Breach & Terminating a Contract

A paper presented by Michael Bennett at the State Legal Conference CLE, 30 March 2012

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About the Presenter

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These materials represent the law as it stood on 23 March 2012.

1 Introduction

As recently as 22 March 2012 it was said:[1]

> Contract law forms one of the most important elements of any legal framework. It is the bedrock of modern economies and the basis of many everyday interactions.

We, in Australia, are the beneficiaries of a system of certain – or sufficiently close to certainty to say certain – contract law. Australia's contract law performs well be international standards: Australia ranks 17th out of 183 countries on a measure of ease with which contracts can be performed.[2]

But to be sure of your rights under contract law it is necessary to know when your bargain has been breached and what you can do about it. Breach of contract is therefore a significant area of contract law.

In this area of the law much assistance will be gained from J W Carter, *Carter's Breach of Contract*, LexisNexis Australia 2011. Recently released, it is up to date and comprehensive in breaches of contract, proof thereof and what consequences follow.

This paper will discuss the changing nature contract law in Australia (section 2). We will see that we are in a state of flux. It will then confirm that the jurisdiction applicable to a contract can be chosen (section 3), and confirm that this paper considers the laws of the Commonwealth and of New South Wales. A discussion of what constitutes breach of contract, and how it will be characterised (section 4), then precedes consideration of termination rights (section 5). Termination rights are considered in the following areas: the right to terminate, electing to do so, complete termination, partial termination and the revival of a right to terminate. A specific topic is then considered (section 6). That is holding another party to an agreement to settle proceedings. The concluding section (section 7) considers express terms to terminate for convenience.

2 The Changing Landscape of Contract Law

For various reasons what we would term 'contract law' is in a state of flux.

Specifically in relation to 'contract law' itself, the Commonwealth Government's announcement on 22 March 2012 to reform the entire field. The forward to *Improving*

[1] *Improving Australia's Law and Justice Framework* at page 1

[2] World Bank/International Finance Corporation, *Doing Business – Economy Rankings,* 2011: see www.doingbusiness.org/rankings

Australia's Law and Justice Framework by The Hon. Nicola Roxon MP (Federal Attorney General) says:

> Contracts are a fundamental part of our daily lives. Businesses and consumers would be hamstrung without a law of contract to underpin even basic transactions like buying food items, accessing finance and connecting to the Internet. In recent decades our contract law has undergone vital changes through legislative reform and judicial adjustment. However, uneven development of the law can cause confusion and uncertainty.
>
> Australian contract law owes its origins to English common law, which remains an important source of law for many international commercial transactions. Over time our systems have diverged and alternative legal systems—including those of our major trading partners—are assuming greater importance around the world. As nations look for ways to emerge from the global financial crisis, it is timely for Australia to focus on further reducing business costs and improving our international standing.
>
> The purpose of this paper is to start that discussion in the area of contract law. As with many debates, there is likely to be both champions for reform and defenders of the status quo. The European Commission has identified potential gains of €26 billion from harmonising contract law across the 27 member states of the European Union. This must raise questions as to whether Australian contract law is also in need of renovation.

This foreshadows significant changes to contract law. It may even lead to a codification of the area in a way similar to the United State's *Uniform Commercial Code*.

More generally, contract law is also affected by the significant amendments and reforms to other areas of the law with which it intertwines. The recently enacted *National Consumer Credit Protection Act* 2009 (Cth) and the *Personal Property Securities Act* 2009 (Cth) are two examples of other areas of the law that impact on contract law.

Technological advancements are also developing contract law in new ways. The Internet, as a forum, is an ever-increasing percentage of commercial transactions. Although the law has struggled to keep pace with technological advancements – which struggle continues today – the passage of Commonwealth, State and Territory legislation [3] confirms that formal requirements for validity such as writing or signature could be fulfilled electronically, though important areas remain outstanding.

Far from making today's conference redundant, these changes evince the importance of attending conferences such as this and staying abreast of the developments. The significance of contracts to our clients will not go away and neither, therefore, should our understanding of the latest developments for them.

[3] *Electronic Transactions Act* 1999 (Cth); *Electronic Transactions Act* 2000 (NSW); *Electronic Transactions (Victoria) Act* 2000 (Vic); *Electronic Transactions Act* 2001 (Qld); *Electronic Transactions Act* 2003 (WA); *Electronic Transactions Act* 2000 (SA); *Electronic Transactions Act* 2000 (Tas); *Electronic Transactions Act* 2011 (ACT); and *Electronic Transactions Act* 2000 (NT)

3 Applicable Jurisdiction

Unlike most other areas of the law the parties to a contract can agree as to the law that will apply to their agreement. That is, every contract has a 'proper law'. This means that the contract is governed by a particular legal system, be it English law or Sharia law, under which the contract has binding force and according to which it's meaning is interpreted.

The courts will usually give effect to an express or implied choice of law, even if the jurisdiction chosen has little or no objective connection to the parties or to their agreement. However, some Commonwealth, State and Territory statutes override the parties' ability to choose a foreign system of law: see for example s 77 of the *Bills of Exchange Act* 1909 (Cth) s 11 of the *Carriage of Goods by Sea Act* 1991 (Cth). Others will apply irrespective of the parties' express choice of law: see for example s 8 of the *Insurance Contracts Act* 1984 (Cth) and s 17(3) of the *Contracts Review Act* 1980 (NSW).

But some contracts do not stipulate a 'proper law'. If there is no such stipulation the system of law 'with which the transaction has its closest and most real connection' will apply: *Bonython v Commonwealth* (1950) 81 CLR 486 at 498 per Lord Simonds delivering the opinion of the Board. Which system has the 'closest and most real connection' will depend on various factors including where the contract was made, the place of its performance, the jurisdiction in which the parties reside or conduct business, and the subject matter of the contract: *Re United Railways of Havana and Regla Warehouses Limited* [1960] Ch 52 at 91 per Jenkins LJ. Justice Rogers said it thus in *Mendelson-Zeller Co Inc v T & C Providores Pty Limited* [1981] 1 NSWLR 366 at 368-9:

> The matters to which regard may be had in seeking to determine with what country a contract has its closest and most real connection were adverted to by Jenkins LJ in the Court of Appeal in, *Re United Railways of Havana & Regla Warehouses Ltd* [1960] 1 Ch 52. Although the decision went on an appeal to the House of Lords, I do not understand anything to have been said to cast doubt on the accuracy of the observations which I am about to quote. His Lordship said (at p 91):
>
> > In an inquiry as to what is the proper law of contract in which the parties have not expressed their own selection of the law to be applied, many matters have to be taken into consideration. Of these, the principal are the place of contracting, the place of performance, the places of residence or business of the parties, respectively, and the nature and subject matter of the contract.
>
> It is right to say that the weight to be given to these factors may vary according to the facts of the case.

We have a common law of Australia, with most principles applying throughout: *Lange v Australian Broadcasting Corporation* (1997) 189 CLR 520 at 563 per the Court; *John Pfeiffer Pty*

Ltd v Rogerson (2000) 203 CLR 503; *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89 at 152,[135] per the Court. This point was recently made clear in *Western Export Services Inc v Jireh International Pty Ltd* (2011) 86 ALJR 1. Interestingly this was a special leave application before Gummow, Heydon & Bell JJ. The matter came on at 10am but, after argument, their Honours adjourned the matter to 2pm. In refusing special leave – because 'the result reached by the Court of Appeal in this case was correct' – their Honours made very clear that the intermediate courts of appeal have no business in questioning decisions of the High Court. Although the issue of how much weight should be placed on reasons following special leave applications, their Honours chastised intermediate courts. At 2,[3] to 3,[5] their Honours said:

> Acceptance of the applicant's submission, clearly would require reconsideration by this Court of what was said in *Codelfa Construction Pty Ltd v State Rail Authority (NSW)* by Mason J, with the concurrence of Stephen J and Wilson J, to be the "true rule" as to the admission of evidence of surrounding circumstances. Until this Court embarks upon that exercise and disapproves or revises what was said in *Codelfa*, intermediate appellate courts are bound to follow that precedent. The same is true of primary judges, notwithstanding what may appear to have been said by intermediate appellate courts.
>
> The position of *Codelfa,* as a binding authority, was made clear in the joint reasons of five Justices in *Royal Botanic Gardens and Domain Trust v South Sydney City Council* and it should not have been necessary to reiterate the point here.
>
> We do not read anything said in this Court in *Pacific Carriers Ltd v BNP Paribas; Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd; Wilkie v Gordian Runoff Ltd* and *International Air Transport Asosicaiton v Ansett Australia Holdings Ltd* as operating inconsistently with what was said by Mason J in the passage in *Codelfa* to which we have referred.

New South Wales' court decisions, however, are given more weight in this State than they would in others. Conversely, decisions of other States are given less weight in New South Wales than our own decisions. This paper will therefore proceed on the basis that the laws of the Commonwealth of Australia and those of New South Wales apply.

4 Breaches of Contract

A breach of contract occurs if a promisor:

(a) fails to perform a contractual obligation within the time stipulated for its performance; or

(b) commits an anticipatory breach of contract.

The precise consequences of any breach of contract must depend on the particular circumstances of the case.

An inevitable consequence of a breach of contract by a promisor is that the promisee is entitled to claim damages. That right accrues to the promisee at the time of the promisor's breach: *O'Connor v SP Bray Ltd* (1936) 36 SR (NSW) 248 at 260.[4] This right does not depend on proof of loss or damage; but absent such proof the right to recover is limited to nominal damages: *Luna Park (NSW) Ltd v Tramways Advertising Pty Ltd* (1938) 61 CLR 286 at 300-1, 307, 311 and 312. Further, except in cases of anticipatory breach, the right to claim damages does not depend on the promisee being entitled to terminate the performance of the contract for the promisor's breach.

In addition to the right to claim damages there are three other possibilities for the non-breaching party. First, the breach may activate an express right under the contract. What that right is will depend on the particular contract. Secondly, the breach may disentitle the promisor from enforcing the promisee's promise to perform. Thirdly, the breach may entitle the promisee to terminate the performance of the contract.

The third right – the right to terminate – will be a focus of this paper. It is set out at '5 Termination Rights' below. An interesting point, though the converse of the right to terminate, is what rights a party has to hold an opponent in litigation to an agreement to settle. This is set out at '6 Settlement Agreements in Litigation' below. And finally, terminating a contract for convenience, which does not require a breach, is set out at '7 Termination for Convenience' below.

Before addressing these issues it will be necessary to consider the nature and significance of breach.

4.1 Tripartite Classification

Once a breach of contract has been established – by proving failure of a promisor to perform a term of the contract in accordance with their contractual duty – the question arises whether breach of the term entitles the promisee to terminate the performance of the contract. To answer this question the term must be classified according to whether it is a condition, a warranty or an intermediate term. A common feature of all three types of term is that they are promissory in nature or effect, and therefore create obligations for the breach of which the promisor will be liable to pay damages to the promisee.

The three terms are:

(a) *condition* – a condition is a contractual term any breach of which entitles the promise to terminate the performance of the contract;

[4] Overturned in *O'Connor v SP Bray Pty Ltd* (1937) 56 CLR 464 without reference to the point.

(b) *intermediate term* – an intermediate term is a wide contractual term the breach of which entitles the promisee to terminate the performance of the contract only if the breach is sufficiently serious; and

(c) *warranty* – a contractual term no breach of which entitles the promisee to terminate the performance of the contract.

The condition/warranty dichotomy is one of long standing. The emergence of the intermediate term, although referred to in the first in the first half of the 20th century by eminent judges, did not become a mainstream term until the famous decision in *Hongong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha Ltd* [1962] 2 QB 26. See particularly Diplock LJ at 69-70.

It can be seen that the consequences following the breach are not dependent on what classification is given to a term, they give the term it's classification. That is, whether a breach entitles the promisee to terminate the contract will dictate the term's classification rather than looking to the classification to decide whether the promisee can terminate performance.

Whether a contractual term is a condition, intermediate term or a warranty depends on the construction of the contract. Since the classification of a term depends on precedent as well as the word of the contract (whether written or oral), the issue is always one of law: *L Schuler AG v Wickman Machine Tools Sales Ltd* [1974] AC 235 at 271.

4.2 Complications of classification

It is, of course, not this simple. A term may be a complex or a composite term. A contract in a relatively simple commercial context provides an example.

In *Associated Newspapers v Bancks* (1951) 83 CLR 322, clause 5 of the agreement between Bancks and the plaintiff imposed an obligation on Bancks to prepare and furnish weekly a full-page drawing. The term also stated an undertaking by the plaintiff 'that each weekly full-page drawing will be presented on the front page' of the comic section of the newspaper. The plaintiff breached its undertaking. When considering whether there was a breach of a condition or breach of warranty, the High Court said at 337:

> The undertaking is really a composite undertaking comprising three ingredients: (1) to present a full-page drawing; (2) to present it weekly; and (3) to present it on the front page of the comic section.

Therefore, both parties were subject to undertakings, and the plaintiff's undertaking contained three ingredients, each of which involved a performance obligation. To decide whether clause 5 was a condition or a warranty, it was necessary to identify the aspect of the term which was at issue. Consequentially, where a composite term exists there is, in reality, as many terms to classify as there are ingredients that may be breached. At 339 the High Court said:

> In the present case the undertaking of the plaintiff company … formed a condition a substantial failure in the performance of which would enable the defendant to treat the contract as at an end. The plaintiff committed three successive breaches of this condition and thereupon the defendant was certainly entitled to treat the contract as discharged. Such a failure to perform the condition went to the root of the contract and gave the defendant as the injured party the right immediately to treat the contract as at an end … .

Although *Associated Newspapers v Bancks* is consistent with the tripartite classification, it shows how one term can contain multiple classifications that involve successive and, it seems, cumulative effect as they are breached. Given how simple, relatively, the agreement in *Associated Newspapers v Bancks* was compared to modern commercial agreements the trap of applying a tripartite classification in a simple manner is one to watch out for.

5 Termination Rights

The right to terminate will arise from breach of a condition or a breach of an intermediate term sufficiently serious to enable termination of performance. Specifically, this paper, in dealing with this right to terminate, deals with:

(a) the promisee's termination rights;

(b) the promisee's 'election' to terminate;

(c) a complete termination;

(d) a partial termination; and

(e) the revival of a right to terminate after continuation of performance.

To help reduce uncertainty in this area, this paper also uses the word 'terminate' only. As Lord Wilberforce said in *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827 at 844:

> A vast number of expressions are used to describe situations where a breach has been committed by one party of such a character as to entitle the other party to refuse further performance: discharge, rescission, termination, the contract is at an end, or dead, or displaced; clauses cannot survive, or simply go. I have come to think that some of these difficulties can be avoided; in particular the use of 'rescission', even if distinguished from rescission ab initio, as an equivalent for discharge, though justifiable in some contexts (see *Johnson v Agnew* [1980] AC 367) may lead to confusion in others.

Lord Wilberforce thought that the use of 'discharge' or 'termination' helps to avoid being misled and to reduce confusion.

5.1 Right to terminate

The right to terminate a contract is a right enjoyed by one party (the promisee) to terminate the performance of a contract, including for breach of contract or repudiation of obligations by the other party (the promisor). The right to terminate, therefore, is not limited to cases of breach.

A promisee's termination rights may be implied by law or expressly conferred by the contract.

Express Rights

If a contract includes an express right to terminate the performance of the contract for breach, the scope of the right is a question of construction. It is therefore a question of law. Clause 5 of the *New York Produce Exchange* form, often used in charterparty contracts, provides an example of this construction. It provided:

> Payment of said hire to be made … in cash … semi-monthly in advance, and for the last half month or part of same the approximate amount of hire, and should same not cover the actual time, hire is to be paid for the balance day by day, as it becomes due, if so required by owners, … otherwise failing the punctual and regular payment of the hire, … or on any breach of this charterparty, the owners shall be at liberty to withdraw the vessel from service of the charterers, without prejudice to any claim they (the owners) may otherwise have on the charterers.

In *Mardorf Peach & Co Ltd v Attica Sea Carriers Corp of Liberia (The Laconia)* [1977] AC 850 the House of Lords held that the withdrawal of a vessel due to payment failure by the charterer was a proper exercise of the right.

However, in a difference case the English Court of Appeal had to decide whether the words 'or on any breach of this charterparty' – which applied literally would confer a right to terminate for any breach by the charterer, no matter how minor the breach – in clause 5 of the *New York Produce Exchange* form were to have this significant effect. In *Telfair Shipping Corp v Athos Shipping Co SA (The Athos)* [1983] 1 Lloyd's Rep 127 at 145 Stephenson LJ said:

> It would be surprising to find in a clause dealing with the payment of hire and withdrawal of the vessel from service of the charters a provision that any breach of any clause of the charterparty, without restriction, would entitle the owners to take the extreme step of withdrawing their vessel from the service of the charterers. It is so unreasonable a construction that it must make a court search for some other possible meaning of the clause, in order to avoid making the clause arbitrary, capricious or fantastic …

The breach alleged here was the failure by the charterers to reimburse the shipowners' extra war risk insurance. The court unanimously held that there had been no breach of that clause.

As this outcome was inconsistent with Kerr's J decision in *Tropwood AG v Jade Enterprises Ltd (The Tropwind)* [1977] 1 Lloyd's Rep 397 it was necessary for the House of Lords to settle it in

Antaios Compania Naviera SA v Salen Rederierna AB (the Antaios) [1985] AC 191. The House held that the clause needs to be applied commercially, not literally.

When interpreting express clauses conferring the right to terminate for breach, therefore, a commercial approach will be preferred to a literal one.

Rights implied by law

The right to terminate the performance of a contract implied at law arises in three circumstances: *first,* breach of a condition; *secondly,* the sufficiently serious breach of an intermediate term; and *thirdly,* repudiation of obligation. These have been discussed above.

Unlike New Zealand – where a general right to terminate is legislated, see the *Contractual Remedies Act* 1979 (NZ) – Australia does not have a general right to terminate the performance of a contract. Any statutory right to do so is therefore specific. Usually, the right will depend on the contract being of a certain kind, a certain kind of breach or a certain category of term.

5.2 Election

A breach of contract, whether a condition or an intermediate term, automatically operates to terminate the performance of the contract. The position is different where a contract is frustrated, because termination by frustration is automatic: *National Carriers Ltd v Panalpina (Northern) Ltd* [1981] AC 675 at 702 and 712. We are not here considering termination by frustration.

Termination is choice

Termination is always a matter of choice. The parties may provide to the contrary in their agreement, but absent such provision this is a common law rule that will apply. The principles applicable to an automatic termination clause were stated by Lord Atkinson in *New Zealand Shipping Co Ltd v Societe des Ateliers et Chantiers de France* [1919] AC 1 at 9:

> It is undoubtedly competent for the two parties to a contract to stipulate by a clause in it that the contract shall be void upon the happening of an event over which neither of the parties shall have any control, cannot bring about, prevent or retard … . But if the stipulation be that the contract shall be void on the happening of an event which one or either of them can by his own act or omission bring about, then the party, who by his own act or omission brings that event about, cannot be permitted either to insist upon the stipulation himself or to compel the other party, who is blameless, to insist upon it, because to permit the blameable party to do either would be to permit him to take advantage of his own wrong, in the one case directly, and in the other case indirectly in a roundabout way, but in either way putting an end to the contract.

See also *Suttor v Gundowda Pty Ltd* (1950) 81 CLR 418 at 440-2, *Grange v Sullivan* (1966) 116 CLR 418 at 429 and *JAG Investments Pty Ltd v Strati* [1973] 2 NSWLR 450 at 465-6.

Therefore the courts will not allow a party to a contract to include in their bargain the consequences of automatic termination from an event the party can cause to occur. This must be distinguished from a clause permitting termination for convenience. The former involves no election but merely the self-executing termination on the happening of an event; the latter allows for an election, at any time, to terminate further performance.

The rule against automatic termination means that termination is a matter for 'election'. The need for an election is ever-present.

What is the choice?

That an election is to be made suggests that alternatives are open to the promisee: essentially the idea of election is that promisee has made a choice between terminating the contract and continuing with performance of the contract.

The general principles of election relate to a party choosing between two inconsistent rights or remedies. In *United Australia Ltd v Barclays Bank Ltd* [1941] AC 1 at 30, which has been adopted in *Ciavarella v Balmer* (1983) 153 CLR 438 at 449, Lord Atkin explained, in relation to alternative remedies, a plaintiff cannot be required to elect between them until the claim is 'bought to judgment'. Once made, however, the election is generally final whether or not the judgment is satisfied: *O'Connor v SP Bray Ltd* (1936) 36 SR (NSW) 248 at 261-2.[5] But in relation to inconsistent rights, Lord Atkin said (at 30) that once a person has 'done an unequivocal act showing that he has chosen the one he cannot pursue the other'. In the context of the right to terminate a contract, only an election to terminate is necessarily final: see *Yukong Line Ltd of Horea v Rendsburg Investments Corp of Liberia (The Rialto)* [1996] 2 Lloyd's Rep 604 at 607 per Moore-Bick J.

There are four specific principles concerning election between rights:

(a) *First,* where a promisee elects to terminate a contract, what matters is whether the promisee is entitled to do so, not the basis given. As a general rule, the promisee is neither required to specify the ground for termination nor bound by any specification. Therefore, provided that a promisee was entitled to terminate, the termination will be attributed to a valid basis: *Sunbird Plaza Pty Ltd v Maloney* (1988) 166 CLR 245 at 262 and 274-5. Thus, in *Marcedelanto Compania Naviera SA V Bergbau-Handel GmbH (The Mihasli Angelos)* [1971] 1 QB 164, although charterers under a voyage charterparty purported to terminate the charter on the basis of force majeure, when that ground was found not to be available they successfully relied on the shipowners' breach of condition. Carter calls this the 'attribution' principle.[6]

(b) *Secondly,* under the general law an election to terminate a contract merely requires 'unequivocal' words or conduct: *Stocznia Gdynia SA v Gearbulk Holdings Ltd* [2010] QB

[5] Overturned in *O'Connor v SP Bray Pty Ltd* (1937) 56 CLR 464 without reference to the point.
[6] J W Carter, *Carter's Breach of Contract*, LexisNexis Australia 2011 at 441,[10-07]

27 at 46. It is therefore sufficient for the promisee to do an unequivocal act even though it may not be done with the intention of electing to terminate.

(c) *Thirdly,* subject to statute, the requirements for an effective election to terminate depend on the intentions of the parties. As a default rule, the principle at '(b)' assumes that the contract does not specify a procedure to be followed by the promisee when electing to terminate the contract. If the contract does specify the termination procedure, the specification must be satisfied.

(d) *Fourthly,* the one specific principle that is not derived from principles of election is a 'presumption in favour of common law rights': *Gilbert-Ash (Northern) Ltd Modern Engineering (Bristol) Ltd* [1974] AC 689 at 7171 approved in *Beaufort Developments (NI) Ltd v Gilbert-Ash NI Ltd* [1999] 1 AC 266 at 279 and 286-7. This presumptions can be one of two manifestations. The first is that any express rights of termination conferred by a contract operate in addition to any common law rights of termination: *L Schuler AG v Wickman Machine Tools Sales Ltd* [1974] AC 235 (termination for breach of condition) or *Stocznia Gdanska SA v Latvian Shipping Co* [1998] 1 WLR 574 (termination for repudiation). The second is that the consequences of termination in exercise of an express right do not prejudice the promisee's common law rights: *Hyundai Heavy Industries Co Ltd v Papadopoulos* [1980] 1 WLR 1129 (recovery of sum due at the time of termination) or *Progressive Mailing House Pty Ltd v Tabali Pty Ltd* (1985) 157 CLR 17 (loss of bargain damages).

But what is required for a valid election? As it is for the promisee who claims to have terminated the performance of a contract for breach (or repudiation) by the promisor to justify the termination by establishing an effective election, the requirements for an effective election assume importance.

Requirements for an election to terminate

The onus of proving the election is an effective election is on the promisee electing: *Southern Foundries (1926) Ltd v Shirlaw* [1940] AC 701 at 729. Assuming that the right to terminate has accrued to the promisee, they must establish the following two things for an effective election.

First, that the right was available to the promisee at the time of the election. It is insufficient to establish that the right to terminate existed at some time, either before or after the election; it must be established that it existed at the time of the election to terminate. *Secondly,* there must be compliance with the requirements for exercise of the right. This is a question of fact: *Hoad v Swan* (1920) 28 CLR 258 at 265.

These two factors are influenced by the source of the right to terminate. This means:

(a) if reliance is placed on an express contractual right to terminate, the requirements, if any, provided for by the contract must be fulfilled;

(b) where reliance is placed on a statutory right to terminate, the requirements, if any, stated in the statute must be satisfied; and

(c) where reliance is placed on a common law right to terminate, the common law requirements of election must be satisfied.

It is to be noted, though, that whatever the source of the right to terminate, contractual or statutory requirements may apply to the termination. Conversely, where no procedure for termination is specified by the contract or by statute, the common law requirements of election apply. In this respect they can be said to be 'default rules'. They are set out above under the heading 'What is the choice?'.

Unless the parties have agreed otherwise, an election by a promisee to terminate a contract in exercise of an express right activated by breach by the promisor has the same effect as exercise of a common law right: *Westralian Farmers Ltd v Commonwealth Agricultural Service Engineers Ltd (in liq)* (1936) 54 CLR 361 at 379.

As no particular contract is being considered it is not possible, in a paper such as this to go through the express rights to terminate by way of specific examples. It is possible, however, to note the following. Contractual rights to terminate performance will be strictly construed (*Eriksson v Whalley* [1971] 1 NSWLR 397 at 401) and a failure to follow the contractual regime will generally render invalid any termination in purported exercise of the express right: see *Lakshmijit v Sherani* [1974] AC 605 at 616 (where communication was held to be essential), *Schelde Delta Shipping BV v Astarte Shipping BV (The Pamela)* [1995] 2 Lloyd's Rep 249 at 253 (where compliance with anti-technicality clause required the notice to state that the promisor must remedy its default) and *Western Bulk Carriers K/S v Li Hai Maritime Inc (The Li Hai)* [2005] 2 Lloyd's Rep 389 at 406 (where notice which said the vessel would be withdrawn did not comply with the contractual requirements where it did not say that termination would occur if outstanding payment was not made).

Whatever the source, a right to terminate the performance of a contract may be affected by statute. In this lies the importance of the statutory requirements. There are numerous statutory provisions which lay down procedures, or impose restrictions, to regulate termination of performance of a contract. They are not uniform, though common features exist. Giving of notice is often required: see s 269 of the *Australian Consumer Law* for example. Sometimes the requirement of notice involves the right to be heard in reply or a period of grace before termination can occur: se s 72 of the *Property Law Act* 1974 (Qld).

Impediments to termination

In addition to compliance with formal procedures for termination, one of the following six grounds may impede any purported termination of performance under the contract.

First, the presence of an exclusion clause, which is a contractual term that excludes, restricts or qualifies the rights of a promisee under the contract. If the exclusion clause has the objective of qualifying the right to terminate, which not all exclusion clauses will have, the right to terminate will not be available in circumstances contemplated by the exclusion clause.

Secondly, the terminating party having breached the contract. The general rule is that breach by the promisee is not an impediment to an election by the promisee to terminate performance of the contract for breach or repudiation by the promisor. Similarly, the fact that the promisee was not at the time of its election ready and willing to perform is not an impediment to termination. Though, the contract may provide to the contrary: see *Re Stewardson Stubbs & Collett Pty Ltd* [1965] NSWR 1671.

Thirdly, the impossibility of *restitution in integrum*, which means to restore the parties substantially to the positions which they occupied prior to entry into the contract, which is a bar to rescission (see *Alati v Kruger* (1955) 94 CLR 216 at 223-5), is not an element of the termination process. This is because termination operates in the future.

Fourthly, waiver of the right to terminate. Although the word 'waiver' refers to a conclusion or result about rights or remedies (*Commonwealth of Australia v Verwayen* (1990) 170 CLR 394 at 406), the word is unhelpful unless two things are clearly described: the requirements necessary to bring about the result and what the result entails. In the present context the conclusion or result is 'waiver' by the promisee of a right to terminate the performance of a contract for breach or repudiation. But given that waiver is regarded as a restriction on termination, the question is how to deal with the concept in a meaningful way.

Fifthly, an estoppel of the terminating party's right to do so. This is a complex concept, based on the variety of categories available. What is required, however, are three elements: clear and unequivocal words or conduct; reliance on the part of the person setting up the estoppel; and detriment to the person setting up the estoppel if the termination can occur.

Sixthly, unfair conduct of the terminating party. The paper will not go into the detail here; suffice it to say that unfair conduct has been suggested as an impediment to termination as an umbrella term for the requirement for good faith, for fair dealing or to avoid unconscionability.

Consequences of termination

If, having worked through the above, there is a valid or effective termination of future performance of the contract it becomes necessary to consider what the promisee is actually bringing about by their termination. There may be a complete termination, a partial termination or a continuance of performance that, in certain circumstances, may be affected by a revival of the right to terminate.

5.3 Complete termination

The primary effect of an election to terminate the performance of a contract for breach or repudiation of obligation is to discharge the parties from the duty to perform their respective contractual obligations. This discharge includes any duty to be ready and willing to perform: *Bowes v Chaleyer* (1923) 32 CLR 159 at 198. The termination applies from the time of the election to terminate: *Boston Deep Sea Fishing and Ice Co v Ansell* (1888) 39 Ch D 339 at 365. It does not operate retrospectively.

A significant outcome of termination, therefore, is the removal of the promisee's need to be ready and willing to perform. Unless the contract provides otherwise, termination will discharge both parties: *McDonald v Dennys Lascelles Ltd* (1933) 48 CLR 457 at 476-7. Therefore, both parties are removed of the need to be ready and willing to perform. Although it is often said that termination for breach only discharges the party who has elected to terminate performance (see eg *Fibrosa Spolka Akcyjna v Fairfairn Lawson Combe Barbour Ltd* [1943] AC 32 at 53), such statements merely emphasise the liability of the party in breach to pay damages notwithstanding termination. Since the parties are both discharged, neither party may perform or call on the other to perform any unperformed obligations: *Ripka Pty Ltd v Maggiore Bakeries Pty Ltd* [1984] VR 629 at 635 concerning the issue of election to continue performance that cannot arise after termination.

This effect is often expressed by saying that the contract is 'terminated' or 'rescinded' (though see the criticisms above of the term 'rescission'). This does not accurately reflect the position because the contract survives termination. As Lord Porter explained in *Heyman v Darins Ltd* [1942] AC 356 at 399:

> To say that the contract is rescinded or has come to an end or has ceased to exist may in individual cases convey the truth with sufficient accuracy, but the fuller expression that the injured party is thereby absolved from future performance of his obligations under the contract is a more exact description of the position. Strictly speaking, to say that on acceptance of the renunciation of a contract the contract is rescinded is incorrect. In such a case the injured party may accept the renunciation as a breach going to the root of the whole of the consideration. By that acceptance he is discharged from further performance and may bring an action for damages, but the contract itself is not rescinded.

Ultimately, the position of the parties following termination must depend on their intention – as expressed or inferred. Therefore:

(a) any contractual terms which were intended to deal with the consequences of termination must be applied;

(b) any terms which the parties intended to apply notwithstanding the discharge of the parties must also be applied; and

(c) rights which accrued unconditionally prior to the termination remain enforceable.

Some of these are considered below, after the scope of the discharge is discussed.

Scope of the discharge

The extent of the obligations that are discharged upon termination is important. General statements of the scope of discharge use expressions such as that the parties are discharged from 'further performance', the duty to perform 'unperformed' obligations and the duty to perform 'executory' obligations. The general preference in the cases for a description in terms of 'unperformed' obligations is attributable to Lord Diplock. For example, in *Moschi v Lep Air Services Ltd* [1973] AC 331 at 350 his Lordship said:

> Generally speaking, the rescission of the contract puts an end to the primary obligations of the party not in default to perform any of his contractual promises which he has not already performed by the time of the rescission … . The primary obligations of the party in default to perform any of the promises made by him and remaining unperformed likewise come to an end.

See also his Lordship's comments at *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827 at 849.

It seems to be the case that unperformed obligations of the parties, whether the time for performance has passed or not, need not be performed following termination. Nevertheless, it is sometimes suggested that obligations that had fallen due for performance before the time of termination are presumed not to be discharged. This is significant for the parties' accured rights, discussed below.

Accrued Rights not divested

An important distinction exists between terminating performance of a contract for breach or repudiation and the rescission of a contract, which results in the parties being treated as though the contract never existed. As he often did, in a commonly quoted passage Dixon J summarised this contrast in *McDonald v Dennys Lascelles Ltd* (1933) 48 CLR 457 at 476-7 (Rich and McTeirnan JJ agreeing):

> When a party to a simple contract, upon a breach by the other contracting party of a condition of the contract, elects to treat the contract as no longer binding upon him, the contract is not rescinded as from the beginning. Both parties are discharged from the further performance of the contract, but rights are not divested or discharged which have already been unconditionally acquired. Rights and obligations which arise from the partial execution of the contract and causes of action which have accrued from its breach alike continue unaffected. When a contract is rescinded because of matters which affect its formation, as in the case of fraud, the parties are to be rehabilitated and restored, so far as may be, to the position they occupied before the contract was made. But when a contract, which is not void or voidable at law, or liable to be set aside in equity, is dissolved at the election of one party because the other has not observed an essential condition or has committed a breach going to its root, the

> contract is determined so far as it is executor only and the party in default is liable for damages for its breach.

The House of Lords adopted this passaged in *Johnson v Agnew* [1980] AC 367 at 396.

The impact of this distinction is that any rights which accrued unconditionally prior to termination are not divested by the termination. Accrued rights relate to the entitlement of either party to recover damages or receive performance. From the perspective of the party against whom it is available, an accrued right is an obligation or liability.

The most common right is that of damages – every breach of contract gives rise to a cause of action for damages. Except in the case of anticipatory breach, the promisee's cause of action does not depend on the existence, or exercise, of a right to terminate the performance of the contract: *Luna Park (NSW) Ltd v Tramways Advertising Pty Ltd* (1938) 61 CLR 286 at 300. Once the cause of action has accrued it is an unconditional right. It therefore survives termination of the contract. Performance of the obligation usually involves the payment of the liquidated sum.

Terms that survive termination

Whether or not the parties intend a contractual term to operate or apply following termination of the performance of the contract necessarily depends on the construction of the contract. This is therefore a question of law.

Putting aside accrued rights, there are four main categories of term that may survive the termination of performance of the contract. *First,* exclusion clauses and other non-promissory provisions intended to regulate rights and liabilities for breach of contract. *Secondly,* terms of a promissory nature intended to regulate the enforcement of rights and liabilities for breach of contract, including arbitration clauses and agreed damages provisions. *Thirdly,* promissory terms, generally incidental to the principal performance obligations of the parties, such as a term relating to confidential information. *Fourthly,* any terms expressly stated to apply notwithstanding (or after) termination of the contract. The nature of the term will dictate the method of its enforcement.

5.4 Partial Termination

It is generally assumed that where a contract is terminated for breach (or repudiation), or by frustration, the contract as a whole is discharged. There are, however, situations at common law where merely part of the contract may be terminated. The contract itself, of course, may also provide for such partial termination. It is therefore convenient to consider the sources of partial termination separately.

Before addressing the two scenarios it must be emphasised again, for it is set out above, that termination involves bringing to an end the obligation to further perform under the contract.

That this is the operation of termination is important in the context of partial termination and should remain in focus whilst considering partial termination.

Partial termination at Common Law

There are at least three categories of exception to the general rule of complete termination. They are: *first,* termination of unperformed obligations, *secondly,* termination of the severable part of a severable contract and *thirdly* termination of the 'application' of one or more terms of a contract.

Unperformed obligations

This is not a genuine category of partial termination. If no part of a contract has been performed, or the time for performance had passed without such performance, only damages are in issue. But the fact of part performance does not prevent termination for breach. Where partial performance has occurred termination relates to the unperformed part of the contract only. There is a 'partial' termination in this sense. But it is not a genuine category of partial termination because it is the consequences of complete termination where a contract has been part performed.

Severable contracts

Contracts can involve a one-off performance, such as the transfer of land. They can involve multiple performances, such as the provision of services. They can also involve several distinct or related components to be performed concurrently or at different times. The common law's answer to these types of contracts, by way of classification, is to be an 'entire' contract or a 'severable' contract.

Contracts are 'entire' because a lump sum price is not set off against particular components of contract performance. There is a single agreed price. Contracts are 'severable' because there is an apportionment between price and performance and each component of the price has its own agreed return. An example of a severable contract is a building contract where the builder's entitlement to payment accrues in accordance with a stipulated procedure (usually certification by an architect or quantity surveyor) even though there is a lump sum contract price.

Under a severable contract a promisee may enjoy a right of termination in respect of a severable part. Under a contract for the supply of goods, for instance, defective goods in a particular shipment may be rejected even though the contract as a whole cannot be terminated.

Termination of application

Although the parties may agree that the severable components of a severable contract may be treated as if they are in fact separate contracts (see *Cehave NV v Bremer Handelsgesellschaft*

mbH (The Hansa Nord) [1976] QB 44 where the term said 'each shipment shall be considered a separate contract'), absent such provision a several contract is considered to have one set of terms and to be one contract. It is not as many contracts as there are severable components.

But because the contract is severable the parties must intend the provisions to be applied more than once. So the terms will apply to each severable part. In this sense Dixon J referred to 'each divisible application of the contract' in the context of an employment contract in which the employees were entitled to be paid per ton of firewood they cut: *Steele v Tardiani* (1946) 72 CLR 386 at 401. Entire contracts may also be applied more than once. Consider again the building contract progressively providing the builder with entitlements to payments.

Where a contract is to be applied more than once, the non-application to one of those times amounts to a partial termination. For instance, a medical professional's insurer may terminate the application of the policy to a particular claim, but not terminate the policy itself.

Also, in *Bremer Vulken Schiffbau und Maschinenfabrik v South India Shipping Corp Ltd* [1981] AC 909 an arbitration clause was terminated for breach, though the balance of the contract continued. At 982 Lord Diplock said:

> The primary obligations of both parties … are contractual, whether express, or implied by statute or included by necessary implication in the arbitration clause. Breach of any of them would give rise to a general secondary obligation to pay compensation (damages), though this may well be nominal, but if the breach were such as to deprive the other party of substantially the whole benefit which it was the intention of the parties he should obtain from the mutual performance by both parties of their primary obligations in relation to the reference of the particular dispute to arbitration, ie, what in an ordinary synallagmatic contract would be a repudiatory breach, I see no ground in principle why the party not in breach should not be entitled to elect to put an end to all primary obligations to proceed with the reference then remaining unperformed on his part and on the part of the party in default, and, in appropriate cases, to obtain an injunction to restrain the party in default from continuing with the reference to arbitration of that particular dispute.

An example is also *Bremer Handelsgesellschaft mbH v Vanden Avenne-Izegem PVBA* [1978] 2 Lloyd's Rep 109 where a clause enable cancellation of a shipment in certain specified events. One such event occurred. However, the next clause required communication 'without delay' of the event's occurrence. Communication was delayed. The House of Lords held the promise of prompt notice was an intermediate term, breach of which was not fundamental. The sellers could therefore rely on the cancellation clause. If, on the other hand, the promise of prompt notice was held to be a condition, or an intermediate term of fundamental breach, no reliance could be placed on the cancellation clause. Lord Wilberforce (at 113) described this scenario as being 'proper to treat the cancellation as not having effect.' That is, the cancellation would be terminated, but the balance of the contract remains.

Express provision for partial termination

It can be seen that the common law categories of partial termination are not clearly settled and, it seems, do not address all situations where it is commercially desirable to allow partial termination. Express provision in contracts for partial termination is therefore important.

There is no need to state that termination under an express clause is without prejudice to the common law rights (see *Stocznia Gdanska SA v Latvian Shipping Co* [1998] 1 WLR 574 at 585), but there is no harm in doing so.

Generally, parties are free to contract in the terms of their choosing. They can therefore agree to partial termination in their own terms. Although the drafting and categorisation of express rights is the principle concern here, some consideration will be given to the validity of such clauses and issues of their exercise may raise.

There are three broad areas where express provision for partial termination occurs: *first,* termination for cause, *secondly,* unilateral termination and *thirdly* termination due to events beyond the parties' control. This paper considers unilateral termination at point 7 below and will not, therefore, address it here.

Termination for cause

Termination for cause clauses are helpful because the common law does not recognise the ability to terminate a limited aspect of a contract where a fundamental breach has occurred. As an example, a service provider who provides a number of services under a contract, and whose failure in relation to one type of services so provided is fundamental to the parties' bargain, would give the promisee the choice of terminating the entire contract or none of it. An express termination clause would enable the promisee to terminate the troubled service only, while leaving the balance on foot.

Circumstances beyond the parties' control

Where circumstances are beyond the parties' control, and may or may not amount to a frustrating event of the contract, the parties can provide that those stipulated circumstances permit termination of the agreement in part. They may also permit complete termination, but the focus here is partial termination.

Two common examples of these clauses are force majeure clauses and movement in price clauses. They are particularly helpful in contracts that regulate the parties over a long term.

Issues of validity

An express term to allow partial termination of an agreement should be drafted so as to include three elements: the trigger event, the response and the consequences. The trigger event is simply the basis for partial termination. The response is the further requirements for the partial termination clause, which is unlikely to be self-executing. Notice is common. A time in which the defaulting party may remedy is common. Set procedures, such as mediation,

may occur. These are the responses to the trigger event. The consequences are those discussed above.

It is important for the promisee to exercise the termination clause in accordance with its terms. A failure to do so may amount to a repudiation of the contract by the promisee. Areas of challenge may be whether the trigger event actually occurred, whether the requirements of the clause have been followed, whether the right to terminate was lost through election and whether the promisee is precluded from relying on an otherwise valid exercise by estoppel.

An example of such an outcome is *Carr v J A Berriman Pty Ltd* (1953) 89 CLR 327 where the principal attempted to omit work under a building contract pursuant to an express right to do so. The High Court held that the right was not validly exercised because the work in question was not omitted. It had been taken over. This wrongful exercise was itself a repudiation of the contract by the promisee.

Further, in *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234 a requirement of reasonableness was implied into a show cause termination provision in a building contract. It follows that unless the parties expressly state that the right of partial termination need not be exercised reasonably, the promisee who exercises such a right on the basis of breach of contract by the promisor must be prepared to show that is has acted reasonably.

5.5 Revival of a right to terminate

The mere fact that a right to terminate the performance of a contract has been lost does not mean that the promisee is forever bound to the agreement. Unless estopped by reason of the circumstances under which the right was lost, a promisee who lost a right to terminate by electing to continue with the performance of a contract may elect to terminate the performance of the contract in respect of a right arising from:

(a) a continuing breach by the promisor;

(b) a subsequent breach by the promisor;

(c) a continuing repudiation by the promisor;

(d) a subsequent repudiation by the promisor; or

(e) a failure by the promisor to comply with a notice to perform.

If a promisor repudiates a contract, but promise elects against termination, the promisee is entitled to terminate the contract if the promisor nevertheless continues to repudiate: *Sibbles v Highfern Pty Ltd* (1987) 164 CKR 214 at 227. The position is the same if the promisor repudiates the contract on a subsequent occasion, following the promisee's election to continue performance: *Wood Factory Pty Ltd v Kiritos Pty Ltd* (1985) 2 NSWLR 105 at 145. The

promisee obtains a fresh right to terminate unless what is put forward as the subsequent repudiation is an effective exercise of a right to terminate enjoyed by the promisor against the promisee.

Subsequent breaches by a promisor will give the promisee a right to terminate in four situations. *First,* if the subsequent repudiation is independent of the promisor's prior breach the right to terminate arises. *Secondly,* a second breach may, when combined with the former breach, exhibit an absence of readiness and willingness to perform amounting to a repudiation. This can include a failure to remedy the earlier breach. *Thirdly,* a subsequent repudiation may take the form of an inability to perform. *Fourthly,* a promisor's failure to comply with a notice to perform served by the promisee following the promisee's election continue with the performance of the contract.

Normally, an extension of time for performance following breach of condition is an election to continue to performance which results in loss of the right to terminate. The position is different where the doctrine of *Barclay v Messenger* (1874) 30 LT 351 operates. Under that doctrine, if time is of the essence of a contract for sale of land, but the vendor extends the time for payment by the purchaser, the vendor may terminate the performance of the contract if the purchaser does not pay on the extended time. This doctrine of conditional election has a general application: *Charles Rickards Ltd v Oppenhaim* [1950] 1 KB 616.

Estoppel on the fresh right

The right to terminate may survive, but it will be necessary for the promisee to establish a fresh right. Though the ability to assert that fresh right may be qualified by an estoppel.

The promisee may be estopped from relying on a fresh right to terminate. In *Bull v Gaul* [1950] VLR 377 a vendor, who the purchaser had agreed to pay £3 per week, had accepted various late payments. At a later time, when further amounts were outstanding, the vendor elected to terminate the contract and sought a declaration from the court that her election was effective. The court held that although payments were outstanding at the time of the vendor's purported election, she could not rely on breach by the purchaser as a ground for termination because, in the circumstances, the vendor had led the purchaser to believe that she would not insist on punctual payment (at 380). In view of the purchaser's reliance it would have been unconscionable to permit the vendor to terminate without first giving notice that the vendor would insist on punctual payment.

6 Settlement Agreements in Litigation

It is an everyday occurrence in courts across Australia: parties to litigation, or their legal representatives, settle proceedings. The agreement by which the proceedings are settled is a contract. If it is a binding agreement one of the parties can hold another party to the promises

of that agreement. Cases that make this clear have involved one of the parties trying to avoid the terms of any settlement agreement.

It is instructive to consider these cases due the regularity in which we will find ourselves entering settlement agreements for our clients or, they entering an agreement themselves, doing so in light of our advice and on our representation.

6.1 Solicitors and Clients Only

Before considering the cases that confirm the settlement agreement can bind the parties, it should be noted that entering a settlement agreement is open to the clients themselves but those clients, if represented by a solicitor, should not execute the documents. It is for the solicitor to sign. Consequentially, it is also not for the barrister to sign.

Rule 4.4 of the *Uniform Civil Procedure Rules* 2005 (NSW) (the "Rules") requires a solicitor to sign all documents in a proceeding, where a party is represented by a solicitor, that are to be signed by a party. The client themselves cannot sign the document, nor can counsel.

This rule is picked up in the recently issued statement from the District Court, *Settlements*. A copy of that statement is set out in full at Annexure A to this paper, however, item 8 of the checklist is here relevant and it provides:

> SIGNATURES: The consent judgment/orders must contain the original signatures of the parties authorised by r 4.4. R 4.4 does not include counsel. It must be clear as to the party or parties on whose behalf the solicitor is signing (eg 'for the plaintiff and 1st cross defendant').

From the writers experience the requirements of r 4.4 of the Rules is honoured more in the breach than the observance. But the District Court's issue of the *Settlements* statement, and the mere fact that the Rules provide for it, suggest we should all be aware of this provision.

6.2 Settlement Agreements

As stated, an agreement to settle proceedings is a contract. Provided the agreement satisfies the requirements of binding the parties – intention to bind, certainty of terms, consideration – it will bind the parties.

Even if the agreement of the party is fleeting, provided they agreed at the relevant time (a meeting of the minds) they will be held to their agreement. In *Harvey v Phillips* (1956) 95 CLR 235 a party to proceedings overtly resisted settlement proposals. She was encouraged to settle the dispute by the judge, senior and junior counsel of both sides, her solicitors and a trusted friend. Finally, overborn by the pressure, she agreed to a settlement. Senior Counsel of both parties executed the terms of settlement. The court was informed of the settlement, and congratulated the parties on the settlement, but did not enter the terms of settlement as

an order or judgment. Immediately after the court was adjourned party changed her mind and disputed that the settlement. Her appeals led to the High Court[7] said (at 243-4):

> The question whether the compromise is to be set aside depends upon the existence of a ground which would suffice to render a simple contract void or voidable or to entitle the party to equitable relief against it, grounds for example such as illegality, misrepresentation, non-disclosure of a material fact where disclosure is required, duress, mistake, undue influence, abuse of confidence or the like. The rule appears rather, from the positive statements of the grounds that suffice (cf. *Halsbury's Laws of England,* vol. 26, 2nd ed., pp. 84, 85); but there is a dictum of *Lindley* L.J. which is distinct enough: " … To my mind the only questions is whether the agreement on which the consent order was based can be invalidated or not. Or course if that agreement cannot be invalidated the consent order is good": *Huddersfield Banking Co. Ltd. v Henry Lister & Son Ltd.*(1).

The decision has been interpreted and applied by the Full Court of the Federal Court as authority for the proposition that the court has no jurisdiction to allow the defendant out of his settlement agreement. In *Singh v Secretary, Department of Family & Community Services* [2001] FCA 1281 at [8]-[10] Beaumont, Kiefel & Hely JJ said it thus:

> The relevant principles for present purposes were explained in *Harvey v Phillips*. The High Court there distinguished between two possible situations, as follows: [sic]
>
> One is the situation which exists before the formal entry of judgment. Here, the Court possesses a judicial discretion to set aside a compromise and to intercept that entry, for instance, in the event of an injustice arising by reasons of misapprehension or mistake made by counsel in consenting to an order. This discretion may be exercised notwithstanding that there were not grounds sufficient to invalidate a contract under general law. But in the case of a compromise made within the actual, as well as the apparent, authority of counsel, a court does not appear to possess an authority to rescind it or set it aside (at 242-243 [of *Harvey v Phillips*]).
>
> The second situation is after the entry of formal judgment. Here (as in the case of a compromise entered into within counsel's actual and apparent authority), the question whether the compromise is to be set aside depends upon the existence of a ground sufficient to render a simple contract void or voidable, or to entitle the party to equitable relief for illegality, fraud, non-disclosure, duress, mistake, undue influence, abuse of confidence or the like (at 243-244 [of *Harvey v Phillips*]).

Thus, whether the consent orders are entered or not, the court has no authority to set aside the parties agreement. This must be, in part, because the other party is entitled to rely on the bargain made. So much was discussed by the High Court in *Harvey v Phillips* at 244:

> The issue is one which must be considered from the defendant's point of view as well as from hers. When the defendants accepted the compromise requiring them to pay £4,000 they believed that thereby they were putting an end to the litigation. They

[7] Dixon CJ, McTiernan, Williams, Webb & Fullagar JJ

> acted upon the statement made by her counsel that the compromise was made with the authority of the plaintiff. Once it appears that the plaintiff did in fact give an assent which had not been withdrawn up to the moment when the terms of settlement were signed, it can be nothing to the point to say afterwards to the defendants that it was the result of her real desires or her judgment being overborne by advisers, whatever may have been the degree of moral pressure she felt.

In a case in which the writer was recently involved an argument was put that an agreement is not binding if it is described as a "Heads of Agreement", whether or not the terms of the agreement bear this out. They submitted that an agreement containing the heading "Heads of Agreement" makes it an agreement to agree and is thus not binding. This argument was recently rejected by Sackar J in *A W Ellis Engineering Pty Ltd v Malago Pty Ltd* [2012] NSWSC 55. This case is particularly relevant to this discussion.

In *A W Ellis Engineering Pty Ltd v Malago Pty Ltd* a mediation attended by the parties and their legal representatives led to a document titled "Heads of Agreement" to be executed by the parties. Clause 1(g) of the heads of agreement provided:

> Without affecting the binding nature of these Heads of Agreement the parties within 7 days to execute a formal document or documents as agreed between their respective solicitors to carry out and express in more formal terms and additional terms as these Heads of Agreement. The formal agreement is to contain a provision for monthly payments of 21.6% share of gross Marina berth income based on a reasonable estimate of income for that year

The legal representatives attempted to finalize the subsequent formal agreement; it was to no avail. The plaintiffs there contended that there was a binding arrangement whether or not a formal document was executed. The defendants there contended that the heads of agreement could not as a matter of law be a binding and legally enforceable agreement and that the document on its proper construction is incomplete and uncertain in its terms.

Whilst discussing the general principles applicable in this area (at [96]-[113]) Sackar J said the following:

> [96] Whether or not the parties here intended the agreement to be immediately binding is to be determined objectively having regard to the language contained in the Heads of Agreement. The High Court has repeatedly affirmed this proposition [citations omitted].
>
> [97] The Heads of Agreement must of course be read in the light of the surrounding circumstances.
>
> …
>
> [102] If the terms of such a document indicate that the parties intended to be bound immediately, effect must be given to it. Construction of a document may make it sufficiently clear that the parties were content to be bound

> immediately by the terms to which they had agreed, notwithstanding they contemplated further documentation.

After setting out the principles on this issue, his Honour concluded as follows at [114]-[116]:

> In my opinion the terms of the Heads of Agreement indicate in plain and unequivocal language that the parties intended to bind themselves immediately upon signing the document. I am also of the view that the Heads of Agreement contain all the relevant and essential terms required for a legally binding and enforceable contract.
>
> I am simply unable to accept any of the arguments advanced by the Defendants in opposition to such a conclusion. I am entirely unpersuaded that the language chosen by the parties could objectively be viewed as anything other than evincing an intention to be immediately bound, subject to more formal documentation including the potential for additional terms to be settled by the parties' respective solicitors.
>
> There are a number of pointers in the language in the Heads of Agreement which clearly indicate that the parties were intended immediately to conclude an agreement. First, the description "Heads of Agreement" is a very clear indicator in and of itself. …

The relief Sackar J gave in *A W Ellis Engineering Pty Ltd v Malago Pty Ltd* was to declare the settlement agreement was a binding contract and to grant specific performance of that contract.

If you find yourself in the position of having entered a settlement agreement, to which the other side considers themselves not committed, they can be held to the agreement despite it not having been entered as orders of the court.

7 Termination for Convenience

The common law does not usually permit termination in absence of breach. It will, however, imply into a contract of indefinite duration a term permitting termination by giving reasonable notice: see eg *New South Wales Cancer Council v Sarfaty* (1992) 28 NSWLR 68.

Of course there is no limit to the situations in which a contract might confer a right to terminate on one party but not the other. But a party wishing to terminate at will must include an express provision to that affect.

A termination for convenience clause provides an additional means of terminating a contract without the need for a substantial breach or any breach.

While termination for convenience clauses are drafted in a variety of different ways and can be for the benefit of either party, they are generally drafted for exercise by the principal. They encompass the following fundamental aspects:

(a) a unilateral right to terminate, which is clear and unambiguous and exercisable without default; and

(b) an entitlement to compensation where the right of termination is exercised.

Where the parties have agreed that one or both of them is to have the right to terminate the contract in this way, it is essential that this be made abundantly clear in the contract. This is because there is no common law right to terminate for convenience, as stated above.

For example, in *Thiess Contractors Pty Ltd v Placer (Granny Smith) Pty Ltd* (2000) 16 BCL 255, a clause that entitled Placer 'at its option, and at any time and for any reason it might deem advisable' to terminate the contract, was held to be clear and unambiguous in providing Placer with an absolute and unfettered right of termination.

Adequate compensation needs to be provided in the termination for convenience clause to ensure that the clause is not unenforceable for want of consideration. This requirement seems somewhat strange as the clause itself formed part of the initial agreement for which adequate consideration would have been provided upon its execution.

Termination for convenience clauses will often include payment for costs incurred by the contractor to the date of termination and demobilisation costs. The question is the extent to which the contractor should be entitled to recover any loss of profit on the incomplete work. In *Abbey Developments Ltd v PP Brickwork Ltd* [2003] EWHC 1987, Lloyd J said:

> It remains unsettled whether providing the contractor with compensation for goods and materials ordered (which will then vest in the principal) and reasonable costs of demobilisation from the worksite will be adequate compensation, or whether a termination for convenience clause needs also to provide for an amount of loss of profit.

The answer to this question – is compensation limited to amounts paid or to be paid, or those amounts plus an amount for loss of profit – is clearly of interest to parties agreeing in a commercial context.

Annexure A – District Court Settlement Checklist

Settlements

An increasing number of settlement consent documents are being rejected by the Court. This results in delay, further cost and sometimes unnecessary court appearances.

The following checklist has been prepared with a view to alleviating the problem.

Checklist

1. FORM: The appropriate form is generally Form 44 (Consent judgment or order). Note: that there is no form entitled *Terms of settlement*.

2. IDENTITY OF PARTIES: The names of the parties as they appear on the consent judgment/orders must be identical with the names as they appear on the originating process (as amended, if applicable). The consent judgment/order must contain the party details of all the parties.

3. VERDICT: Unless there are special circumstances, it is generally unnecessary and inappropriate for there to be a verdict (as opposed to or in addition to a judgment) against any party. Practitioners are reminded that the registrars do not have the power to enter a verdict.

4. MULTIPLE DEFENDANTS: If there are multiple defendants it must be clear against which defendant(s) any judgment for the plaintiff is to be entered and the amount.

5. UNNECESSARY ORDERS AND NOTATIONS: Draft consent judgment/orders ought be reviewed to consider whether all notations and orders are appropriate to the particular matter (especially where the plaintiff is a minor of tender years).

6. FINALISATION OF ENTIRETY OF PROCEEDINGS: Unless it is a partial settlement the consent judgment/orders ought dispose of the entirety of the proceedings against all parties (unless there has already been judgment, discontinuance, etc).

7. CROSS-CLAIMS: Matters are not regarded as finalised unless the cross-claims (including costs) are disposed of in the consent judgment/orders. Cross-claims are frequently overlooked.

8. SIGNATURES: The consent judgment/orders must contain the original signatures of the parties authorised by r 4.4. R 4.4 does not include counsel. It must be clear as to the party or parties on whose behalf the solicitor is signing (eg 'for the plaintiff and 1st cross defendant').

9. DISMISSAL: Where an order for dismissal is sought the consent judgment/orders should provide for the dismissal of either the 'proceedings' or of the 'proceedings commenced by the statement of claim/cross-claim'. Pleadings are generally 'struck out', not 'dismissed'.