance of both parties as to Mr Hill's right to marshall, coupled with the ambit of the dispute, the subject of the release, made it unconscientious to rely on the general words of the release.

Leeming JA noted that the Victorian Court of Appeal, following *Grant*, decided that a party's subjective intention was admissible in evidence to inform the contemplation of a release. However, a releasor's ignorance of a potential claim is not always determinative in this context.

Relevantly, Leeming JA said:

> *[51] That is not inconsistent with the statement in Grant that it is possible to draft a release which extends to claims which are unknown. There is a stream of authority to that effect. One decision which is often cited to that end, and was relied on by the primary judge, is Doggett v Commonwealth Bank of Australia (2015) 47 VR 302; [2015] VSCA 351, where Whelan JA said at [63] that Grant:*
>
> > *"is not authority for the proposition that a release can only ever apply to matters then known to the parties. It is possible to enter into an arrangement which does settle 'all conceivable further disputes'. The equitable principles articulated in Grant v John Grant restrain a party from unconscientious reliance on legal rights. Particular circumstances may reveal that it would be unconscientious to allow the general words of a release to be relied upon. Grant v John Grant was such a case. But there will be no room for the application of those equitable principles if it is clear that the parties intended the general words of a release to encompass all conceivable further disputes." (footnote omitted)*
>
> *[52] Those passages confirm that there are circumstances in which parties may release unknown claims, falling outside the scope for equitable intervention. That the exception exists is undoubted. But identifying in advance of a trial precisely when one can confidently conclude that there is no scope for equitable intervention is problematic, to say the least, in cases where a release is sought to apply to facts not present in existence and of which it is alleged that one party has not disclosed what occurred to the other.*

In allowing Mr Reid's appeal, his Honour said:

> *[53] In the present case, the question is not whether Mr Reid can evade the operation of the release. Nor does this appeal raise for determination the proper construction of the release, which may be informed by contextual considerations not presently in evidence and which may be controversial.*
> *The only question is whether the Bank's case based on the release is so strong that Mr Reid should not*

be permitted to go to trial. That question falls to be determined on the basis that Mr Reid did not contemplate that the vandalism might occur or the $370,000 allowance be given, and had no intention to release the Bank from a claim in respect of such matters.

[54] It may readily be seen that that question is not amenable to summary dismissal. The allowance of $370,000 is large – considerably more than 10% of the selling price. It arose out of what may be taken to be highly unusual circumstances – claims of serious vandalism to the property while the Bank was in possession and after contracts had been exchanged. The circumstances in which that occurred are not known and may be contentious. The deed does not expressly mandate a sale, although it is plain that that is its intent, and it is arguable that when it is construed in context a substantial allowance made without notice to Mr Reid for the vandalism may be outside its proper construction. Alternatively, if not, it is also arguable that it would be unconscionable for the Bank to rely upon the release. The basis upon which the release came to be executed, and what the Bank thereafter did, will be the subject of evidence at trial. It cannot confidently be concluded, in advance of trial, that facts could never emerge in light of which it would be unconscientious for the Bank to rely on the release.

Bell CJ said:

[3] As Leeming JA's scholarly judgment explains, equitable doctrine has always been rightly solicitous of the interests of those unintentionally giving up future unknown rights or releasing claims in ways that could not have been contemplated at the time of the compromise. It also guards against the unconscientious exercise of legal rights conferred by releases, whether secured by contract or under deed. While any deed of release or compromise should be interpreted consistently with the guidance supplied by the seminal decision in Grant v John Grant & Sons Pty Ltd (1954) 91 CLR 112; [1954] HCA 23, as the judgments of Leeming JA and White JA in this case both demonstrate, consistent with the recent decision of the Victorian Court of Appeal in Burness v Hill [2019] VSCA 94, this is one area in which evidence of the subjective intentions of the parties to a deed of (or contractual) release may legitimately inform the analysis of the operation and efficacy of any release.

White J, also allowing the appeal, made the following observations:

[126] In Perry Herzfeld and Thomas Prince, Interpretation (2 ed, 2020, Thomson Reuters) para [30.80], the learned authors say that the equitable principle has no application where the parties have clearly released unknown or future claims.

[127] The Bank relies upon the release as covering all claims which Mr Reid at any time in the future may have against the Bank for, or by reason, or in respect of any act, cause, matter or thing in connection with, or incidental to, the sale of the Menangle Property (cl 5.1).

[128] The words "in connection with or incidental to" are undoubtedly wide. But the conduct of the Bank about which Mr Reid complains had no direct or necessary relation to the Bank's exercise of its power of sale. Prima facie, the release of claims in respect of the future sale of the property would cover matters such as an alleged failure by the Bank to take proper steps to market the property for sale, or otherwise not taking reasonable care to sell the property for its market value or the best price reasonably obtainable having regard to the circumstances existing when the property is sold (Corporations Act 2001 (Cth) s 420A). Possibly, although this might be contentious, the release might extend to a failure to exercise the power of sale in good faith.

2. Drafting tips

It is suggested that the following matters be considered in drafting a release:

(a) Is it intended that only one party will be released, or do the releases need to be mutual?

(b) Will the release only trigger on payment of the settlement sum, or will it trigger on execution of the deed?

(c) Is the release intended to capture both known and unknown claims? If both, the definition of "claim" should make this clear. Additionally, any excluded claim must be clearly identified in the definition.

(d) It may be useful to incorporate an acknowledgment by the releasor that though they may discover facts or circumstances or information different from or in addition to the facts or information that they now know, it is their intention to, and they do, fully and finally settle all claims on the terms of this deed. This acknowledgment may minimise the risk of the releasor subsequently relying on the equitable principle in *Grant* to avoid the release in making a later claim.

(e) The release should contain an indemnity from the releasor to the releasee, indemnifying the releasee from and against all claims against the releasee by any person or body claiming through, by or under the releasor.

(f) Unlike a deed poll, the doctrine of privity of contract applies to a deed inter partes. Thus, if a person not a party to the deed is intended to benefit from the release, the releasor should be declared to hold the release on trust for itself and any other nominated party.

(g) It is open to introduce a time of the essence clause into the deed of release. This would enable a party to terminate the deed immediately if the counterparty failed to meet a time obligation.

3. Releases and covenants not to sue

The Australian authorities have drawn a clear distinction between, on the one hand, a release and, on the other, a covenant not to sue, although in certain circumstances a covenant not to sue may operate as a release. Thus, Dixon J in *McDermott v Black* (1940) 63 CLR 161, 186-7 stated:

> *At law, "the only case in which a covenant or promise not to sue is held to be pleadable as a bar, or to operate as a suspension, and by consequence a release or extinguishment of the right of action, is where the covenant or promise not to sue is general, not to sue at any time. In such cases, in order to avoid circuity of action, the covenants may be pleaded in bar as a release…for the reason assigned, that the damages to be recovered in an action for suing contrary to the covenant would be equal to the debt…or sum to be recovered in the action agreed to be forborne" (per Parke B., Ford v Beech).*

Subsequently, in *Thompson v Australian Capital Television Pty Ltd* (1996) 186 CLR 574, 609, Gummow J said:

> *The reason why a covenant not to sue of this nature has been held to provide a plea in bar was more fully explained by Williston in the following passage:*
> *"This is to avoid circuity of action; for, if the plaintiff in the original action should recover, the defendant could easily recover precisely the same damages back for breach of the covenant to forbear or not to sue. Instead of permitting the double action, the court produces the same effect more simply by giving judgment for the defendant in the original action."*

It is a question of construction whether a covenant in any particular case operates as a release or purely as a covenant not to sue.

4. Joint obligations

In *Thompson* (supra), Gummow J restated the common law principle adopted in English law that the release of one joint tortfeasor, or one joint debtor, operates to release the other joint tortfeasors or joint debtors. The reason being that the cause of action, which is one and indivisible, having been released, all persons otherwise liable are consequently released.

Conversely, a covenant not to sue one joint debtor does not release the others. In this situation, the cause of action remains alive.

The Australian appellate Courts have considered the application of the equitable doctrine of contribution in relation to a covenant not to sue provided by a creditor to a co-guarantor, the question being whether the other co-guarantor may seek equitable contribution despite the covenant not to sue.

The basis of the equitable doctrine of contribution was explained by the High Court in *Friend v Brooker* (2009) 239 CLR 129 in which the plurality noted:

> *[39] The equity to seek contribution arises because the exercise of the rights of the oblige or creditor ought not to disadvantage some of those bearing a common burden; the equity does not arise merely because all the obligors derive a benefit from a payment by one or more of them. As explained in United States authority, contribution is an attempt by equity to distribute equally, among those having a common obligation, the burden of performing it, so that without that common obligation there can be no claim for contribution.*
>
> *[40] Hence the basic characteristics for the doctrine were identified, with reference to long established authority, in Burke as requiring contribution between parties sharing coordinate liabilities or a common obligation to make good the one loss, where the liabilities were of the same nature and to the same extent. In that case, the purchaser, who had bought retail premises under a misrepresentation concerning the sitting tenants, recovered damages from the vendor for contravention of s 52 of the Trade Practices Act 1974 (Cth); the purchaser also had been negligently advised on the matter by its solicitor but the vendor failed to recover contribution from that solicitor. The liabilities were not of the same nature and extent. Further, McHugh J emphasised that not enable the vendor to diminish the consequences of its contravention of s 52, by obtaining contribution, would be contrary to the policy of the legislation.*
>
> *[41] It was said in Burke, with reference to authority, that the doctrine is "usually expressed" in terms of "co-ordinate liabilities" or "common obligation". The terminology of "co-ordinate liabilities" is to be preferred to that of "common obligation", which it subsumes, as indicative of the class of circumstances in which the equity arises.*

In *Lavin v Toppi* [2014] NSWCA 160, the NSW Court of Appeal considered whether a creditor's covenant not to sue one co-guarantor affected the right of the other co-guarantor to seek equitable contribution. Relevantly, Leeming JA (Emmett and Macfarlan JJA agreeing) said:

> *[73] In point of principle, a covenant not to sue (in the usual form) does not alter an existing liability. Giving such a covenant means merely that the covenantor is in breach if it does sue. True it is that in some circumstances, the covenant could be pleaded in bar as a release, and in any event, it could amount to a good equitable defence, enforceable in appropriate circumstances by injunction: McDermott v Black (1940) 63 CLR 161 at 186-188 (Dixon J); Baxter v Obacelo Pty Ltd [2001] HCA 66; 205 CLR 635 at [66]-[68] (Gummow and Hayne JJ). This does not detract from the fundamental difference between releasing a primary liability, and making a promise in respect of that primary liability.*
>
> *[74] I return to Ms Lavin's submission that it is necessary that the liabilities, in order to be "co-ordinate" so as to support a right to contribution, be "of the same nature and to the same extent". A covenant not to sue does not alter the liability. Indeed, the premise of the covenant is that the liability remains; it is the liability which is the subject of the covenant. There remained a community of interest shared by Ms Lavin and Ms Toppi, at least in the broader sense in which the term was used in equity.*
>
> *[75] Ms Lavin invoked the maxim that equity looks to the substance, rather than the form, and said that Ms Lavin's liability once she had the benefit of the covenant not to sue, was "infinitesimal" - for the Bank could not enforce any further liability against her. However, in HIH Claims the application of this maxim was rejected in a similar context at [47]. Moreover, Ms Lavin's submission clashes with well-settled principles. As Glanville Williams said at 165:*
>
> > *"The right of contribution among co-debtors is independent of any present right of the principal creditor. Thus the right of contribution exists although the right of the principal debtor has become statute-barred."*
>
> *[76] For similar reasons, and contrary to Ms Lavin's submissions, the payment by Ms Toppi of the outstanding indebtedness of some $2.9 million did confer a benefit upon Ms Lavin. Prior to the payment, Ms Lavin was liable to pay her share of the guaranteed debt, albeit that the Bank had promised not to enforce it. After the payment, there was no guaranteed debt left to pay. Moreover, as Glanville Williams said at 165-166:*
>
> > *"The right of contribution … does not depend on a present common obligation between the debtor who pays the debt and the debtor against whom (or whose estate) contribution is sought. It is enough that the joint or joint and several obligation existed at some period in the past."*

The High Court, in dismissing Lavin's appeal [2015] HCA 4, said:

> *[30] The appellants' argument seized upon the timing of the covenant not to sue. It was said that the respondents' right to contribution depended on the respondents and appellants sharing coordinate liabilities at the date of the respondents' payment of the balance of the guaranteed debt. It was said that only at the time could a right to seek contribution accrue to the respondents; yet at that time the appellants and respondents no longer shared coordinate liabilities because the appellants could no longer be sued by the Bank.*
>
> *[31] There are two answers to the appellants' argument. The first is that given by the Court of Appeal, ie that the Bank's covenant not to sue the appellants did not extinguish, but indeed assumed, the appellants' ongoing liability for the guaranteed debt. Accordingly, the appellants and respondents shared coordinate liabilities to the Bank under the guarantee both before and after the covenant not to sue. The second answer is that the respondents' right to contribution from the appellants was cognisable in equity even before the respondents made their disproportionate payment to the Bank and could not be defeated by the separate agreement of the Bank and the appellants. Before elaborating upon these points, the juridical foundation of the right to contribution should be noted.*

5. The impact of legislation on the common law rule relating to the release of joint obligors

Section 95 of the *Civil Procedure Act 2005* (NSW) provides:

> ***95 Joint liability** (cf Act No 52 1970, section 97)*
>
> *(1) If two or more persons have a joint liability and, in any proceedings, judgment on the liability is given against one or more but not all of them—*
>
> > *(a) the liability of the other or others of them is not discharged by the judgment or by any step taken for the enforcement of the judgment, and*

(b) after the judgment takes effect, those of them against whom the judgment is given and the other or others of them become liable, as between those of them against whom the judgment is given on the one hand and the other or the others of them on the other hand, severally but not jointly, and

(c) if there are two or more such persons against whom the judgment is not given, they remain, after the judgment takes effect, jointly liable amongst themselves, and

(d) if the judgment is satisfied wholly or in part by payment or by recovery under execution, the liability of the persons against whom the judgment is not given is taken also to have been satisfied in the amount of the payment or recovery.

(2) This section does not affect a person's right to contribution or indemnity in respect of the person's satisfaction, wholly or in part, of a liability that the person has (whether jointly or severally or jointly and severally) with any other person.

(3) This section does not apply to a judgment to which section 5 (1) (a) of the Law Reform (Miscellaneous Provisions) Act 1946 applies.

*(4) In this section, **liability** includes liability in contract, liability in tort and liability under a statute.*

Section 24AA of the *Wrongs Act 1958* (Vic) provides:

> *Judgment recovered against any person liable in respect of any debt or damage shall not be a bar to an action, or to the continuance of an action, against any other person who is (apart from any such bar) jointly liable with the first-mentioned person in respect of the same debt or damage.*

In commenting on the difference in drafting between the New South Wales and Victorian Acts the New South Wales Court of Appeal (consisting of Gleeson, Leeming and Mitchelmore JJA) in *Cassaniti v Ball* [2022] NSWCA 161 said:

> *[75] Thus, rather than having two separate provisions (s 5(1)(a) applicable to joint tortfeasors, and s 95 applicable to joint obligees who fall outside of s 5(1)(a)), the Victorian legislation has a single provision, extending to recovering compensation "whatever the legal basis of liability" and explicitly including "breach of trust". The Victorian Court of Appeal found no difficulty in applying the construction of the narrower provision considered in Thompson to s 24AA, to achieve the implied abrogation of the single and indivisible status of causes of action for debt in the same way as had been held for causes of action for tort in Thompson. We respectfully agree.*

In considering the impact of section 95 on the common law rule as to the release of joint obligors, the Court said:

> *[73] Each of paragraphs (2)(a), (b), (c) and (d) is inconsistent with a judgment effecting a release of other joint obligees. Applying the reasoning which was dispositive in Thompson produces the result that the provision must impliedly abrogate the concept that the non-tortious cause of action was one and indivisible. That is to say, s 97(2)(a) of the Supreme Court Act 1970 provides that where a judgment is given against one of a number of persons who have a joint liability, then the liability of the others is not discharged by the judgment or any step taken for its enforcement. That is to the same substantive effect as s 5(1)(a) of the 1946 NSW statute and is contrary to the proposition that there could be a single cause of action which merged in the judgment obtained against one of the persons jointly liable. If s 5(1)(a) impliedly abolishes the rule that the release of one joint tortfeasor releases the others, then so too must s 97(2)(a) in the cases to which it applies, namely, co-obligors who are not joint tortfeasors. Paragraphs (b), (c) and (d) of s 97(2) confirm that that is so.*

Accordingly, in New South Wales and Victoria, the difference between a release and a covenant not to sue, in relation to a joint liability in contract, has been effectively extinguished. However, the common law position remains in the other States and Territories.

6. Accord and satisfaction

Apart from recording a release in a formal deed of settlement, the parties may reach agreement through an accord and satisfaction. This typically arises by the acceptance of a *Calderbank* offer made by one party to another. The common law has recognised three categories of accord which were recently summarised by Kyrou JA (Beach and Walker JJA agreeing) in *Zivkovic v Parke* [2022] VSCA 43 as follows:

> *[81] An accord executory describes a settlement agreement under which no binding contract arises until there is compliance with the obligations it sets out. Until then, the plaintiff's cause of action subsists and can be pursued. Thus, if the plaintiff claims $1,000 and under the settlement agreement the defendant promises to pay $100 within 30 days, a binding contract does not arise until the defendant makes that payment. If the defendant fails to comply with his or her obligations under the settlement agreement, neither party can enforce it because it is not a binding contract. In that situation, the settlement*

agreement does not preclude the plaintiff from pursuing his or her claim for $1,000. If the defendant complies with his or her obligations under the settlement agreement, it becomes a binding contract and the plaintiff's cause of action is discharged.

[82] An accord and satisfaction describes a settlement agreement which becomes a binding contract when it is made and has the effect of discharging the plaintiff's cause of action at that time, irrespective of whether the defendant complies with his or her obligations under the agreement. Thus, in the above example, the plaintiff is treated as accepting the defendant's promise to pay $100 within 30 days, rather than the actual payment of that amount, as the consideration for settling his or her claim for $1,000. That promise has the effect of discharging the plaintiff's claim for $1,000 as soon as the settlement agreement is made. From that time, the only right the plaintiff has against the defendant is to receive the amount of $100. If the defendant does not pay that amount in accordance with the settlement agreement, the only remedy available to the plaintiff is to enforce the defendant's contractual obligation to pay $100. The plaintiff can no longer pursue his or her claim for $1,000 against the defendant.

[83] An accord and conditional satisfaction describes a settlement agreement which becomes a binding contract when it is made but it does not have the effect of discharging the plaintiff's cause of action unless and until the defendant complies with his or her obligations under the agreement. If the defendant's failure to do so constitutes a repudiation of the contract, the plaintiff may bring the contract to an end by accepting the repudiation, and pursue his or her original cause of action. Alternatively, the plaintiff may treat the contract as subsisting and seek specific performance of the defendant's obligations under it. Thus, in the above example, where the defendant has promised to pay the amount of $100 within 30 days, if that amount is tendered within that period, the plaintiff is bound to accept it and cannot pursue his or her original claim for $1,000. However, if the defendant does not pay the amount of $100 within 30 days and his or her failure constitutes a repudiation of the settlement agreement, the plaintiff has two options. The plaintiff may bring the agreement to an end and pursue the original claim for $1,000 or, alternatively, the plaintiff may seek specific performance of the defendant's obligation to pay $100.

Turning to the facts.

The case involved the categorisation of the terms of a settlement of a defamation action brought by the respondent. The applicants accepted a *Calderbank* offer by the respondent which, relevantly, provided:

1. *Payment to the plaintiff [the respondent] by the defendants [the applicants] of $80,000 in full and final settlement of this matter.*

2. *Payment to be made by electronic funds transfer into an account nominated by the plaintiff. The payment is to be made by 29 August 2020 (and an agreement to the entry of judgment for that amount in the event of default).*

3. *Mr Zivkovic [the first applicant], immediately delete each of the publications the subject of the County Court proceedings that remain visible on the Internet, namely the Second Publication (as defined in the Statement of Claim) published via the 'Google review' facility to the Google record for Parke Lawyers Ringwood, the Third Publication (as defined in the Statement of Claim) published via the 'Google review' facility to the Google record for ASE [the second applicant], and the Fourth Publication (as defined in the Statement of Claim) published via the 'Google review' facility to the Google record for IAS [the third applicant]. (Collectively, these publications are referred to as the '**Defamatory Publications**').*

4. *Mr Zivkovic, agree to publish immediately the following apology, which is to remain visible until 30 January 2021…*

5. …

6. …

The $80,000 was never paid. Thereafter, the respondent re-listed the matter. The primary judge awarded the respondent $160,000 in damages.

The applicants (defendants) sought leave to appeal on the basis that the settlement was an accord and satisfaction and thus the plaintiff's cause of action had been discharged and replaced by a promise to pay $80,000. Conversely, the respondent contended that the agreement was an accord and conditional satisfaction which the applicants had repudiated by failing to pay the settlement sum within the prescribed period.

Accordingly, the respondent was entitled to pursue his original cause of action.

The primary judge held that the settlement was an accord and conditional satisfaction, the conditions of which had not been satisfied.

The Court of Appeal by a majority agreed.

In their joint reasons, Beach and Walker JJA said:

> *[8] The settlement agreement must be construed as a whole, with regard to its full context and purpose. It is not to be construed piecemeal or by reference to individual terms, or individual phrases within individual terms.*
>
> *[9] Absent the words in brackets in cl 2, we think there could be no doubt that, properly construed, the settlement agreement was not an accord and satisfaction, but rather, was an accord and conditional satisfaction. The settlement agreement, not being expressed to be a resolution of the proceeding on the basis of an exchange of promises, does not contain language of the kind traditionally seen in a settlement agreement that constitutes an accord and satisfaction of an underlying proceeding.*
> *…*
>
> *[13] Construed as a whole, in our view the chronological obligations imposed on the applicants by the settlement agreement suggest that full and final settlement (in the sense of the discharge of the respondent's claims against the applicants) was only to occur upon the performance of each of those obligations, culminating in the payment of the settlement sum. That is, the settlement agreement is an accord and conditional satisfaction, not an accord and satisfaction. That conclusion is supported by the following matters, although we accept that none of them is determinative.*
>
> > *(a) First, the chapeau to the offer stated that the 'following offer' was to 'resolve this matter'. The offer then set out six clauses. It is plain that, although cl 1 referred to the payment of $80,000 'in full and final settlement of this matter', the offer was not one where payment of $80,000 was all that was required to perform the agreement.*
> >
> > *(b) Secondly, the text of cl 1 referred to 'payment' of the settlement sum. That supports the proposition that what the respondent was to receive in consideration for discharging the applicants from liability was the payment of the sum, not a promise to pay the sum.*
> >
> > *(c) Thirdly, cls 3, 4 and 5 require the immediate taking of certain actions. In our opinion it is inherently unlikely that a party to an agreement of this kind would accept a promise to take these actions in return for the discharge of the underlying claim, rather than agreeing to discharge the claim once the actions were taken. That is particularly so where there is a real doubt as to whether, under each of cls 3, 4 and 5, the publication of an apology might not be enforceable by an action for specific performance. We discuss this issue in greater detail below.*

Kyrou JA in dissent said:

> *[109] There are two striking features of the above chronology. First, settlement occurred after Mr Parke obtained default judgment for damages to be assessed. In many cases, settlement occurs prior to any judgment which determines any aspect of a plaintiff's cause of action and results in the cause of action merging in the judgment. However, in the present case, the default judgment determined that Mr Parke was entitled to damages for defamation, with the only outstanding issue relating to the damages being their quantum. That means that, insofar as Mr Parke's cause of action in defamation involved a claim for damages, that claim merged in the default judgment, such that the judgment was the exclusive repository of his rights in relation to damages. Secondly, Mr Parke made the Calderbank offer on the eve of the date initially fixed for the assessment of damages hearing and specified that it could only be accepted prior to the time initially fixed for commencement of that hearing.*
>
> *[110] These two features indicate that the parties intended that acceptance of the Calderbank offer within a very narrow timeframe would resolve the outstanding issue of quantum by agreement rather than by curial assessment. It would be consistent with that intention for Mr Parke's right to an assessment of damages to be discharged and replaced by the applicants' promise to pay the sum certain of $80,000, with that right being enforceable by a consent judgment for that amount in the event of non-payment by the due date.*
>
> *[111] On the other hand, it would be inconsistent with that intention for Mr Parke to have the right to put aside the settlement agreement and seek an assessment of damages in the event of non-payment by the due date. That is because the existence of such a right would fail to give effect to the remedy for breach specified by the settlement agreement, namely, the entry of judgment for the amount of $80,000. The applicants could not oppose the entry of judgment for that amount because, by accepting the Calderbank offer, they agreed to the entry of such judgment.*

Chapter 3

Chapter 3: Performance bonds and the availability of injunctive relief

1. The nature of a performance bond

The key features of a performance bond were restated by the High Court in *Simic v New South Wales Land and Housing Corporation*.[16] French CJ said:

> *[5] The principles governing the legal effect and operation of performance bonds are similar to those applicable to letters of credit. A letter of credit represents payment for the performance of an obligation. A performance bond represents payment on default or in lieu of performance. The commercial purpose of performance bonds, as described in Wood Hall Ltd v Pipeline Authority, is to provide an equivalent to cash.*
>
> *[6] Two complementary principles apply to letters of credit and performance bonds alike the principle of strict compliance and the principle of autonomy or independence. According to the principle of strict compliance, a bank paying on a letter of credit or performance bond only has an obligation to do so and only has an entitlement to claim indemnity for the performance of that obligation if the conditions on which it is authorised and required to make payment are strictly observed. A demand for payment cannot be accepted on the basis that near enough is good enough. The principle of autonomy requires that the letter of credit or performance bond be treated as independent of the underlying commercial contract. The principles of strict compliance and autonomy serve the immediate commercial purpose of such instruments of providing an equivalent to cash and the further purpose of performance bonds of allocating risk between the parties to the underlying contract until their dispute, if there be one, is resolved.*
>
> *[8] The autonomy principle requires that the obligations of the issuing or accepting bank under the bond not be read as qualified by reference to the terms of the underlying contract. That said, it does not prevent a party to a contract who procures the issue of a performance bond claiming as against the beneficiary that the beneficiary's action in calling upon the bond is fraudulent or unconscionable or in breach of a contractual promise not to do so unless certain conditions are satisfied…*

2. Strict compliance in practice

The recent decision of the Queensland Supreme Court in *Santos Limited v BNP Paribas*[17] is a salutary warning about the perils of failing to observe the principle of strict compliance in calling on a bank guarantee.

Turning to the facts.

Santos and Fluor Australia entered into an EPC contract under which Fluor was required to provide a bank guarantee. Relevantly, the contract incorporated a pro forma letter of demand in respect of the bank guarantee.

> *"(insert Santos Limited letterhead)*
>
> *To:*
> *BNP Paribas*
> *60 Castlereagh Street*
> *Sydney NSW 2000*
> *date:*
> *Attention: Head of Operations*
> *Dear Sir/Madam*
> *Contractor - Bank Guarantee*
> *We refer to the Bank Guarantee issued by you in our favour and dated 30th January, 2012 in relation to the EPC Contract.*
> *We hereby demand payment under the Bank Guarantee of (insert amount).*
> *Please make payment of this sum to the account of (insert) at (account number).*
> *Capitalised words and expressions used in this demand shall have the same meanings as are ascribed to them in the Bank Guarantee.*
>
> *Yours faithfully*
> *……..*
> *Authorised signatory of*
> *Santos Limited" (Emphasis added)*

On 21 December 2015 the plaintiff made a demand on BNP Paribas in the following form:

> *"18 December 2015*

[16] (2016) 260 CLR 85.
[17] (2018) QSC 105.

Our Ref: STO-BNP-EPC-L-006
BNP Paribas
Group Operations – Guarantees
Level 4, 60 Castlereagh Street
Sydney, NSW, 2000 Australia
e-mail: finance@au.bnpparibas.com
Attention: Head of Operations
Dear Sir or Madam,
Performance Payment Security – Bank Guarantee No 120054 – Gladstone LNG Upstream Project EPC Contract
We refer to the above noted Bank Guarantee (copy appended) issued by you in our favour dated 8 January 2014 and with an expiry date of 31 December 2015 (Amendment No. 2).
We hereby demand payment under the Bank Guarantee of Australian Dollars Fifty-five Million only (AUD 55,000,000.00).
Please make payment of this sum to the account of Santos Limited per the details below:
Bank: ANZ Bank, 121 King William Street, Adelaide SA 5001
BSB: 015-010
Account: 8374-78516
Account Name: Santos Limited Payments Account
Capitalised words and expressions used in this demand shall have the same meanings as are ascribed to them in the Bank Guarantee.
Yours sincerely,
Santos Limited – GLNG Upstream Project
[signature]
Rob Simpson
General Manager Development
cc: SEJ; RSI; TBR; AJS; MSO; ND: AH; KB; SBI"

The Bank refused to pay on the demand on the basis that the demand did not purport to be signed by an authorised representative of Santos Ltd. Jackson J, in his judgment, noted that the prescribed letter of demand in Annex A required that the signatory be stated to be the "authorised signatory of Santos Limited", whereas the demand was signed by a Rob Simpson who was described as the "General Manager Development". In finding for the Bank his Honour said:

> *[19] The purpose of the instrument is to operate as a bond by a financial institution of worth that will unconditionally pay the amount promised to the named beneficiary when presented with a complying demand. The instrument is given as security for the performance by the beneficiary's contractual counter-party, the contractor, of an underlying construction contract. The contractual counter-party, or someone at its request, will usually promise to indemnify the issuing financial institution for any amount paid under the bond to the beneficiary. The financial institution's entitlement to indemnity will depend on the terms of the contract between it and the indemnifier. Usually, the financial institution must pay without reference to the indemnifier or the beneficiary's contractual counter-party, upon a complying demand. It is also usual that payment must be made immediately upon demand. In these senses, the bond is said to be "as good as cash" for the beneficiary. Accordingly, it is of critical importance that the financial institution pay only upon a complying demand, that entitles the financial institution to indemnity from the indemnifier, and that a complying demand must strictly comply with the requirements of the instrument for payment.*
>
> *[20] In such a context, in my view, the signature by Mr Simpson coupled with the description of his position did not amount to a representation that he was an authorised representative or authorised signatory (if there be any difference) of the plaintiff. The position description did not represent anything about Mr Simpson's authority, per se. It follows, in my view, that the demand did not constitute a notice in writing purporting to be signed by an authorised representative of the plaintiff in compliance with paragraph (c) and Annex A.*

As the expiry date of the bank guarantee was 31 December 2015 it was too late for Santos to submit a demand in proper form. An expensive mistake.

3. Challenges to autonomy

In the important decision of the Full Federal Court in *Clough Engineering Limited v Oil and Natural Gas Corporation Limited*[18] the Court identified the bases upon which the autonomous character of a performance bank guarantee may be subject to challenge. The Court said:

> *[77] Nevertheless, the authorities have recognised three principal exceptions to the rule that a court will not enjoin the issuer of a performance guarantee, or bond, from performing its unconditional obligations to make payment ....*

[18] [2008] FCAFC 136.

First - the Court will enjoin the party in whose favour the performance guarantee has been given from acting fraudulently: …
Second - the party in whose favour the performance bank guarantee has been given may be enjoined from acting unconscionably in contravention of s 51AA of the TPA.... On this point, different views have been expressed about the reach of s 51AA. The High Court has not determined which of these views is correct ...
Third - the most important exception for present purposes, is that, whilst the Court will not restrain the issuer of a performance guarantee from acting on an unqualified promise to pay:
… if the party in whose favour the bond has been given has made a contract promising not to call upon the bond, breach of that contractual promise may be enjoined on normal principles relating to the enforcement by injunction of negative stipulations in contracts.

4. The construction of the underlying contract

In any analysis of the third exception to the autonomy principle the starting point is the decision of the Court of Appeal of Victoria in *Fletcher Construction Australia Ltd v Varnsdorf Pty Ltd*[19], in which the observations of both Charles and Callaway JJA have been frequently cited in Australian appellate decisions as authoritative statements of the applicable principles of construction:
Importantly, Callaway JA said at 826:

There are broadly two reasons why the beneficiary may have stipulated for a guarantee. One is to provide security. If it has a valid claim and there are difficulties about recovering from the party in default, it has recourse against the bank. The second reason, which is additional to the first, is to allocate the risk as to who shall be out of pocket pending resolution of a dispute. The beneficiary is then able to call upon the guarantee even if it turns out, in the end, that the other party was not in default. Compare Burleigh Forest Estate Management Pty Ltd v Cigna Insurance Australia Ltd [1992] 2 Qd R 54 at p59 and Themehelp Ltd v West [1996] QB 84 in the dissenting judgment of Evans LJ at p103. It is a question of construction of the underlying contract whether the guarantee is provided solely by way of security or also as a risk allocation device. Remembering that we are speaking of guarantees in the sense of standby letters of credit, performance bonds, guarantees in lieu of retention moneys and the like, the latter purpose is often present and commercial practice plays a large part in construing the contract. No implication may be made that is inconsistent with an agreed allocation of risk as to who shall be out of pocket pending resolution of a dispute and clauses in the contract that do not expressly inhibit the beneficiary from calling upon the security should not be too readily construed to have that effect. As I have already indicated, they may simply refer to the kind of default which, if it is alleged in good faith, enables the beneficiary to have recourse to the security or its proceeds.

This passage was cited with manifest approval by the Full Federal Court in *Clough Engineering Limited v Oil and Natural Gas Corporation Limited*.

Turning to the facts of *Clough*.

Clough, as contractor, entered into an EPC contract on 30 November 2004 with Oil & Natural Gas Corporation Ltd (**ONGC**) for the development of certain oil and gas fields off the east coast of India.
The contract was governed by Indian law and, subject to arbitration, the parties agreed to submit any dispute to the exclusive jurisdiction of the Indian courts.

Relevantly, the contract required Clough to provide a performance guarantee as follows:

3.3 Performance Guarantee
3.3.1 The Contractor shall furnish to the Company within 2 weeks from the date of signing of this Contract an unconditional and irrevocable Performance Bank Guarantee for due performance of the Contract, as per proforma given at ... for a sum equivalent to 10% of the Contract price....
3.3.3 The Company shall have the right under this guarantee to invoke the Banker's guarantee and claim the amount there under in the event of the Contractor failing to honour any of the commitments entered into under this Contract. In case Contractor fails to furnish the requisite Bank Guarantee as stipulated above, then the Company shall have the option to terminate the Contract and forfeit the Bid security amount and no compensation for the Works performed shall be payable upon such termination. ...

The performance guarantee provided as follows:

2. We ... (name of the Bank) ... do hereby guarantee and undertake to pay immediately on first demand in writing any/all moneys to the extent of ... on breach of Contract by Contractor without any demur, reservation, contest or protest and/or without any reference to the Contractor. Any such demand made by Company on the Bank by serving a written notice shall be conclusive and binding, without any proof, on the bank as regards the amount due and payable, notwithstanding any dispute(s) pending

[19] [1998] 3 VR 812.

before any Court, Tribunal, Arbitrator or any other authority and/or any other matter or things whatsoever, as liability under these presents being absolute and unequivocal. We agree that the guarantee herein contained shall be irrevocable. This guarantee shall not be determined, discharged or affected by the liquidation, winding up, resolution or insolvency of the Contractor and shall remain valid, binding and operative against the Bank....

The security was provided by three Australian banks in the prescribed form.

Disputes arose between the parties in connection with alleged late performance by Clough and associated with these disputes were issues relating to the extension of the guarantees and insurance cover for Clough.

Negotiations for resolution of these disputes were unproductive. Clough being concerned that ONGC would call the performance guarantees sought interlocutory injunctive relief to restrain ONGC and the Australian banks from calling upon, or paying under these guarantees.

In ex parte proceedings Gilmour J granted an interim interlocutory injunction but on a subsequent motion filed by ONGC, his Honour discharged the injunction.
Clough appealed to the Full Federal Court.

In addressing the applicable principles of construction, the Court said:

[81] In determining whether the underlying contract confers an unfettered right to call upon the performance guarantee, the importance of such instruments in the construction industry, both nationally and internationally, is a factor which bears upon the question of construction of the Contract.

[82] Notwithstanding the importance of commercial practice, the statements in these authorities do not suggest that the Court should depart from the task of construing the terms of the contract in each case. What the authorities emphasise is that the commercial background informs the construction of the contract. In particular, as Callaway JA said in the passage quoted above, the Court ought not too readily favour a construction which is inconsistent with an agreed allocation of risk as to who is to be out of pocket pending resolution of the dispute about breach. A number of authorities support this proposition.

[83] It follows that clear words will be required to support a construction which inhibits a beneficiary from calling on a performance guarantee where a breach is alleged in good faith, le, non-fraudulently. This view is also supported by the remarks of Charles JA in Fletcher Construction [1998] 3 VR at 820-821. There, his Honour analysed and placed some doubt upon the correctness of decisions such as Pearson Bridge (NSW) Pty Ltd v State Rail Authority of New South Wales (1982) 1 Australian Construction Law Reports 81 at 86.

The Court concluded:

[92] The essential question then is whether, clause 3.3.3 of the Contract, when read with clause 2 of the performance guarantee, imports an express or implied negative stipulation in the Contract that ONGC would not invoke the security absent actual breach. More particularly, was there an express or implied negative stipulation precluding ONGC from calling upon the guarantee in the event that Clough was able to establish a genuine dispute as to whether it was in breach of the Contract?

[93] In our view there was no such stipulation. We reject Clough's submission that the words "on breach of Contract" in the performance guarantee indicate that the intention of the parties was that there must be actual breach before the guarantee could be invoked. To so confine the terms of the Contract would be to ignore the words "notwithstanding any dispute(s) pending" in clause 2 of the performance guarantee.

[94] It seems to us to be plain that upon the proper construction of clause 3.3.3 of the Contract, when read together with clause 2 of the performance guarantee, ONGC was entitled to invoke the guarantee notwithstanding the existence of a dispute between Clough and ONGC as to whether Clough had failed to honour any of its commitments under the Contract.

[95] The whole tenor of the performance guarantee is that it was payable on demand by ONGC on breach by Clough but without reference to Clough and without any "demur, reservation, contest or protest" by that company. In our view this emphasises the proposition that the intention of the parties to the Contract was that Clough was not entitled to raise the existence of a dispute as to whether it was in actual breach as an answer to an invocation of the guarantee and a claim under it.

[99] Here, the terms of cl 3.3 of the Contract, read with cl 2 of the guarantee, show that the commercial purpose of the Contract was to allocate the risk of who should be out of pocket notwithstanding that there may be a genuine dispute as to whether Clough had failed to honour commitments under the Contract. The risk was allocated to Clough, there being no clear words to inhibit ONGC as the beneficiary of the guarantee from invoking it: Fletcher Construction [1998] 3 VR at 821 at 827.

[100] Indeed, not only are there no clear words inhibiting a call, the express words of cl 2 of the performance guarantee show that it was the intention of the parties that ONGC could invoke the guarantee even if the claimed breach was genuinely disputed.

[101] It is true, as Clough submitted, that the Contract makes no reference to a "bona fide belief' as to the genuineness of the claimed breach. But as Callaway JA observed in Fletcher Construction [1998] 3 VR at 827, the operative words simply refer to the kind of breach which:
if it is alleged in good faith enables the beneficiary to have recourse to the security or its proceeds,

5. The correctness of the approach in Clough

Doubt as the correctness of *Clough* was expressed by Macfarlan JA in the New South Wales Court of Appeal in *Lucas Stuart Pty Ltd v Hemmes Hermitage Pty Ltd*[20].

The applicant Lucas Stuart, contracted to construct for the respondent a multi-storey retail bar, restaurant and function centre known as "The Ivy" at the respondents premises in George Street, Sydney. In accordance with the contract the applicant provided to the respondent, as security for performance of its obligations under the construction contract, 6 undertakings issued by QBE Insurance (Australia) Ltd.

Under clause 16.3 of the contract the respondent was entitled to make a call on the undertakings if the applicant failed to comply with a notice issued under clause 16.2. Clause 16.2 provided:

16.2 If the contractor has not materially complied with its obligations under this contract, the principal may give a written notice to the contractor stating:
16.2.1 The contractor's breach.
16.2.2 What the principal requires the contractor to do to remedy the breach.
16.2.3 A specific reasonable time in which the contractor must remedy the breach.

On 19 July 2010 the respondent issued a notice under clause 16.2.

By notice of motion the applicant sought an injunction restraining the respondent from calling on the undertakings. The applicant argued that the notice dated 19 July 2010 was invalid because the condition precedent in clause 16.2 had not been satisfied (that is, the contractor has not materially complied with its obligations under this contract).

The Court of Appeal allowed the applicant's appeal from the refusal of the primary judge to grant the injunction. Macfarlan JA said:

[38] Because Clough is distinguishable and its correctness was not fully debated before this court, I refrain from expressing a concluded view as to its correctness. It is appropriate however for me to indicate that I have reservations about its correctness.

[39] There are at least two principal goals that parties may seek to achieve by requiring that performance bonds be provided by a contractor to a principal in circumstances such as the present.

[40] One is to provide security in the event of the insolvency of the contractor. The other is to enable the principal to obtain prompt payment of amounts it claims, notwithstanding disputes raised by the contractor. Not every contract seeks to achieve both goals. The present is one in which only the first is sought to be achieved. To assist in achieving the first goal the Contract thus states that the bonds to be provided are to be "unconditional", with the consequence that the issuer is obliged to pay, without argument, if called upon by the respondent to do so.

[41] So far as the second goal is concerned, cl 16.2 however only entitles the respondent to call upon the bonds if, as a matter of objective fact, the applicant "has not materially complied with its obligations". Accordingly, it is open, as has occurred here, for the applicant to seek to restrain the respondent from calling upon the bonds upon the basis that the pre-condition has, at least arguably, not been satisfied.

[42] The position would have been different if cl 16.1 had made the respondent's entitlement to call upon the bonds dependent on the respondent's satisfaction or even simply upon the respondent's assertion that the applicant was in breach of the Contract. Provisions of this type would have gone a long way to achieving the second of the goals to which I have referred above.

[43] My reservation about the decision in Clough is as to whether the contract in that case can truly be regarded as having been intended to achieve both purposes. Certainly the terms of the performance guarantee that the Full Court relied upon made it clear that the issuer of the guarantee could not withhold payment if a proper call were made but the condition precedent to the principal's right to call upon the

[20] [2010] NSWCA 283.

guarantee was expressed in terms of objective fact, that is, "in the event of the Contractor failing to honour any of the commitments entered into under this Contract" (see cl 3.3.3 quoted at 249 ALR 458 at [24]). It is not obvious to me why the terms of the guarantee given by the issuer should have been regarded as affecting the proper construction of this provision which related to the circumstances in which the Principal was entitled to call on the guarantee.

In addressing the balance of convenience Macfarlan JA said:

[44] There is no evidence that inability of the respondent to call upon the performance bonds now would cause any particular financial prejudice to the respondent. Nor is there any evidence that, apart from any impact they may have on the applicant's reputation, calls by the respondent upon the performance bonds would cause the applicant particular financial prejudice.

[45] Courts have recognised on a number of occasions that calls upon performance bonds may cause significant damage to a contractor's reputation and financial standing that is not readily curable by an award of damages (see for example Barclay Mowlem Construction Ltd v Simon Engineering (Aust) Pty Ltd (1991) 23 NSWLR 451 at 461-462 and Reed Construction Services Pty Ltd v Kheng Seng (Aust) Pty Ltd (1999) 15 BCL 158 at 167).

[47] For reasons I have given, the applicant has shown there is a serious question to be tried that the respondent's Notice of 19 July 2010 requiring defects to be remedied within a specified time is invalid. It is common ground between the parties that the respondent wishes to use non-compliance with the Notice as a ground for calling upon the performance bonds under cl 16.3. As it is clearly implied in the Contract that the respondent will only call upon the performance bonds in the circumstances identified in the Contract, the applicant has demonstrated an arguable case that the respondent is threatening to breach an implied negative stipulation in the Contract. Authorities dealing with performance bonds confirm that injunctive relief may be given in such circumstances (see for instance Reed Construction Services Pty Ltd v Kheng Seng (Rust) Pty Ltd.

[48] As the considerations referred to above in connection with the balance of convenience in my view establish that there is a serious question to be tried about whether damages would not adequately compensate the applicant for the harm it would suffer if the bonds were called upon, there is a serious question to be tried about whether final injunctive relief is available.

Subsequently in *Universal Publishers Pty Ltd v Australian Executor Trustees Limited*[21] White J considered a lessor's submission that recourse may be had to a bank guarantee to secure a lessee's performance of its obligations under a lease if the lessor claimed in good faith that the lessee was in default. It was submitted by the lessor that the authorities established that this is how such a clause should be construed and that clear words were necessary to inhibit a beneficiary from making a call where a breach is alleged in good faith. *Clough* was cited in support.

After examining *Clough* and *Lucas Stuart Pty Ltd v Hemmes Hermitage Pty Ltd*[22] his Honour noted:

[58] In my view, the decision in Lucas Stuart Pty Ltd v Hemmes Hermitage Pty Ltd is inconsistent with the suggestion that Clough Engineering lays down principles applicable to all contracts that where an unconditional performance bond, or a like instrument, is provided as security for a party's obligations, express words will be needed to preclude a beneficiary of such security from calling on it if a breach is alleged in good faith.

In *Dedert Corporation v United Dalby Bio-Refinery Pty Ltd*[23] the Court of Appeal of Victoria examined a design and construct contract which included the following provisions:

5.2 Recourse
Security shall be subject to recourse by a party who remains unpaid after the time for payment where at least 5 days have elapsed since that party notified the other party of intention to have recourse.
…
39.7 ***Set off***
The Principal may set-off any amount due and payable by the Contractor to the Principal against any amount that the Principal owes the Contractor under the Contract.
If the moneys payable to the Contractor are insufficient to discharge the liability of the Contractor to pay such sum to the Principal, the Principal may have recourse to the security provided by the Contractor.
39.9 ***Recourse for unpaid moneys***
Where, within the time provided by the Contract, the Contractor fails to pay the Principal an amount due and payable under the Contract, the Principal may have recourse to security under the Contract and any deficiency remaining may be recovered by the Principal as a debt due and payable from the Contractor to the Principal.

[21] [2013] NSWSC 2021.
[22] [2010] NSWCA 283.
[23] [2017] VSCA 368.

In that case, the Court of Appeal by a majority (Whelan JA dissenting) held that the contractor was entitled to injunctive relief preventing the principal from calling on the security in respect of a claim for unliquidated damages.

Kaye JA said:

> *[110] Ordinarily, according to the plain usage of language, monies would not be understood to remain 'unpaid after the time for payment', unless those monies have already become due and payable. Such a conclusion is axiomatic. That meaning, of the critical phrase in cl 5.2, is supported by the contractual context to which I have just referred, by which the contract, in specific terms, has identified the circumstances in which amounts are 'due and payable' by one party to the other under the contract. …*
>
> *[115] Counsel for the respondent submitted that the construction of cl 5.2, contended for on behalf of the applicant, would have the effect that any claim by the respondent for unliquidated damages would not be secured, unless that claim was certified by the Superintendent pursuant to cl 43.3, and no notice of dispute had been served by the applicant under cl 45.1, before the expiration of the security. It was submitted that, if the contract were interpreted in that way, the applicant could easily frustrate the right of the respondent to have recourse to the security, in respect of any claim by the applicant for unliquidated damages, by giving a notice of dispute in respect of any claim by the respondent for unliquidated damages. Counsel contended that such an anomalous conclusion could not have been contemplated by the parties. ….*
>
> *[118] Finally, counsel for the respondent contended that if (apart from cl 39.7 and cl 39.9) cl 5.2 is the sole means by which the respondent might have recourse to the security, the losses which it alleged it had sustained, in its letter dated 13 November 2017, constituted a claim which 'remains unpaid after the time for payment', so as to come within the ambit of cl 5.2. It was contended that the respondent's letter of 13 November constituted a claim based on a cause of action, for damages for breach of contract, which had accrued. Accordingly, it was submitted, the damages, claimed in that letter, relevantly remained unpaid after the time for payment of them, so that the respondent, pursuant to cl 5.2, was entitled to have recourse to the security in respect of those monies.*
>
> *[119] That contention cannot be sustained. To say the least, it is highly artificial to postulate that a claim for unliquidated damages, which has not been adjudicated, of its own force has the effect that those damages constituted money which 'remains unpaid after the time for payment'. As I have stated, according to ordinary usage, monies may be understood to remain 'unpaid after the time for payment', where such monies have been due and payable, but have not been paid. An assertion, by the respondent, that the applicant is liable for unliquidated damages for losses sustained as a result of a breach of contract, could not, in any sense, be characterised as having the effect that monies (in respect of that unadjudicated claim) remain unpaid after the time for payment.*

6. Bank guarantees and parent company guarantees

The Court of Appeal of Western Australia in *JKC Australia LNG Pty Ltd v CH2M Hill Companies Ltd [No.2]*[24] explored the relationship between a bank guarantee and a parent company guarantee and, specifically, whether a parent company guarantee could operate as a risk allocation device pending resolution of a dispute.

Turning to the facts.

JKC was the main contractor for the Ichthys LNG Project in the Northern Territory. The subcontractor was an unincorporated joint venture consisting of four companies. The joint venture parties with one exception procured parent company guarantees from each of their respective parent companies in favour of JKC. Those parent company guarantees, relevantly, incorporated the following provisions.

> 2. ***Guarantee***
>
> *Subject to Clause 9, the Guarantor unconditionally and irrevocably guarantees to Contractor the due and punctual performance of the obligations of the Subcontractor under the Subcontract including:*
>
> a. *the discharge of the obligations and liabilities of the Subcontractor under the Subcontract; and*
>
> b. *the payment of any amounts due and unpaid under the Subcontract.*
>
> 3. ***Guarantor to perform***

[24] [2020] WASCA 112.

If, in Contractor's reasonable opinion, the Subcontractor fails to perform any of the Subcontractor's obligations or discharge any of the Subcontractor's liabilities under the Subcontract, the Guarantor must upon receipt of written notice from Contractor requiring it to do so, perform or cause to be performed those obligations or discharge those liabilities (as the case may be) and thereafter continue to perform those obligations and discharge those liabilities (as the case may be) until the termination of the Subcontract by the effluxion of time or otherwise.

The Contractor is not required to enforce its rights against the Subcontractor prior to having recourse to its rights under this deed. (emphasis added)

Clause 9 provided for a liability cap.

JKC sought to rely on the parent guarantees in respect of a claim for costs under another provision of the subcontract.

JKC's case was that reliance on clause 3 did not depend upon an actual liability or proof of fault by the subcontractor. As noted in the joint reasons of Buss P and Vaughan JA, JKC's preferred construction of clause 3 was that on the formation of the requisite reasonable opinion and upon receipt of a notice the parent companies must act and continue to act as required by JKC. In support of that construction, JKC characterised clause 3 as a "risk allocation device" and that the parent company guarantees were functionally equivalent to a bank guarantee. Further, JKC contended that clause 3 covered payment obligations and provided for a continuing obligation that extended beyond termination of a subcontract.

In dealing with the contrast between a guarantee and a performance bond Buss P and Vaughan JA in their joint reasons said:

> *127. In this regard there is a substantial difference between the standard conception of a guarantee and a performance bond. As has been seen, as between the issuer (usually a financial institution) and the beneficiary of a performance bond, the issuer's unconditional promise to pay on demand has the character of cash. By contrast, the nature of a guarantor's obligation is to answer for the debt or default of the principal obligor. In the latter case (ie answering for a default), ordinarily, the obligee's remedy for the failure to perform lies in damages for breach of contract - the failure by the principal obligor to perform its contract putting the guarantor in breach of the guarantee*.
>
> *128. So understood, there is a distinction between an obligation to pay an amount by way of debt and an obligation to pay an amount by way of damages in the event of breach by the primary obligor. Both matters are conventional obligations of a guarantor under a guarantee. Such conventional obligations by way of guaranteeing the due and punctual performance of the principal obligor's contractual obligations do not, however, encompass an obligation to actually perform the contractual terms as guaranteed. The obligation is to pay any debt or damages arising from the principal obligor defaulting on its obligations. Such a conventional guarantee does not impose an obligation on the guarantor to see to it that the principal obligor actually performs its obligations to the counterparty. Nor is it a promise that the guarantor will itself perform the principal obligor's contractual obligations.*

In rejecting JKC's submissions as to the characterisation of the parent company guarantees, Buss P and Vaughan JA said:

> *234. JKC's assertion that the Parent Company Guarantees were the functional equivalent of the bank guarantees was not grounded in the language of the instruments. Rather, it depended on acceptance of JKC's preferred construction. So understood the assertion added nothing to whether, on its proper construction, cl 3 had the meaning contended for by JKC. The assertion of functional equivalence was no more than a sloganistic bootstraps argument, relying on the correctness of JKC's view as to the effect of cl 3, which summarised what the outcome would be if JKC's preferred construction was accepted.*
>
> *235. The same is true of JKC's assertion that the Parent Company Guarantees were an interim risk allocation device*.
>
> *236. In any case it will be evident from the conclusions we have reached, and the reasons for those conclusions, that there is an absence of textual and contextual support for JKC's contention that the purpose of cl 3 was to allocate risk to the respondents pending the determination of any dispute between JKC and the Subcontractor. Clause 3 does not create an obligation to 'pay now, argue later' without regard to any defence, set-off or counterclaim that the Subcontractor could assert to the alleged failure as asserted by JKC. In that regard the coextensive nature of the commitment under cl 3 is significant. Excluding the bank guarantees (instruments to which the Subcontractor is not the relevant counterparty) JKC never suggested that the Subcontractor had any 'pay now, argue later' commitments under the Subcontract. There is no foundation to construe cl 3 of the Parent Company Guarantees as enabling JKC to require the respondents to do more in this connection than may be required of the Subcontractor under the Subcontract.*

Beech JA also rejected JKC's submissions. His Honour set out his view as to the proper construction of clause 3 as follows.

> *245… Clause 3 can be activated only when JKC forms the reasonable opinion that the Subcontractor has failed to perform an obligation or has failed to discharge a liability under the Subcontract. When cl 3 is activated by JKC, by the giving of written notice following the formation of a reasonable opinion, the Parent becomes obliged to perform or cause to be performed the Subcontractor's obligations, or discharge the Subcontractor's liabilities (as the case may be), that were the subject of the notice. In cl 3, the reference to 'those obligations' and 'those liabilities' is a reference to the obligations or liabilities the subject of the written notice given by JKC. The Parent is thereby made subject to the same liability and obligation as the Subcontractor was (and continued to be) subject. In the case of an obligation, the Parent must actually itself perform the Subcontractor's relevant obligation, as if it were the Subcontractor. In the case of a liability, the Parent becomes itself directly subject to the Subcontractor's relevant liability. The Parent is not made subject to any greater obligation or liability than the Subcontractor. Thereafter, the Parent must continue to perform those obligations or discharge those liabilities until the termination of the Subcontract, however that termination occurs. If the Subcontract has been terminated, in whatever manner and for whatever reason, there is no room for any notice under cl 3.*

7. Injunctive relief

Any application for an interlocutory injunction must demonstrate:

1. that there is a serious question to be tried;
2. that the applicant would suffer irreparable harm in respect of which damages would be an inadequate remedy unless the injunction was granted; and
3. the balance of convenience favours the grant of an injunction.

8. Construing the contract at the interlocutory stage

The authorities establish that the primary judge should determine at the interlocutory stage any question of construction and not defer such determination until the final hearing. This approach is explained by the Court of Appeal of Victoria in *Sugar Australia Pty Ltd v Lend Lease Pty Ltd.*[25]

A design and construct contract between Sugar as principal and Lendlease as contractor required Lendlease to provide two unconditional bank guarantees. Clause 5.2 of the contract provided for recourse to the guarantees as follows:

> *Any security provided by the Contractor in accordance with the Contract shall be available to the Principal whenever the Principal may claim (acting reasonably) to be entitled to:*
>
> *(i) the payment of monies or an indemnity by the Contractor under or in consequence of or in connection with the Contract;*
>
> *(ii) reimbursement of any monies paid to others under or in connection with the Contract; or*
>
> *(iii) other monies payable by the Contractor to the Principal (whether by way of set off or otherwise).*
>
> *Recourse to security shall only be subject to the Principal having given the Contractor five days' notice of its intention to have recourse to the security for the purpose of allowing the Contractor to replace the security with cash where it has been issued in a form other than cash. Where the Principal has recourse to security in accordance with clause 37.3, the Contractor shall provide replacement security in accordance with clause 37.3.*

Disputes arose between the parties. The contractor than applied for an interlocutory injunction restraining the principal from having recourse to the bank guarantees. The primary judge granted the injunction on the basis that the construction of the conditions in clause 5.2 raised a serious question to be tried. However, his Honour declined to construe clause 5.2, and in particular, the meaning of the phrase "*acting reasonably*".

The principal's appeal to the Court of Appeal to set aside the injunction was allowed.

Ferguson JA having referred to *Fletcher* and *Clough Engineering* said:

> *[25] The fact that a performance bond is intended to operate as a risk allocation device is not, of course, necessarily determinative of the right of a party to have recourse to it. It may be subject to a contractual qualification or limitation upon the circumstances in which recourse may be had. Nevertheless, the*

[25] [2015] VSCA 98.

fundamental characteristic of a risk allocation device informs the task which the court must undertake in resolving whether or not to grant an injunction.

And his Honour continued:

[28] The primary judge correctly encapsulated the principles governing the construction issues raised by the application before him but the obvious question raised by these principles is whether his Honour should have gone on to construe GC 5.2 in order to resolve first, whether the contractual provisions were intended to operate as a risk allocation device and secondly, what was the nature of the qualification imposed upon recourse to it by GC 5.2.

[29] We respectfully agree with the view expressed by Charles and Callaway JJA in Fletcher that in the first instance in a case such as the present the court must ask whether the performance bond is intended to allocate risk pending the final determination of the parties' rights. If GC 5.2 is intended to operate in part as a risk allocation provision, the failure to resolve its construction until trial renders it effectively nugatory in this respect and defeats its evident commercial purpose. In substance, it deprives the parties of the commercial bargain that they made. The consequence of the grant of an injunction restraining recourse to a performance bond pending trial in these circumstances is that it will in effect amount to final relief in respect of a principal benefit intended to be conveyed by the performance bond. It is well recognised that where an injunction in effect grants final relief that consequence must bear upon the fundamental question of whether the grant or refusal of the injunction carries with it the lower risk of injustice.

[31] Whilst it may be accepted that the usual principles governing interlocutory injunctions fell to be applied in the present case, it must also be accepted that they fell to be applied in respect of an unusual form of contract, if it be the case that the commercial purpose of the performance bond was to allocate risk pending final determination of the dispute. Such a contractual provision fundamentally alters the context in which the court must exercise its discretion by changing the complexion of the status quo and raising the prospect of substantial injustice if the purpose of the provision is defeated. That is, the status quo in such circumstances becomes what the parties have agreed as to which of them should bear the financial risk pending final determination, not the continuation of where that risk would naturally fall in the absence of a performance bond to call upon.

His Honour concluded:

[67] The primary judge did not decide whether GC 5.2 was intended to allocate risk pending the resolution of a dispute. In our view it was so intended and this in turn constitutes a consideration of fundamental importance in assessing whether the grant of an injunction carries with it the lower risk of injustice.

[68] The parties made a commercial agreement as to when and how the performance bonds might be called upon. In doing so, they effectively determined which of them would bear the financial risk (up to approximately $4.2 million) without the need for the appellant to prove an entitlement to be paid. The safeguard negotiated and agreed by the parties was that the appellant must act reasonably when claiming an entitlement to payment and calling on the bonds. One important commercial effect of this was that the appellant did not have to wait until trial for payment of some amount by the respondent. This evident commercial purpose of GC 5.2, when viewed in the context of the accepted principles governing the grant of interlocutory injunctions and the ordinary practice adopted in performance bond cases, required the primary judge to resolve the construction issues raised in order to properly determine whether an injunction should be granted. If this were not done, in effect, the parties would be deprived of the commercial bargain that they made.

9. The latest authority: *Synergy Construct Australia Pty Ltd v GSA North Terrace Pty Ltd*[26]

The principles governing performance bonds were comprehensively examined by the Court of Appeal of South Australia in this 2025 decision.

Turning briefly to the facts:

GSA as principal engaged Synergy to design and construct a building to house student accommodation in North Terrace.

The contract provided for the provision of bank guarantees by the contractor, and in clause 5.2, provided for recourse as follows:

[26] [2025] SASCA 72.

5.2 Conversion and Recourse

Security shall be subject to recourse by the *Principal* at any time:

(a) where the *Principal* has become entitled to exercise a right under the *Contract* in respect of the *security*.

(b) …

(c) To satisfy any bona fide *Claim* the *Principal* may have against the *Contractor*, or

(d) …

The Court made the following observations on this drafting of the recourse provision:

> *[19] It is plain from the language of cl 5.2 that GSA's entitlement to have recourse to the bank guarantees (and the proceeds realised by making a demand on them) is triggered by the existence of a bona fide 'Claim' on its apart against Synergy.*
>
> *[20] As will be seen, in cases where the clause is explicit about that matte, there is a constructional bias in favour of the conclusion that the entitlement of a beneficiary of a bank guarantee to have recourse to it is not conditioned upon that party having or demonstrating a legal right that is coextensive or coincident with the claim. If a genuine dispute about the claim sufficed to throw into doubt the beneficiary's right to have recourse to the bank guarantee, its function as a risk allocation device (as distinct merely from a form of security to guard against the contractor's risk of insolvency) would be easily thwarted. In the present case, however, cl 5.2 makes the position explicit. The bank guarantees were explicitly risk allocation devices.*

Disputes having arisen between the parties, Synergy sought an interlocutory injunction restraining GSA from calling on the bank guarantees. A key issue was whether, at the time GSA called on the guarantees, it was required to release and return the guarantees to Synergy. This was a contestable issue.

The question for the Court of Appeal was whether the primary judge, Bochner AJ, was correct in refusing to grant the injunction on the basis that the bank guarantees operated as risk allocation devices, and that the contentious issue whether GSA was required to release the guarantees at the time of demand did not detract from the balance of convenience in favour of GSA.

In reversing the primary judge's decision and granting the injunction, the Court made the following key observations:

> *[103] The risk allocation function of the guarantees cannot control or dictate the outcome of the Court's consideration of the balance of convenience, nor can it conclusively determine the status quo in some limiting way, when the very issue about which a serious question arises is whether that function had come to an end.*
>
> *[104] In our respectful view, the judge erred by elevating the risk allocation function of the guarantees during the period that GSA was entitled to maintain possession of them to the status of a decisive or controlling consideration in the weighing of the balance of convenience. In our view, that involved an error of approach which vitiates the decision to refuse interlocutory injunctive relief, requiring that we reconsider for ourselves whether the injunction should be granted.*

CHAPTER 4

Restitution and damages following contract termination on a repudiatory breach: alternative or concurrent remedies

1

The relationship between the remedy of restitution and an award of damages for breach of contract and their combination in one action is explained by the High Court in the leading decision of *Baltic Shipping Company v Dillon*[27]*.*

Turning to the facts.

The plaintiff Mrs Dillon purchased a 14 day cruise on the defendant's vessel the "*Mikhail Lermontov"* for which she paid $2,205. On the ninth day of the cruise the ship struck a shoal on the north-east tip of the South Island of New Zealand. The ship was holed and sunk. After the shipwreck the defendant company refunded some $787 as a *"full refund…of the unused portion of the passage money".*

After settlement discussions with the company, Mrs Dillon signed a deed of release and received a further $4,700 in compensation.

In subsequent proceedings by Mrs Dillon, the deed of release was declared by the primary judge to be void under the *Contracts Review Act 1980* (NSW). In those proceedings, Mrs Dillon was held entitled to restitution of the balance of the fare which she paid, together with compensatory damages for personal injuries and disappointment and distress.

In an appeal to the High Court, Baltic Shipping contended that Mrs Dillon was not entitled to pursue both a claim for restitution of the consideration paid under a contract and a claim for damages for breach of that contract.

In allowing Baltic Shipping's appeal on the restitution claim the High Court addressed two issues of fundamental importance.

First, in what circumstances may a contracting party recover a pre-payment on a failure of consideration?

Secondly, whether a restitutionary claim may be combined with a claim for damages for breach of contract?

As to the first issue Mason CJ said[28]:

> *When, however, an innocent party seeks to recover money paid in advance under a contract in expectation of the entire performance by the contractbreaker of its obligations under the contract and the contractbreaker renders an incomplete performance, in general, the innocent party cannot recover unless there has been a total failure of consideration. If the incomplete performance results in the innocent party receiving and retaining any substantial part of the benefit expected under the contract, there will not be a total failure of consideration.*
>
> *In the context of the recovery of money paid on the footing that there has been a total failure of consideration, it is the performance of the defendant's promise, not the promise itself, which is the relevant consideration. In that context, the receipt and retention by the plaintiff of any part of the bargained for benefit will preclude recovery, unless the contract otherwise provides or the circumstances give rise to a fresh contract.*

His Honour concluded[29]:

> *The consequence of the respondent's enjoyment of the benefits provided under the contract during the first eight full days of the cruise is that the failure of consideration was partial, not total. I do not understand how, viewed from the perspective of failure of consideration, the enjoyment of those benefits was "entirely negated by the catastrophe which occurred upon departure from Picton", to repeat the words of the primary judge.*
>
> *Nor is there any acceptable foundation for holding that the advance payment of the cruise fare created in the appellant no more than a right to retain the payment conditional upon its complete performance of its entire obligations under the contract. As the contract called for performance by the appellant of its contractual obligations from the very commencement of the voyage and continuously thereafter, the advance payment should be regarded as the provision of consideration for each and every substantial benefit expected under the contract. It would not be reasonable to treat the appellant's right to retain the fare as conditional upon complete performance when the appellant is under a liability to provide substantial benefits to the respondent during the course of the voyage.*

[27] (1992) 176 CLR 344.
[28] at 350.
[29] at 375.

In their joint reasons, Deane and Dawson JJ said[30]:

> *The present case is not, however, one in which a party who has provided part only of the promised consideration seeks to recover part of the agreed purchase price. In the present case, it is the promisee, Mrs Dillon, who seeks to recover the whole of a prepaid purchase price on the ground that the consideration for which it was paid has wholly failed. Mrs Dillon does not rely upon any provision of the contract between Baltic and herself under which Baltic was obliged to refund the whole of the fare in the events which happened. There was no such contractual provision. The basis of her claim is the obligation of restitution which the law prima facie imposes upon the recipient of a payment made under a contract which has become "abortive for any reason not involving fault on the part of the plaintiff" in a case "where the consideration, if entire, has entirely failed, or where, if it is severable, it has entirely failed as to the severable residue". Such a claim is not a claim on the contract. Its historical antecedent in terms of forms of action is the old indebitatus count for money had and received to the use of the plaintiff. Its modern substantive categorization is as an action in unjust enrichment. In other words, the receipt of a payment of money for a consideration which wholly fails "is one of the categories of case in which the facts give rise to a prima facie obligation to make restitution ... to the person who has sustained the countervailing detriment".*

Their Honours concluded[31]:

> *In circumstances where Mrs Dillon accepted and enjoyed the major portion of the pleasure cruise, however, there was no complete failure of the consideration for which she paid the fare. The catastrophe of the shipwreck and its consequences undoubtedly outweighed the benefits of the first eight complete days. It did not, however, alter the fact that those benefits, which were of real value, had been provided, accepted and enjoyed.*

Turning to the second issue, namely, the combination of a restitutionary claim with a claim of damages for breach of contract.

Relevantly, Mason CJ said[32]:

> *…the earlier cases support the view expressed by Corbin and Treitel that full damages and complete restitution will not be given for the same breach of contract. There are several reasons. First, restitution of the contractual consideration removes, at least notionally, the basis on which the plaintiff is entitled to call on the defendant to perform his or her contractual obligations. More particularly, the continued retention by the defendant is regarded, in the language of Lord Mansfield, as "against conscience" or, in the modern terminology, as an unjust enrichment of the defendant because the condition upon which it was paid, namely, performance by the defendant may not have occurred. But, equally, that performance, for deficiencies in which damages are sought, was conditional on payment by the plaintiff. Recovery of the money paid destroys performance of that condition. Secondly, the plaintiff will almost always be protected by an award of damages for breach of contract, which in appropriate cases will include an amount for substitute performance or an amount representing the plaintiff's reliance loss. It should be noted that nothing said here is inconsistent with McRae v Commonwealth Disposals Commission.*

And on the same point, Deane and Dawson JJ state[33]:

> *There is a further reason, which would appear not to have been raised in argument in the courts below, why Mrs Dillon's action for restitution of the fare paid to Baltic must fail. It is that she has sought and obtained an order against Baltic for compensatory damages for Baltic's failure to perform its contractual promises to her. In particular, she has received a refund of a proportionate part of the fare and has obtained and will retain (see below) the benefit of an award of damages for the disappointment and distress which she sustained by reason of Baltic's failure to provide her with the full pleasure cruise which it promised to provide. In these circumstances, Mrs Dillon has indirectly enforced, and indirectly obtained the benefit of, Baltic's contractual promises.*
>
> *Ordinarily, as has been seen, "when one is considering the law of failure of consideration and of the ... right to recover money on that ground, it is ... not the promise which is referred to as the consideration, but the performance of the promise". That statement has nothing to say, however, to the situation which exists when the promisee has sought and obtained an award of full compensatory damages for the failure to perform the promise. In that situation, the damages are awarded and received as full compensation for non-performance or breach of the promise and represent the indirect fruits of the promise. That being so, it would be quite wrong to say either that the only quid pro quo which has been obtained for the payment by the promisee is the bare promise or that the promise and the recovery of compensatory damages for its breach can realistically be seen as representing no consideration at all.*

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[30] at 375.
[31] at 379.
[32] at 359.
[33] at 379.

In the recent important decision of the High Court in *Mann v Paterson*[34], the Court considered whether a builder was entitled to elect between restitution and damages for breach of contract following the builder's acceptance of the principal's repudiation of the building contract in circumstances where the building contract had been partly performed at the time of termination.

In their joint reasons, Kiefel CJ, Bell and Keane JJ held that the builder was restricted to a claim for contractual damages.

However, Gageler J, in finding that the builder was entitled to elect between restitution and damages, said:

> *[82] The critical question in the present category of case is why the common law should not treat the innocent party as adequately remunerated for the services rendered to the defaulting party by having an entitlement to maintain an action for damages for breach of the contract in part performance of which the innocent party rendered those services.*
>
> *[83] My view is that the answer to that critical question cannot lie in the notion of the contracting parties having arrived at a contractual "allocation of risk", which the common law of restitution will not disturb. Contracting parties are, of course, at liberty to determine by contract the "secondary" obligations, which are to arise in the event of breach or termination of the "primary" obligations they have chosen to bind them. Even where the parties have not so determined, it may for some purposes be appropriate to describe obligations that the common law imposes to pay damages for breach of contract as "secondary" obligations which, in the event of termination by acceptance of a repudiation, are "substituted" for the primary obligations. However, it would be artificial as a matter of commercial practice and wrong as a matter of legal theory to conceive of contracting parties who have not addressed the consequences of termination in the express or implied terms of their contract as having contracted to limit themselves to the contractual remedy of damages in that event. Parties contract against the background of the gamut of remedies that the legal system makes available to them. The common law gives to them the benefit, and saddles them with the detriment, of what they expressly or impliedly agree in their contract. Outside the scope of what they agree in their contract, the common law gives to them what the common law itself allows them to get.*

Nettle, Gordon and Edelman JJ also found in favour of the builder's entitlement to elect between restitution and damages, but in this case emphasised that the builder's entitlement to restitution was based on a total failure of consideration. Their Honours said:

> *[167] The availability of restitution, and the form of restitutionary remedy awarded, will depend on the type of enrichment alleged. Generally speaking, a personal restitutionary remedy will be assessed as money had and received where the alleged enrichment is the receipt of money; it will be assessed as upon a quantum meruit where the alleged enrichment is the receipt of services; and it will be assessed as upon a quantum valebant where the alleged enrichment is the receipt of goods. Where the alleged enrichment takes more than one form, such as the provision of money and services to a party, the other party is entitled to the money paid together with a reasonable sum for the services, subject, of course, to prohibitions against double recovery.*
>
> *[168] The "qualifying or vitiating" factor giving rise to a prima facie obligation on the part of the enriched party to make restitution is a total failure of consideration, or a total failure of a severable part of the consideration. In this context, consideration means the matter considered in forming the decision to do the act: "the state of affairs contemplated as the basis or reason for the payment". In many cases the relevant basis will be the benefit that is bargained for. In those cases, "[t]he test is whether or not the party claiming total failure of consideration has in fact received any part of the benefit bargained for under the contract or purported contract".*
>
> *[169] More specifically, a total failure of consideration for work done exists by reason of the termination of a contract for breach where the basis on which the work was done has failed to materialise or sustain itself, and the total failure of consideration is seen as the occasion and part of the circumstances giving rise to the other party's obligation to make restitution to the extent of the fair value of that work. It is for that reason that no such obligation can arise while the obligation under which the benefit was conferred and accepted remains enforceable, open and capable of performance.* (emphasis added)

The High Court held that the builder was entitled to elect between loss of bargain damages and restitution of the value of the benefit of part performance of the services, except where the builder had an accrued right to contractual payment for the services performed. Thus, the restitutionary right would accrue if the contract were terminated prior to the builder acquiring a contractual right to payment.

However, the Court also held that where the builder had an accrued right to a contractual payment for services performed, the builder was restricted to its contractual remedy. The Court also held that the contract price represented a ceiling to any restitutionary claim.

[34] (2019) 267 CLR 560.

Chapter 5

Expectation and reliance damages after *Cessnock City Council v 123 259 932 Pty Ltd* (2024) 281 CLR 39

In their joint reasons in *The Commonwealth v Amann Aviation Pty Ltd*[35], Mason CJ and Dawson J explained the origin of the expression 'expectation damages'. Relevantly, their Honours said[36]:

> *The award of damages for breach of contract protects a plaintiff's expectation of receiving the defendant's performance. That expectation arises out of or is created by the contract. Hence, damages for breach of contract are often described as "expectation damages".*

To succeed in a claim for expectation damages the plaintiff must prove by reference to the civil standard, namely, on a balance of probabilities, that his or her expectation of a certain outcome had a likelihood of attainment rather than a mere prospect. Usually, in a commercial contract the expected outcome of performance is net profit. Thus a claim for expectation damages is essentially a claim for loss of profit which is typically referred to as claim for loss of bargain damages. However it is important to note that a claim for loss of bargain damages may only be sustained if the subject contract has been terminated.

There are four important points to note in respect of the joint reasons.

First, it does not follow that no damages are recoverable because either the relevant contract was not profitable or because the amount of profit could not be established on the evidence. As noted by their Honours[37]:

> *It would be an invitation to the repudiation of contractual obligations if the law were to deny to an innocent plaintiff the right to recoupment by an award of damages of expenditure justifiably incurred for the purpose of discharging contractual obligations simply on the ground that the contract breached would not have been or could not be shown to have been profitable.*

Thus, in place of expectation damages the plaintiff would be entitled to reliance damages, namely, expenditure reasonably incurred and wasted by the plaintiff in anticipation of or in performance of contract which has been wrongfully repudiated.

Secondly, unlike the position in English law a plaintiff under Australian law is not entitled to elect between expectation and reliance damages. As noted in the joint reasons, damages for loss of profit and damages for expenditure reasonably incurred are manifestations of the rule in *Robinson v Harman.* This point was recently confirmed by the High Court in *Cessnock City Council v 123 259 932 Pty Ltd*[38].

Thirdly, if the plaintiff seeks recovery of reliance damages, the plaintiff may rely on an assumption that if the contract had been performed according to its terms and not wrongfully repudiated by the defendant, the plaintiff would have recouped expenditure incurred in anticipation of or in reliance of the defendant's performance. Thus, to defeat the plaintiff's claim the defendant would bear the ultimate onus of establishing on a balance of probabilities that the plaintiff would not have recouped expenditure incurred even if the contract had been performed. There has been some discussion in the literature as to whether the defendant in these circumstances only bears an evidential burden in relation to the non-recoupment expenditure by the plaintiff. Indeed this was the approach adopted by Gaudron J in *Amann Aviation*. Another expression used is that the plaintiff has a prima facie case to recover wasted expenditure in circumstances where the defendant has repudiated the subject contract. This issue must now to be considered in light of the High Court's recent decision in *Cessnock*.

Fourthly, the expressions "expectation damages", "damages for loss of profits", "reliance damages" and "damages for wasted expenditure" are merely manifestations of the *Robinson v Amann* rule.

Turning to the facts of *Amann Aviation*.

In March 1987 Amann entered into a contract with the Commonwealth to provide aerial surveillance of Australia's northern coastline for a fixed period of three years commencing in September 1987. In anticipation of commencing performance Amann arranged for the acquisition and fitting out of 14 aircraft in the United States at a cost of some $5 million. The contract incorporated a cancellation clause based on a show cause process. By September 1987 it was clear that Amann did not have all of the aircraft to commence performance of the services. The Commonwealth then purported to terminate the contract relying on common law rules to do so. By failing to comply with the termination process in the contract the Commonwealth repudiated the contract. Amann accepted the repudiation and terminated the contract.

It was clear that Amman would only have generated a substantial profit on the contract if the contract were renewed for a further period of three years. Although the primary judge approached the case as a loss of profits claim by Amann the Full Federal Court awarded Amann compensation on a wasted expenditure or reliance basis. On the question as to whether the expenditure incurred by Amann in procuring the aircraft would have been recouped had the contract been performed Amann enjoyed the benefit of a presumption that a party would not

[35] (1991) 174 CLR 64.
[36] at 80.
[37] at 81.
[38] [2024] HCA 17.

enter into a contract in which its costs were not recoverable. Relevantly Mason CJ and Dawson J in their joint reasons said:

> *In this case, the law assumes that a plaintiff would at least have recovered his or her expenditure had the contract been fully performed.*

Their Honours also held that even though Amann had no contractual entitlement to a renewal of the contract at the end of its term, the prospect of renewal had to be brought into account in considering the value of the contract to Amann Aviation. In the circumstances once it was considered appropriate to factor in the prospect of renewal the Commonwealth faced insuperable difficulties in establishing on a balance of probabilities that Amann would not have recouped its expenses on performance of the contract. Relevantly, Mason CJ and Dawson J said[39]:

> *It follows that we consider that the Full Court was correct in taking into account the prospect of renewal of the contract as a factor relevant to the assessment of damages. The consequence of this conclusion, in view of the onus cast upon the Commonwealth as the party in breach, is that the Commonwealth must demonstrate that the value to Amann of the prospect of renewal of the contract when combined with those expenses that would have been recovered by way of gross receipts was less than the total expenses to be incurred by Amann in the performance of its contractual obligations. If the Commonwealth was able to demonstrate that this would have been the result, had the contract been fully performed, then, in conformity with Robinson v. Harman, Amann would not be entitled to all of its expenditure incurred in reliance on the Commonwealth's promise to perform and wasted as a result of the Commonwealth's breach. The Commonwealth was unable, however, to demonstrate this and so discharge the onus. Accordingly, the presumption that Amann would not have entered into a contract in which it would not recover the value of its expenditure incurred remains undisturbed. We agree with the Full Court's conclusion that Amann was entitled to recover as damages an amount commensurate with what it had expended in reliance upon the Commonwealth's promise to perform its contractual obligations.*

Also, Brennan J said[40]:

> *The sufficient and necessary justification for shifting the onus to the party in breach in the assessment of damages for wasted expenditure incurred in reliance on the defendant's promise before rescission for breach is that the breach of the contract itself makes it impossible to undertake an assessment on the ordinary basis.*
>
> *…*
>
> *A plaintiff's inability to quantify his lost benefits is no justification by itself for casting on the defendant an onus to prove that the plaintiff would not have recouped reliance damages had the contract been performed. What justifies the reversal of the onus is the defendant's repudiation or breach which denies, prevents or precludes the existence of circumstances which would have determined the value of the plaintiff's contractual benefits.*

The availability of reliance damages and the question of onus were further recently considered by the High Court in *Cessnock City Council v 123 259 932 Pty Ltd*[41].

Turning to the facts.

In July 2007 the Cessnock Council entered into an agreement for a 30 year lease (AFL) with the respondent, then known as Cutty Sark Holdings Pty Ltd. Under the AFL the Council agreed to take all reasonable action to register a plan of subdivision of the land at Cessnock Airport by 30 September 2011. It was envisaged that the subdivision would consist of 25 lots of which lot 104 would be the subject of the lease to the respondent. Pending the subdivision the Council granted the respondent a license to occupy the proposed lot 104. During this period the respondent constructed an aircraft hangar at a cost of $3.6 million. The Council ultimately decided not to proceed with the subdivision for cost reasons. This decision constituted a repudiation of the AFL which the respondent accepted.

In proceedings against the Council the respondent sought damages of $3.6 million representing cost incurred and wasted in reliance on the Council performing its obligations under the AFL. As summarised by Jagot J, the Council's defence was that the respondent's business proposals for the aircraft hangar were inherently speculative and that even if the Council had obtained registration of the plan of subdivision the respondent would not have recouped its cost of construction. Accordingly, the respondent was in no different position because the registration of the plan of subdivision did not take place.

In dismissing the Council's appeal, the plurality referred to a "facilitation principle" under which a plaintiff is assisted in proof where a defendant's breach has resulted in difficulties or impossibilities in proof of loss or

[39] at 94.
[40] at 106.
[41] [2024] HCA 17.

damage. So in this case significant uncertainties as to what would have occurred in relation to the prospective development of Cessnock Airport were created by the Council's wrongful repudiation of the AFL.

Relevantly, the plurality explained the so-called facilitation principle as follows:

> *[168] In summary, the facilitation principle arises in cases where the defendant's breach of an obligation results in uncertainty and difficulty of proof of loss for the plaintiff, who has incurred expenditure in anticipation of, or reliance on, the performance of the obligation that was breached. The facilitation of the plaintiff's proof by an assumption that the plaintiff has suffered loss in the amount of reasonable expenditure is neither a blunt rule nor able to be bluntly dismissed in every case by a slight evidentiary onus. The strength with which the principle applies will depend upon the extent of uncertainty resulting from the defendant's breach. And the extent to which evidence from a defendant can reduce or eliminate the loss represented by a plaintiff's wasted expenditure will depend upon the extent to which that evidence establishes a likelihood of non-recoupment.*

Having identified a number of uncertainties arising out of the premature termination of the AFL the plurality concluded:

> *[183] The uncertainties that arose from the Council's breach of contract made proof of the respondent's loss very difficult. Without any facilitation of the respondent's legal onus of proof to establish that its expenditure on construction of the hangar would have been recouped, the respondent would have been required to lead evidence as to the prospect that, having spent $1.3 million to fulfil the sewerage and water infrastructure requirement in condition 23, the Council would have obtained or used funds to develop the airport, in a manner that would have resulted in a sufficient increase in demand, and within a period of time during which the respondent's businesses could be sustained. Large uncertainties and speculation would be involved.*
>
> *[184] In the absence of further evidence concerning these uncertainties, the facilitation principle treats the respondent as having established its loss in the amount of its reasonable expenditure on the hangar, incurred in anticipation of, or reliance on, the performance of the Council's obligation that was breached. The extent of the uncertainty that resulted from the Council's breach was such as to require the Council to lead substantial evidence as to these matters of uncertainty to establish that some or all of the respondent's wasted expenditure would not have been recouped.*

Relevantly, the Council's repudiation of the AFL created a number of material uncertainties which made it difficult for the plaintiff to establish on the balance of probabilities that had the AFL been performed the plaintiff would have recouped the expense incurred in the construction of the aircraft hangar. As noted by the plurality "the extent of the uncertainty that resulted from the Council's breach was such as to require the Council to lead substantial evidence as to these matters of uncertainty to establish some or all of the respondent's wasted expenditure would not have been recouped".