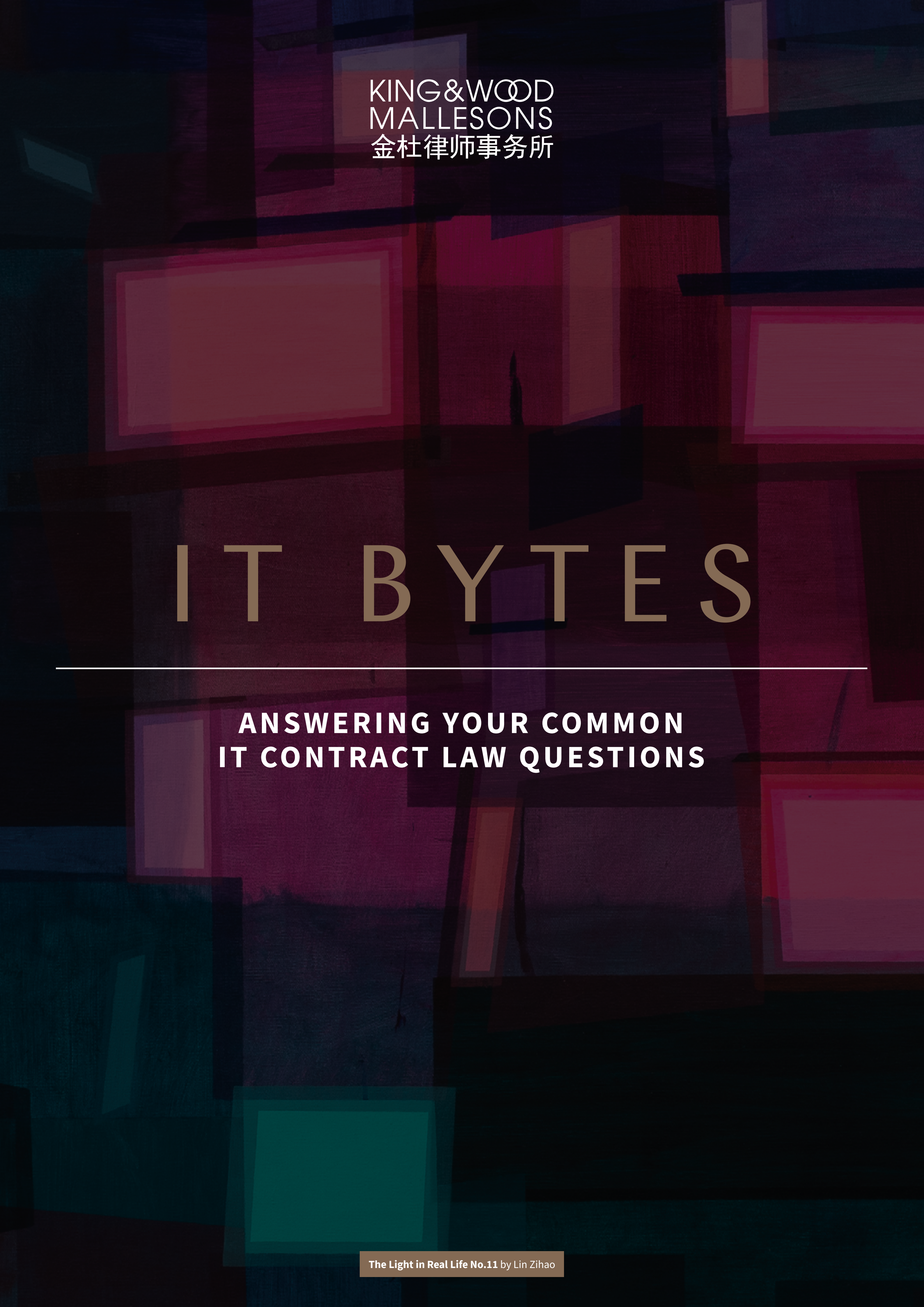

KING&WOOD MALLESONS
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IT BYTES

ANSWERING YOUR COMMON IT CONTRACT LAW QUESTIONS

The Light in Real Life No.11 by Lin Zihao

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IS AN UNSIGNED CONTRACT ENFORCEABLE?

WHEN DOES THIS QUESTION TEND TO ARISE?

Things were going great: you had just won an important tender with a big new customer, and it was going to take your business to the next level. The contract terms were settled and safely stowed away in your bottom desk drawer. The work was proceeding smoothly from your perspective, with your invoices being issued and paid in accordance with the contract terms. But then you ran into a few road bumps and the customer stopped cooperating. When you referred to the contract terms to try to bring things back on track, the customer just laughed and told you that the contract had never been signed and, therefore, wasn't worth the paper it was written on. Your heart drops when you retrieve the contract from the desk drawer and realise that the customer is right – in the rush of activity following the end of the tender, neither party actually got around to signing the documents. So where does that leave you; is the contract still enforceable?

WHAT DOES THE LAW SAY?

In order to form a legally binding contract, there must be an agreement between two or more parties supported by consideration from each of those parties. The framework of offer and acceptance is often used as an analytical device to determine whether or not the parties have reached an agreement. In these cases, where the terms of the contract have been reduced to writing, a signature is often relied upon as an indication of acceptance. However, a signature is not the only way in which the acceptance of an offer may be communicated. And indeed the framework of offer and acceptance as a whole, while sometimes convenient, is not the only way in which an agreement may be made. The ultimate legal test is whether, based on an objective assessment, the parties should be considered to have reached an agreement. If so, then the lack of a signature in order to communicate acceptance of an offer will not of itself be a barrier to a legally binding contract coming into effect.

This is neatly illustrated by the decision by the Victorian Court of Appeal in *PRA Electrical Pty Ltd v Perseverance Exploration Pty Ltd & Anor* [2007] VSCA 310 (***PRA Electrical***), which applied principles established by the House of Lords in *Brogden v Metropolitan Railway Co* (1877) 2 App Cas 666. That case closely followed our opening hypothetical: PRA was an electrical contractor who successfully tendered to carry out some work for Perseverance, with written contract terms negotiated as part of the tender process. PRA started work and for some months the parties acted in accordance with the terms of the contract, including in relation to the provision of bank guarantees by PRA as security and the payment of progress claims. However, a dispute arose and

Perseverance argued that there was in fact no binding agreement between the parties because the written terms of contract had not been executed, and there was a formal condition in the document that said the contract would not come into effect until the document was signed. The Court of Appeal disagreed with this, and said that a contract had been formed by the conduct of the parties, irrespective of the proviso in the written terms.

The Court said that "where, subsequent to the preparation of an unexecuted document - which the parties intend should constitute a contract between them – those parties act consistently with its provisions, it may be concluded that they have entered into an informal or implied contract in the terms of that document". Whether there is a sufficient basis to show that an agreement has been reached based on conduct will necessarily require a close consideration of the factual circumstances. It may also lead to some doubt as to the precise time at which the agreement was formed, as it will depend on the date of the conduct that is said to evidence the fact that an agreement had been reached. However, in the case of *PRA Electrical*, the Court found that the giving and acceptance of the bank guarantees as required by the contract terms was sufficient as "unequivocal evidence" of an agreement having been reached. The Court also observed that even if that was not the case, the subsequent making and payment of the progress payments in accordance with the contract terms would have resulted in the same conclusion. In each case, the Court said that an objective observer would have concluded that an agreement had been reached between the parties, on the written terms they had exchanged, subject only to the exclusion of the proviso that no contract would come into effect until the document was executed.

This pragmatic approach shows that the courts may still find a way to enforce a contractual bargain, even if not all of the execution formalities have been completed. In particular, the conduct of the parties may provide sufficient basis to conclude that a binding agreement had been reached. For completeness, even if that is not the case, if one of the parties has led the other to believe that a binding contract was in place, and the other party has acted to their detriment in reliance on that representation, then there may also be a basis to argue that they should as a matter of equity be estopped from denying that there was a binding contract.

Beware!

While a contract may still be binding even if not signed, you still need to take care in specific cases where the law requires a signature for other reasons. For example, if your contract is being executed as a deed, then in order to satisfy execution formalities a signature will typically be required. As such, an unsigned deed may not be effective. Similarly, the *Copyright Act 1968* (Cth) provides that an assignment of copyright does not have effect unless it is in writing signed by or on behalf of the assignor. As such, a copyright assignment provision in an unsigned contract may not be effective. Accordingly, while a signature may not be legally required in all cases for a contract to come into being, any laxity around contract execution can still have significant legal implications.

WHAT ARE THE PRACTICAL IMPLICATIONS FOR YOUR CONTRACT?

While it may be possible to show, based on the conduct of the parties, that a written contract has been agreed even if the contract was not signed by both parties, the lack of signature will inevitably introduce some uncertainty (including as to the precise time at which the contract came into effect, which may be an important reference point for the performance of obligations under the contract). It is always better to avoid doubt by making sure that all written contracts are properly executed by both parties before starting work. This also has the advantage of ensuring that any contract provisions that require a signature to take effect – such as a copyright assignment – will operate as intended from a legal perspective.

If you intend that written contract terms not become binding until all execution formalities have been fulfilled, then you should be wary of engaging in any conduct that suggests otherwise (e.g., making payments or referencing rights arising in accordance with the written terms). In this case, if work absolutely must begin before the contract is executed, it is best to expressly deal with the basis on which that work will be undertaken through separate correspondence, so that the overall contractual position remains clear and the conduct remains consistent with the position that the broader contract will not take effect until it is signed.

WHAT IS THE EFFECT OF MAKING TIME OF THE ESSENCE IN A CONTRACT?

WHEN DOES THIS QUESTION TEND TO ARISE?

Sometimes a contract will provide that 'time is of the essence' either in relation to some or all of the obligations under the contract. This may be stated in the provision that imposes the obligation itself, or may be included as a 'boilerplate' term. Either way, these statements can often be confusing for a lay person – after all, isn't it ALWAYS important for the contract to be performed on time?

WHAT DOES THE LAW SAY?

Where a contract stipulates that 'time is of the essence' with respect to an obligation, timely performance of that obligation is likely to be considered an essential term of the contract (sometimes referred to as a 'condition' of the contract).

If a term of a contract is an essential term, the party relying on the term may be able to terminate the contract at common law if the term is breached by the other party (in addition to any termination rights specifically drafted into the contract) (see our separate IT Bytes article here for further details on rights to terminate at common law).

This means that where a contract stipulates that 'time is of the essence' with respect to an obligation, late performance of that obligation may entitle the non-defaulting party to terminate the agreement.

The exact phrase 'time is of the essence' does not necessarily need to be included in the agreement for parties to agree that timely performance is an essential term. Other drafting can have the same effect – for instance, where a contract expressly states that a party may terminate the agreement where a time stipulation is not met.

It is also possible for 'time of the essence' to be implied into a contract in respect of obligations in certain circumstances. However, use of an express term like 'time is of the essence' is always preferable to provide certainty.

If a contract does not specify that 'time is of the essence', subject to any express termination rights in the contract, a mere failure to comply with a time period specified in the contract does not usually entitle the other party to terminate. However, delays can impact a party's ability to exercise rights that are specified as applying only within a specific window of time. As an example, the Western Australia Court of Appeal considered in *Chevron (Tapl) Pty Ltd v Pilbara Iron Company (Services) Pty Ltd* [2021] WASCA 193 whether a party was prevented from initiating a price review outside of the prescribed time period in a gas supply agreement even if the agreement did not provide that time was of the essence. Based on the construction of the agreement (and, in particular, the time periods involved in the complicated price review process once initiated), the Court of Appeal held that the time period in the price initiation clause was an essential term and so the price review could only be initiated within the time period provided for in the relevant term of the agreement.

WHAT ARE THE PRACTICAL IMPLICATIONS FOR YOUR CONTRACT?

If timely performance of some or all obligations is important in your contract, you should consider expressly providing that 'time is of the essence' in relation to those obligations.

Certain types of agreements typically provide that time is of the essence for key obligations, for example, agreements for the supply of perishable goods or sale of real estate. This makes sense where the benefit of the contract will be difficult or impossible to realise if performance is delayed. That won't always be the case for IT contracts. It is after all hardly uncommon for IT projects to be delayed!

There may be good reasons why the timing is important. In this case, it may be helpful to provide that 'time is of the essence' to provide suitable leverage (in the form of a right to terminate the agreement) in the event of a delay. However, in doing so, you should consider whether a right to terminate is right for your circumstances and whether there are more specific remedies or consequences that can be provided for in the contract to deal with delays to critical milestones. Afterall, if you exercise your right to terminate your contract, you may be no closer to getting what you need done on time. If you need to protect yourself from delayed performance you may have better-suited tools at your disposal – for example, liquidated damages clauses (see our IT Bytes article here, which covers liquidated damages and penalties) or requiring the delayed party to develop and implement a remediation plan if they are delayed (e.g. by deploying additional resources or reprioritising work to make up for the delay).

It is also worth bearing in mind that counterparties may often be reluctant to agree to make time of the essence, on the basis that a right to terminate may be a disproportionate remedy for a short period of delay in meeting what may not be such an important delivery obligation. Accordingly, it is always important to consider how valuable a termination right really will be to you in the event of a delay, and whether there are other options that you should consider instead of, or in addition to, making time of the essence.

IS THERE AN IMPLIED RIGHT TO SUBLICENSE SOFTWARE?

WHEN DOES THIS QUESTION ARISE?

You have entered into a licence agreement with a software provider to use a brand-new contract automation tool for your business. The software significantly improves the efficiency of your contracting processes and you think it has great potential to deliver benefits across your broader corporate group, so you give it to a subsidiary of your business to trial. You are soon contacted by the software provider alerting you that you are in breach of your licence agreement for sublicensing the software without permission. You consult the licence agreement and there is no mention of sublicensing at all. The licence agreement was between your business and the software provider, with no mention of the broader group. So where does that leave you; do you have an implied right to sublicense the software?

WHAT DOES THE LAW SAY?

Where a right to sublicense software is not expressly provided for in a licence agreement, it is possible for such a term to be implied. In order for a right to sublicense software to be implied in a licence agreement, the term must satisfy the criteria set out by the High Court in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266 ***(BP Refinery)***.

The implied term must be:

a. reasonable and equitable;

b. necessary to give business efficacy to the contract (which will not be satisfied if the contract is effective without it);

c. so obvious that 'it goes without saying';

d. capable of clear expression; and

e. non-contradictory of the express terms of the agreement.

The above criteria were recently applied by the High Court to imply a right to sublicense copyrighted material in *Realestate.com.au Pty Ltd v Hardingham* (2022) 406 ALR 678 ***(REA)***. This appeal concerned an informal verbal licence agreement.

When considering the criteria set out in *BP Refinery*, the Court in *REA* emphasised the subjective nature of the criteria and that they must be applied flexibly to the term in question.[1] In particular, the Court stressed that there will be no universal set of conditions that must be satisfied for an implied term to be considered 'reasonable and equitable' or 'necessary to give business efficacy' to an agreement.[2] However, the Court did note that where a term is 'necessary' it will likely be 'obvious' as well.[3] The Court also noted that certain criteria, such as 'obviousness' and 'clarity', will have a stricter application in the context of a formal written agreement where the express terms are thorough and clear, compared to a more informal or verbal agreement.[4]

Most importantly, the Court held that 'the criteria serve only to answer the ultimate question: what would have been intended by a reasonable person in the position of the contracting parties'.[5] This question will normally require consideration of the text of the agreement, as well as the surrounding circumstances known to the parties, and the purpose and object of the transaction.[6] In considering these factors, the Court in *REA* determined an implied right to sublicense copyrighted material was the 'natural and obvious implication' contained in the agreement.[7]

As such, in the absence of an express provision, there will be no general right to sublicense software - whether such a right will be implied will depend on the terms of your agreement and the nature of the transaction. This could include consideration of the function that the software was intended to perform (e.g., whether in the ordinary course it would be necessary for third parties such as related entities or third party service providers to interact with the software in order to realise the business outcome it was designed to achieve).

WHAT ARE THE PRACTICAL IMPLICATIONS FOR YOUR CONTRACT?

Where you have a pre-existing licence agreement which makes no reference to sublicensing, it will be necessary to determine whether a reasonable person would have intended for such a right to have existed in the agreement. In our initial scenario, the right to sublicense was arguably not necessary to give effect to the agreement, as the software could be used by the parent company for its own benefit without the subsidiary having access.

While it may be possible to have an implied right to sublicense this will only be possible if there is no express term to the contrary. To avoid doubt it is better to deal with the issue upfront in the express terms of your agreement, whether it be to expressly permit or disallow sublicensing. This will ensure that the agreement reflects the intended use of the software by both the licensor and licensee and will limit the risk of future disputes regarding its permitted use. It will be far simpler and cost efficient to negotiate a right to sublicense software from the outset, than to have such a right be later determined by the courts.

1 *Realestate.com.au Pty Ltd v Hardingham* (2022) 406 ALR 678, 705 [114]-[116], 707 [121] (Edelman and Steward JJ) ('*REA*').

2 Ibid 690 [51] (Gordon J), 705 [114] (Edelman and Steward JJ).

3 Ibid 683 [20] (Kiefel CJ and Gageler J).

4 Ibid 705 [114], 707 [121]-[122] (Edelman and Steward JJ).

5 Ibid 705 [115] (Edelman and Steward JJ).

6 *Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd* (2004) 219 CLR 165, 179 [40] (Gleeson CJ, Gummow, Hayne, Callinan and Heydon JJ).

7 *REA* (n 1) 710 [134] (Edelman and Steward JJ).

WHAT IS THE IPSO FACTO RULE?

WHEN DOES THIS QUESTION TEND TO ARISE?

You are in the midst of negotiations with a supplier for some business critical software. The supplier isn't one of the bigger players in the market but they offer a market leading software product for a specific function in your business. One of the protections you're relieved to have in the terms with the supplier is a termination right if the supplier is subject to an insolvency event, like voluntary administration, receivership or liquidation. However, your lawyers have mentioned that the termination right might not be able to be relied on in some cases and may in fact be unenforceable against the supplier even if one of those insolvency events happen. This is due to the 'ipso facto' rule. So when does the ipso facto rule apply and how can you protect yourself as a customer if it may apply?

WHAT DOES THE LAW SAY?

The term 'ipso facto' is a Latin phrase directly translates as 'by the fact itself'. An 'ipso facto' clause is a contractual provision that triggers a right to terminate or modify the operation of a contract simply because the counterparty becomes insolvent or specified insolvency related events occur affecting the counterparty, even if there has been no breach of the contract.

Under the ipso facto rule, certain contractual rights are rendered unenforceable against a company during a specified period after the commencement of certain types of insolvency events:

a. voluntary administration;

b. schemes of arrangements (to avoid insolvent liquidation); and

c. substantial receiverships (where the receiver is appointed over the whole or substantially the whole of the property of the company).

The ipso facto rule is aimed at allowing the insolvent company to restructure successfully, preserve the enterprise value when entering administration, or otherwise sell the business as a going concern. The intention is to assist viable but financially distressed companies to continue to operate while they restructure their business.

The ipso facto rule applies to arrangements entered into on or after 1 July 2018 and novations or variations of pre-1 July 2018 contracts entered after 1 July 2023.

The rule applies for contracts for the supply of goods or services (for example, outsourcing agreements, software licence and maintenance agreements) and a range of other agreements and arrangements, subject to some specific exceptions (including software escrow arrangements that may be triggered when a software vendor goes into administration).

In addition, where the ipso facto rule applies, it will not render all types of contractual rights unenforceable. For example, step-in rights, set-off rights and assignment / novation rights are not subject to ipso facto protection.[1]

WHAT ARE THE PRACTICAL IMPLICATIONS FOR YOUR CONTRACT?

If the contract you are negotiating is subject to ipso facto protection, rights of a counterparty to terminate or modify the operation of the contract only based on an insolvency event may be held unenforceable if challenged.

However, it is important to remember that the counterparty may still be able terminate for other breaches or defaults under the contract (for example, for non-performance or failure to pay debts when due). Other rights and remedies under the contract may also still be enforceable, including step-in rights.

If, as a customer, you are concerned about insolvency risk of your supplier, then drafting can be included in the contract which preserves rights which are triggered on other grounds, including non-payment and non-performance. The supplier should also have an obligation to notify the customer if it is subject to an event which may impact on its ability to continue to perform under the contract or to pay any amounts as they fall due. Similar considerations apply for suppliers who are negotiating these types of provisions with customers.

Including a right for a party to terminate for an insolvency event (which is typical in many services and software arrangements) will not in itself affect the enforceability of other provisions in the contract but you should be aware that (depending on the nature of the contract and the insolvency proceedings affecting a counterpart) it may not be possible to enforce the right as the sole grounds to terminate the contract.

1 The complete list of the types of excluded contracts for the purposes of section 451E of the Corporations Act can be found in Regulation 5.3A.50(2) of the Corporations Regulations 2001 (Cth) and the complete list of the types of excluded rights can be found in the Corporations (Stay on Enforcing Certain Rights) Declaration 2018 (as amended).

SHOULD SERVICE CREDITS BE THE SOLE REMEDY FOR A SERVICE LEVEL BREACH?

WHEN DOES THIS QUESTION TEND TO ARISE?

It is typical to include service credits as a remedy for service level failures, particularly in IT outsourcing or business process outsourcing arrangements where services will be provided over an extended period and the customer wants to have a way to measure and incentivise performance.

In formulating service levels and determining how service credits will be applied, parties should consider the interplay with other remedies and the broader liability framework in the contract. In particular, the question of whether other remedies should be available for service level failures, in addition to service credits, is often a hotly debated point of negotiation between the customer and the supplier.

WHAT DOES THE LAW SAY?

If a contract does not state that payment of service credits is the 'sole and exclusive remedy' for a failure of the supplier to meet service levels in performing the services, then other remedies available under the contract and at law remain available to the customer. This could include a right to terminate the contract (either under a contractual termination framework or at common law if the failure is sufficiently material) or to make a claim for damages if the failure to meet the relevant service level is a breach of the relevant contract.

If the contract does provide that service credits are intended to be the 'sole and exclusive remedy' then other remedies may be shut off for the customer. It is important in this case to bear in mind that the clause will, in effect, operate as a limitation of liability and will be subject to usual caveats around liability clauses. In particular, the clause may be narrowly construed against the party seeking to rely upon it (in this case, the supplier) and it may also raise issues from an Unfair Contract Terms perspective, and applicable consumer protection legislation, if the effect is to unfairly deny the customer a meaningful remedy and there is no legitimate business justification for doing so.

On the other hand, nominating an unreasonably high service credit amount can raise difficulties of its own, as whether such a credit is enforceable will depend on whether the clause could amount to a penalty (i.e. where the nominated credit clearly exceeds any loss that could be reasonably expected to flow from a relevant service failure). See our separate IT Bytes article here for further details on the law of penalties.

WHAT ARE THE PRACTICAL IMPLICATIONS FOR YOUR CONTRACT?

In drafting service credit clauses, you will need to consider how payment of service credits should be treated against other remedies which might be available to the customer for the underlying failure to meet service levels. Your approach will likely vary depending on whether you are the customer or the supplier.

Some typical negotiated positions, in order of most customer-friendly to most supplier-friendly options, include those set out below.

- **No limit on customer's other remedies:** The best position for the customer is to expressly state that service credits apply without limiting the customer's other rights and remedies (including the customer's right to claim damages). This treats service credits as a price adjustment reflecting the reduced value of the services received so that other remedies remain available to compensate for loss that the customer may suffer due to a service level breach.

- **Service credits deducted from general damages:** An alternative is to qualify the above position by deducting any service credits paid from the value of any damages sought by the customer. That way the service credit is effectively treated as one way of compensating for loss suffered by the customer but does not purport to constitute full compensation or cut off the possibility of the customer claiming additional amounts if they feel that they have suffered additional loss.

- **Customer election to claim damages:** The contract could give the customer a specified period to elect to either seek damages or to accept the service credit for the service level failure. In this case, the customer will effectively have to choose between two mutually exclusive remedies. Customers typically resist this position on the basis that the impact of the service level failure may not be known initially and that the customer should not lose its right to claim broader damages simply because it has accepted a capped service credit.

- **Service credits as sole financial remedy unless threshold is met:** As a variation to the above, the contract could provide that the customer will still have a right to claim damages, or pursue other remedies such as termination, even if they accept the service credit, but only if they can demonstrate that their loss has exceeded an agreed threshold or that the service level failure has continued over a certain sustained period. The effect of this is to position service credits as a suitable remedy for lower-level breaches, but not for more significant breaches for which other remedies should remain open.

- **Service credits as sole financial remedy unless the customer terminates for breach:** A further alternative would be to provide that service credits are the customer's sole financial remedy for a service level failure except if the customer terminates the agreement for breach based on that service level failure, in which case any rights to claim damages are not excluded. The effect of this is to position service credits as a suitable remedy so long as the relationship remains workable in the eyes of the customer, but not if the service level failure is so serious that the customer decides to exit, in which case all bets are off and other remedies are reinvigorated.

- **Service credits as the customer's sole financial remedy:** A more supplier-friendly approach is to provide that service credits are the customer's sole financial remedy for a service level failure, while still preserving the customer's rights to pursue other non-financial remedies (including, most importantly, the customer's rights to terminate a service or the agreement). Under this approach, service credits only apply as a financial control, but do not affect other aspects of the relationship between the parties.

- **Service credits are the sole and exclusive remedy:** This is the most advantageous position for the supplier as the customer will be precluded from exercising other rights and remedies (including to claim damages or to terminate the agreement) based on a service level failure. From the supplier's perspective, care needs to be taken to ensure that other provisions of the agreement are not inconsistent with this express position, as doing so could affect the efficacy of the clause (noting that the general position is that limitation clauses will already be construed strictly against the party seeking to rely upon them).

There are many options, but they need not be overwhelming. They key is to remember that service credits should be seen as an integral part of the overall liability framework, and not as a standalone regime. Provisions on liability should generally be negotiated as a package so that they work together to deliver an outcome aligned with the overall intention of the parties. As well as considering the remedies available in addition to service credits, you should also make sure other aspects of the liability framework work appropriately with the service credit structure. For example, this would include making clear whether there is a separate cap for service credits and whether the service credits paid count towards the supplier's general liability cap.

SERVICE CREDITS	CLAIM CREDITS	OTHER REMEDIES	CLAIM DAMAGES
Not sole remedy	Yes	Yes	Yes
Deducted from damages	Yes	Yes	Yes, but total value of damages is reduced by the service credit amount
Election to claim damages	Yes or No, depending on election by Customer	Yes	Yes or No, depending on election by Customer
Sole financial remedy unless threshold met	Yes	Yes, if certain threshold met	Yes, if certain threshold met
Sole financial remedy unless terminated	Yes	Yes	Yes, if terminated
Sole financial remedy	Yes	Yes	No
Sole and exclusive remedy	Yes	No	No

IS A VARIATION VALID IF NO NEW MONETARY CONSIDERATION IS PROVIDED?

WHEN DOES THIS QUESTION TEND TO ARISE?

As with all things in life, contracts are subject to change. Typically where a contract is varied there will be new obligations for each party - for example, if a procurement contract for the supply of widgets is varied to increase the number of widgets to be supplied, then the supplier will be obliged to produce the extra widgets and the customer will be obliged to pay for them. However, occasionally a contract will be varied to only affect the obligations of one party – for example, if the parties to the procurement contract just mentioned were to agree for the widgets to be delivered by an earlier date but without any change to the number of widgets or to the payment required from the customer. In those cases, is the variation still binding on both parties?

WHAT DOES THE LAW SAY?

For a variation to be contractually binding, the variation itself must satisfy all of the legal requirements to form a valid contract, including through the provision of valuable consideration by each party.

As a general rule, past consideration is not sufficient consideration and traditionally, a promise to perform an existing obligation will not be good consideration (see *Wigan v Edwards* (1973) 47 ALJR 586 at 594). This means that the performance of existing contractual obligations under the original contract will not be viewed as sufficient consideration for any subsequent variation – that is, fresh consideration in addition to that already owing will need to be provided for the variation to be binding.

However, Australian courts have found this rule not to apply if the promisor receives a 'practical benefit' (or avoids a disbenefit) as a consequence of the variation. A 'practical benefit' may arise if the performance of existing contractual obligations avoids problems associated with non-performance (e.g. inconvenience) and the benefit of this exceeds the detriment likely suffered by non-performance. For example, in the case of *Musumeci v Winadell Pty Ltd* (1994) 34 NSWLR 723, an agreement to reduce the tenant's rent was considered binding as the consideration received by the landlord was the 'practical benefit' of having a continuing tenancy, as opposed to having a vacant property and having to find a new tenant. This approach in interpreting any 'practical benefit' as consideration was cited with approval by the Full Federal Court in the more recent case of *Hill v Forteng Pty Ltd* [2019] FCAFC 105, where it was found that a variation to a director's employment contract to reduce his pay was supported by sufficient consideration as the director received the 'practical benefit' of retaining his job in circumstances where the company that employed him was steering towards insolvency.

It is also worth noting that consideration does not need to be monetary and can take many forms. For example, the abandonment of an existing legal right, the granting of new benefits or the assumption of additional obligations in the event of a breach could all constitute sufficient consideration. Accordingly, a lack of additional payment is not of itself an indicator that there is a lack of valuable consideration.

Finally, though not a true substitute for consideration, the doctrine of promissory estoppel may operate to prevent a promisor from relying on the absence of consideration to avoid making good their promise where it would be inequitable for them to do so. If a party makes a promise in a purported variation that the other party then relies upon to their detriment, the promisor may be estopped from resiling from their promise, even if there was no valuable consideration provided by the promisee in return.

WHAT ARE THE PRACTICAL IMPLICATIONS FOR YOUR CONTRACT?

While there may be ways around a lack of valuable consideration, it is best to avoid being in this position to begin with. Greatest certainty can be achieved by ensuring that every variation is supported by valuable consideration from each party. For example, if there is any doubt as to the consideration being provided, one way to eliminate doubt is to agree on some token consideration, such as the payment of a nominal amount by the benefitting party.

Another option where there is doubt as to the provision of valuable consideration, is to execute the variation as a deed rather than as an agreement as deeds can be legally binding without consideration. This may require some additional execution formalities to be observed, and you should take care to check that a valid method of execution is being followed in order to ensure that the deed is valid. With any variation, whether taking effect as an agreement or a deed, it is also important to ensure that any change control processes specified in the original agreement are followed.

WHAT IS THE DIFFERENCE BETWEEN A LIQUIDATED DAMAGES CLAUSE AND A PENALTY CLAUSE?

WHEN DOES THIS QUESTION TEND TO ARISE?

A customer under an IT contract may want the supplier to pay a pre-determined amount for certain types of breaches, such as a service credit where they fail to meet an agreed service level or an amount of liquidated damages if they fail to achieve an important project milestone by the due date. This may have various advantages for the customer, including by providing greater certainty and avoiding the need for the customer to substantiate the loss they have suffered, which in many circumstances may be difficult to do (and costly). However, these types of clauses are not always enforceable. Where the pre-determined amount is found to operate as a penalty, then the obligation to pay the liquidated sum may not be enforceable if challenged.

WHAT DOES THE LAW SAY?

The distinction between a legitimate agreement to pay a liquidated sum and an unenforceable penalty has historically been based on principles consolidated in the House of Lords decision in *Dunlop Pneumatic Tyre Co. Ltd v New Garage and Motor Co. Ltd [1915] AC 79 (‘***Dunlop***’)*. According to those principles, a contractual obligation to pay a liquidated sum upon breach of a contract will be enforceable if the sum is held to be based on a ‘a genuine pre-estimate of damage’. However, if the payment is calculated as a punitive measure to deter the other party from breaching the contract, then it will be considered a penalty and so be unenforceable (at least to that extent).

For example, suppose a contract for delivery of construction materials included the following clause:

PUNCTUAL DELIVERY AND LIQUIDATED DAMAGES

a. The Goods must be delivered to the Site in accordance with the Delivery Instructions on or before the Delivery Date.

b. If the Goods are not delivered by the Delivery Date, the Supplier agrees to pay the Customer $1,000 for each successive day of lateness.

If the $1,000 was a 'genuine pre-estimate of the damage' suffered by the customer for each day of delay (e.g. because the customer was forced to lease equipment in place of the goods that have been delayed), then, based on the principles in *Dunlop*, it is likely this clause would be enforceable. This is even the case if it turns out that the pre-estimate exceeded the actual loss suffered by the customer, such as where it turns out that the cost to the customer of leasing substitute equipment is less than $1,000 per day.

Alternately, if the clause was only inserted into the contract to ensure the supplier had an additional incentive to deliver the goods on time and the measure of $1,000 per day had no relation to the loss that the customer anticipated they would suffer due to the late delivery, then the clause may amount to a penalty. For example, if the customer knew in advance that the cost of leasing substitute equipment would be less than $1,000 per day, but wanted to specify a higher amount simply to deter late delivery, then the clause may well be unenforceable. The fact that the clause is called 'Punctual Delivery and Liquidated Damages' is of no relevance to how it would be treated if challenged; a penalty will still be a penalty no matter how it is described.

The principles first outlined in *Dunlop* still apply in Australia. However, the penalties doctrine has since been refined by two related High Court decisions that considered whether late payment and other bank fees were in fact penalties: *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 ('***Andrews***') and *Paciocco v Australia & New Zealand Banking Group Ltd* (2016) 258 CLR 525 ('***Paciocco***').

In Andrews, the High Court held that the penalties doctrine also extends to provisions requiring payments (or other transfer of value, e.g. property) on the occurrence or non-occurrence of events other than breach of contract. In practice, this means that it is not possible to 'draft around' a clause being considered a penalty simply by not framing the relevant trigger event as a breach. Following *Andrews*, a clause which imposes a detriment to secure performance or some other stipulation in the contract can be classified as a penalty if it is challenged, even if there is no underlying breach of contract. The Court also said that if a clause is found to be a penalty, the clause can still be enforced to the extent it can be legitimately applied – the clause isn't wholly unenforceable.

In *Paciocco*, it was argued that since there was no evidence that the fees were a 'genuine pre-estimate of loss', they were in fact penalties and so were unenforceable. The Court disagreed. In doing so, it said that the relevant question was whether the fees charged were extravagant, unconscionable, and 'out of all proportion to the interests of the party which it is the purpose of the provision to protect'. This interpretation was not necessarily inconsistent with *Dunlop*. However, it was seen as loosening some of the restrictions imposed by the principles formulated by the House of Lords, particularly for more complex contracts where predicting the likely loss that would follow a breach may be very hard to do. Practically, this means that since Paciocco contracting parties have had more freedom to draft liquidated damages clauses with a reduced risk of them being held to be unenforceable as a penalty if challenged.

WHAT ARE THE PRACTICAL IMPLICATIONS FOR YOUR CONTRACT?

If you want to require payment of pre-defined agreed amount on a breach of contract or another trigger event in your contract, you will need to carefully consider whether the amount you have in mind appropriately reflects the loss that you may reasonably expect to suffer because of the event or breach. You will want to be able to establish that it represents a 'genuine pre-estimate' of your loss or at least that it was not 'out of all proportion' to the interests you are trying to protect.

Having said that, a clause is not unenforceable as a penalty only because in the circumstances the agreed amount is higher than the actual loss that is suffered because of the trigger. You simply need to be able to show that the agreed amount represents a genuine effort to estimate in advance the cost of the event or breach when considered at the time the contract was entered into. If your genuine estimate overshoots the mark, that will not of itself invalidate the clause.

If there are specific additional costs that you anticipate incurring if a breach or other trigger event occurs, then you should take those into account and ideally ensure that the liquidated damages you specify in the contract is based on those costs. However, that will not always be possible. In those cases, you should aim to ensure that any liquidated damages are set at a defensible amount so that you can still argue the predominant aim is to compensate for loss that you may suffer, rather than to punish the other party for a breach. In this regard, beware of what you include in unprivileged correspondence that may betray other underlying motives and may be discoverable by the other party in the event of a dispute.

Finally, it is also common to include contract terms to the effect that the parties each acknowledge that the liquidated damages in the contract constitute a genuine pre-estimate of the loss that is likely to occur due to the relevant breach. The inclusion of such a clause will make it harder for the other party to argue that, contrary to what they agreed in the contract, they no longer believe that the amounts specific represented a genuine pre-estimate.

WHAT IS THE DIFFERENCE BETWEEN A 'BINDING' AND A 'NON-BINDING' MEMORANDUM OF UNDERSTANDING?

WHEN DOES THIS QUESTION TEND TO ARISE?

A memorandum of understanding or 'MOU' can serve as a useful tool to crystallise the key terms of a transaction in circumstances where some finer details still need to be worked through or where the parties may for other reasons simply not (yet) be ready to enter into a formal contract. In particular, an MOU can help the parties to ensure they are 'on the same page' before investing time and effort in negotiating a formal contract. In some cases, the parties may intend to be bound by and may even start work in reliance on the terms of the MOU, before a formal contract has been concluded. In other cases, the MOU will simply be intended as a non-binding statement of intent. The precise characterisation of the MOU becomes important if things break down and one party feels aggrieved by a promise in the MOU that they believe has been broken. The enforceability of the MOU as a contract will then become a key issue.

WHAT DOES THE LAW SAY?

Determining whether an agreement is binding as a contract will often depend on whether, based on an objective assessment, the parties intended to enter into a legally binding agreement. In considering whether the parties had the requisite intention, the court will consider the language of the document, as well as its context. Relevant context might include the conduct of the parties at the time the document was entered into and the relationship of the parties generally.

Where it is apparent from the context that the MOU was to be followed by a formal contract, it can be particularly difficult to determine whether the parties intended for the MOU itself to be legally binding. Based on the High Court authority in *Masters v Cameron* (1954) 91 CLR 353, if an MOU includes language to the effect that the MOU is intended to be 'subject to contract' then it will fall within one of the following three categories:

If an MOU falls into one of the first two categories, the parties are considered to have entered into a legally binding agreement. Accordingly, an aggrieved party may be able to bring a claim in contract seeking damages if the other party fails to comply with the MOU. On the other hand, if an MOU is found to fall into the third category, then there is no binding agreement and, therefore, there can be no claim in contract if there is a failure to comply.

Determining which of these categories an MOU falls into requires an objective assessment, based on what a reasonable person would have considered the intention of the parties to be on entering the MOU at the time in the relevant context.

1

EXECUTION OF THE CONTRACT IS A MERE FORMALITY

The parties intend on being immediately bound by the terms of the MOU, but also intend in due course to restate their agreement in a more complete or precise manner through a formal contract

2

EXECUTION OF THE CONTRACT IS A CONDITION PRECEDENT TO THE OBLIGATION TO PERFORM

The parties have reached a concluded bargain and do not intend to depart from the terms of the MOU, but have made performance of one or more of the terms of their bargain conditional upon the execution a formal contract

3

EXECUTION OF THE CONTRACT IS A CONDITION PRECEDENT TO FORMATION OF A BINDING CONTRACT

The parties do not intend to be bound by the terms of the MOU unless and until a formal contract is executed

WHAT ARE THE PRACTICAL IMPLICATIONS FOR YOUR CONTRACT?

If entering into an MOU, consider whether it is in your interests for the MOU to be immediately binding. If not, then you should include an express term in the MOU which states that it is not intended to be legally binding (possibly with the exception of some limited aspects, such as confidentiality provisions, in order to protect any ongoing negotiations).

On the other hand, if you do wish for the MOU to be binding, then you should include an express statement to that effect and ensure that other requirements to form a binding contract have been satisfied – e.g. that the terms are sufficiently certain and that there is supporting consideration from both parties. You should also take care to ensure that the MOU includes any relevant conditions you wish to apply in relation to the development of the formal contract. For example, you could include a termination right if a formal contract is not concluded by a set date – that can be a useful tool to ensure the parties remain focussed on completing negotiations and finalising the formal contract.

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

WHEN DOES THIS QUESTION TEND TO ARISE?

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

WHAT DOES THE LAW SAY?

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

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

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

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

While quantum meruit is the most attractive and commonly pursued action to seek compensation for work performed in anticipation of a failed contract, there is an alternative avenue through the equitable doctrine of promissory estoppel.

If a customer, through active encouragement or culpable acquiescence, leads a service provider to rely to their detriment on certain actions or promises (e.g., as to payment), the customer may be legally barred (or "estopped") from acting in an inconsistent manner. In that case, the principal could theoretically be required to follow through on promises relating to payment, even if no binding contract exists. However, it is worth noting that such claimed based on estoppel can be challenging and are not commonly pursued in practice.

WHAT ARE THE PRACTICAL IMPLICATIONS FOR YOUR CONTRACT?

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

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

- service providers should exercise caution when commencing work before a contract has been signed. If an early start is essential to meet relevant customer deadlines, the service provider should make this clear and ideally secure some written endorsement from the customer (with a commitment to pay for the work even if the contract does not proceed) before starting work; and

- conversely, customers should be clear as to when service providers will be starting work early at their own risk. If a service provider does insist on beginning preparatory works before a contract is signed, the customer should consider writing to the service provider to expressly state that the customer has not committed to proceed with the contract and has not agreed to make any payment for work that may be carried out in advance of the contract being signed.

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

WHAT IS THE DIFFERENCE BETWEEN 'GROSS' NEGLIGENCE AND 'NORMAL' OR 'MERE' NEGLIGENCE UNDER AUSTRALIAN LAW?

WHEN DOES THIS QUESTION TEND TO ARISE?

It is common for the parties to an IT contract to want to limit or exclude their liability under the contract in some way. However, typically there will also be exceptions where the parties accept that their liability should not be limited or excluded, such as in cases of fraud or deliberate breach. Occasionally a party will suggest that there should be an exception for negligence. However, such a broad exception may fundamentally undermine the purpose of the limitation of liability clause, as it will often be a simple matter to recast a breach of contract claim as a claim for negligence thereby leading to unlimited liability. In that case, a compromise may be to confine the exception to 'gross negligence' instead. This will then present the question of how 'gross' negligence should be distinguished from 'normal' or 'mere' negligence.

WHAT DOES THE LAW SAY?

The tort of negligence is made out if one party owes a duty of care to another party, they fail to fulfil that duty by falling below the standard of care required, and the other party suffers loss or damage as a result.

From the perspective of a claim in negligence, any difference in meaning between 'gross negligence' and any other type of negligence is inconsequential, as the tort will be made out whenever there is a failure to meet the standard of care, irrespective of whether it is a gross failure or otherwise.

The position in contract is different, though in that context the term 'gross negligence' has been described as being 'at worst, meaningless, and at best, vague'. Nonetheless, while it is not a term of art, it has been accepted that when used in a contract the term 'gross negligence' is different to 'mere negligence'. The courts have generally held that the question whether conduct amounts to 'gross negligence' is to be determined objectively, in accordance with ordinary rules of contractual construction, taking into consideration relevant contextual considerations.

In *GR Engineering Services Ltd v Investment Ltd* [2019] WASC 439 the meaning of 'gross negligence' was held to be a matter of constructing the contract to identify the objective intentions of the parties at the time of contracting. It was noted that Australian courts have tended to follow the English authority of *Red Sea Tankers Ltd v Papachristidis (The 'Hellespont Ardent')* [1997] 2 Lloyd's Rep 547, in which it was said that:

In other words, the court in that case was saying that gross negligence did not require conscious risk taking, but did require a serious failure to meet a relevant duty of care.

At the same time, the court in GR Engineering approved comments in other cases to the effect that the meaning of the phrase was context-specific, and in some circumstances 'gross negligence' would be more than 'mere negligence' and in others it would be the same. If, in the circumstances, a distinction is to be drawn between 'mere' and 'gross' negligence, the distinction is typically 'one of degree and not kind'. In 2021, the WA Supreme Court of Appeal upheld the primary judge's finding in GR Engineering, saying that 'in the context of the present case, gross negligence required more than mere negligence and connoted a serious or significant departure from the standard of care required'.

Based on these precedents, the difference between 'mere negligence' and 'gross negligence' is to be determined on a case-by-case basis, looking to the objective intentions of the parties at the time of contracting and the conduct of the parties within the context in which it took place. However, the difference will always be one of degree and not kind, and the point at which conduct crosses from being 'merely negligent' to 'grossly negligent' will often be a matter of impression.

> **… the concepts of 'gross negligence' here appears to me to embrace serious negligence amounting to reckless disregard, without any necessary implication of consciousness of the high degree of risk or the likely consequences of the conduct on the part of the person acting or omitting to act.**
>
> **If the matter is viewed according to purely English principles of construction, I would reach the same conclusion. 'Gross' negligence is clearly intended to represent something more fundamental than failure to exercise proper skill and/or care constituting negligence. But, as a matter of ordinary language and general impression, the concept of gross negligence seems to me to be capable of embracing not only conduct undertaken with actual appreciation of the risks involved, but also serious disregard of or an indifference to an obvious risk.**

WHAT ARE THE PRACTICAL IMPLICATIONS FOR YOUR CONTRACT?

- The term 'gross negligence' does not have a set meaning, and its interpretation may be highly context specific. As such, the distinction that may be drawn between 'mere negligence' and 'gross negligence' may in some circumstances be hard to predict.
- That may be acceptable if you feel that you are more likely to want to rely upon any liability carve out for gross negligence, as you will be able to argue for a broad interpretation. However, if you are more concerned about your own exposure, you may prefer either to push back on any such carve out (on the basis that the scope will be too uncertain) or to propose including an explicit definition in order to leave less room for doubt.
- While an infinite variety of definitions could be proposed, many will include elements of recklessness or wilfulness as a way of distinguishing from 'mere negligence'. In any case, the definition will need to be carefully crafted in order to accurately reflect how far above the standard measure of tortious negligence (that is, above a mere failure to meet a relevant standard of care) you wish to set the bar. While there is no one right answer, you could consider:
  - A definition that invokes the familiar duty of care concept but focuses on matters of degree, such as 'conduct that goes beyond mere carelessness or a failure to take reasonable care and involves a failure to exercise even a minimal level of care in order discharge a duty owed to another'.
  - Drawing inspiration from the Australian Consumer Law and Fair Trading Regulations 2022 (Vic), which defines the concept as an act or omission 'done or omitted to be done with reckless disregard, with or without consciousness, for the consequences of the act or omission'.
  - A definition that emphasises more conscious risk taking (while still falling short of an intention to cause harm), such as 'conduct that involves a reckless or deliberate disregard for a risk of causing harm that was known or ought to have been apparent at the time'.

WHEN CAN A CONTRACT BE TERMINATED AT COMMON LAW?

WHEN DOES THIS QUESTION TEND TO ARISE?

When considering options to end a contract, it is important to consider rights to terminate the contract at law in addition to any specific termination rights that may apply under the negotiated terms of the contract. Rights at law are also important to consider during the negotiation and drafting of the contract, as it may be appropriate to exclude rights at law so that the rights in the contract itself are in effect exhaustive.

WHAT DOES THE LAW SAY?

As a rule of law, unless it is excluded by the terms of the contract, a party has a right to terminate a contract where there has been:

- a breach of an essential term (otherwise known as a condition);
- a sufficiently serious breach of an intermediate term; or
- a repudiation of the contract.

Breach of a condition

Where a term is classified as a condition, the non-breaching party will have a right to terminate for any breach of the condition, even if the breach is minor. The question of whether a term is a condition is typically assessed by looking at the contract as a whole, the surrounding circumstances and the likely consequences of a breach. A term will be considered a condition where it is so essential that the parties would not have entered the contract unless the condition was going to be strictly performed. For example, if the contract specifies that 'time is of the essence' for a certain obligation, that obligation will likely be interpreted as a condition so that even a slight delay may trigger a right to terminate.

Sufficiently serious breach of an intermediate term

As noted above, breach of a contract term that is classified as a 'condition' will automatically trigger a right to terminate. By contrast breach of a contract term that is classified as a 'warranty' will trigger a right to claim damages but not a right to terminate. There are terms that are not intended to be so important as to qualify as a condition, but are also more important than mere warranties. For these 'intermediate terms', whether a breach will trigger a right to terminate will depend on the nature of the breach and its consequences. Courts have found that a right to terminate will arise where the breach of the intermediate term is so serious as to deprive the non-breaching party of substantially the whole benefit of the contract. This is assessed at the time of termination rather than at the time of the breach or when the contract was formed.

Repudiation

A non-breaching party may also be entitled to terminate a contract as a matter of law where the other party has repudiated the contract. Repudiation occurs where a defaulting party's actions show that they are unable or unwilling to perform their obligations under the contract. A party may repudiate the contract by engaging in conduct that demonstrates an intention to no longer be bound by the contract or to perform it only in a way which is substantially inconsistent with its terms. This conduct could take the form of express statements or simply by actions that show the party is not ready, willing and able to perform the whole of the contract or a fundamental obligation. For example, a purchaser under a contract for the sale of land may consider that the seller has repudiated the contract if the seller disposes of the property to a third party instead.

WHAT ARE THE IMPLICATIONS FOR YOUR CONTRACT?

Before purporting to terminate a contract it is important to be very clear as to your rights. If a party purports to terminate a contract when in fact they don't have a right to do so, then that of itself may be taken as a repudiation of the contract resulting in a turning of the tables as the other party will then be in a position to terminate based on that repudiation and then seek damages.

In drafting and negotiating the termination regime under an IT contract, the key issue for the parties is to create certainty about which breaches will give rise to a right to terminate. It is good practice to:

1. Include terms in the contract expressly permitting parties to terminate in specific circumstances. This may include situations where a party can terminate 'for cause' (where the right will only be triggered by a breach or other failure by the other party) or 'for convenience' (where no trigger event is required). In either case, it will be important to be clear on when the rights may be exercised. For a right to terminate for cause, it is typical to limit the trigger events to certain types of breaches (e.g. breaches of certain critical terms, or other 'material' breaches that are not remedied within a specified period). For a right to terminate for convenience, it is typical for there to be a minimum notice period or for some payment to be made in addition to or in lieu of notice.

2. Use clear and precise language to indicate whether certain obligations are so essential to the contract that they should be treated as conditions (i.e. so that any breach will give rise to a right to terminate). For example, terms as 'we guarantee' or 'fundamental obligation' or 'any breach give rise to a right to terminate' may be taken as indicators of a condition. By contrast, it is also common for suppliers to specify that reperforming services or refunding payment will be the exclusive remedies available for certain types of breaches, effectively signalling that the provisions in question are intended as warranties that will not trigger a right to terminate if breached.

3. Consider whether a party's rights to terminate at law should be expressly excluded by including a specific term in the contract to that effect. This will generally be more advantageous for the supplier given it will usually have the majority of the obligations to perform under the contract, and will want to control the circumstances in which the customer can bring the contract to an end.

WHEN CAN A RELATED ENTITY BRING A CLAIM UNDER A CONTRACT?

WHEN DOES THIS QUESTION TEND TO ARISE?

It is common for IT contracts to be entered into for the benefit of a corporate group. In such arrangements, the contract will in effect purport to confer rights on third parties that are related to the contracting entity. However, privity of contract may prevent the related entity from directly enforcing the contract. In these cases, various other enforcement options may need to be considered.

WHAT DOES THE LAW SAY?

The privity of contract doctrine states that only the parties to a contract are legally bound by and entitled to enforce it. In *Trident General Insurance Co Ltd v McNiece Bros Pty Ltd* (1988) 165 CLR 107, the High Court established one key exception in that a third party covered by a contract of insurance may enforce the contract even if not themselves a party. However, the common law has resisted finding any other exceptions and the doctrine of privity is firmly entrenched in the common law of Australia.

Nonetheless, there are structures that can be adopted to allow group members to enforce a contract to which they are not a party, or at least to allow the contracting party to enforce the contract on behalf of other group members. Below are some examples:

OPTION	CONCEPT	OPERATION	COMMENTARY
Agency	The contracting party (the **agent**) may enter into the contract as agent for its group members (the **principals**). Where an agent enters into a contract on behalf of a principal, the principal can sue or be sued on the contract as the principal is the true party to the contract with the agent acting merely as an instrument on behalf of the principal. Allowing the principal to sue does not deviate from the privity doctrine.	An agency clause will need be included in the contract stating that one party is entering the contract on its own behalf and as agent for each of its group members. Each group member will need to appoint the contracting entity as its agent and authorise the agent to act on its behalf to affect its rights and duties to the contract counterparty. This will require some form of intra-group agreement.	This option has the benefit of providing legal certainty. However, in practice it can be cumbersome as it requires each group member to appoint the contracting entity as its agent, which may require additional documentation. In addition, the effect is that each group member is in fact a party to the contract and may be exposed to claims under the contract. This needs to be carefully thought through, including in relation to the liability regime under the contract, in order not to create any unintended consequences and inadvertently expose the broader corporate group to additional liability.

OPTION	CONCEPT	OPERATION	COMMENTARY
Trust	The contracting party may hold the benefit of the contract, including the right to sue under the contract, on trust for its group members.	For a contract to create a trust, an express intention to create one must be apparent on the face of the contract, or inferred by the court. It will usually be beneficial to have an express provision to the effect that the contracting entity holds the benefit of the contract on trust for its group members. In such a case, following a breach of the contract, the contracting party as trustee will be entitled to enforce the contract on behalf of its beneficiaries. If the trustee refuses to do so, a third-party beneficiary may, by proceedings in equity against the trustee, compel the trustee to enforce the contract or otherwise the beneficial bring proceedings and join the trustee as defendant. Enforcement will be for the benefit of the beneficiary.	This mechanism will ensure that all group members receive the benefit of the contract. However, it also means that the contracting entity will have fiduciary obligations to the group members (e.g. acting in the best interests of group members and avoiding conflicts between its own interests and the group members' interests, which could for example cause issues in relation to rights of the contracting entity to agree to amendments to the contract). There may also be additional formalities that need to be observed in some jurisdictions for the trust to take effect, including potential application of stamp duty.
Tort	Where a group member suffers economic loss arising out of the negligent performance of a contract entered into by one of its related entities, they may be able to establish a claim under tort law if they are able to establish that: • there was a duty of care • the supplier breached this duty of care • the economic loss suffered was caused by the breach As these claims would be based on a claim in tort rather than contract, the doctrine of privity will not apply.	Where the elements of negligence claim are satisfied, the group member that has suffered economic loss could bring a proceeding against the supplier.	The circumstances in which an action in tort could apply may be more limited compared to agency and trusteeship. This is because the individual group member must establish that a duty of care is owed to it by the supplier, which may not be straightforward if the contract itself doesn't contemplate that the benefit of the supplies made under it being extended to other parties. Generally speaking, it is also more difficult to obtain relief for economic loss compared to instances where negligent conduct results in some personal injury or property damage. While a claim in tort may be made outside of the contract, the terms of the contract will still need to be considered – for example, the contract may require the contracting party to ensure that no direct claims are brought by its group members in relation to the subject matter of the contract, in order to avoid the risk of undermining the liability framework agreed in the contract.
Statute	In Queensland, Western Australia and the Northern Territory, legislation has modified the privity doctrine to allow third party beneficiaries to enforce contractual obligations.[1]	In Queensland and the Northern Territory, if a promisor (who has received valuable consideration from the promisee) promises to do or refrain from doing an act for the benefit of a beneficiary and the beneficiary accepts that promise, then the beneficiary may enforce the contract directly. In Western Australia, where a contract expressly purports to confer a benefit on a third party, the contract is enforceable by that third party in their own name.	In order to rely upon this exception, it will be important to specify the governing law that the contract is to be governed by. In addition, the contract will need to be drafted in a way that satisfies the requirements of the relevant legislation. For example, the Western Australian legislation cannot be relied upon unless the third party is named as a third-party beneficiary or is otherwise identifiable.

[1] *Property Law Act 1974* (Qld), s 55; *Property Law Act 1969* (WA), s 11; *Law of Property Act 2000* (NT), s 56.

WHAT ARE THE IMPLICATIONS FOR YOUR CONTRACT?

If you are entering a contract with the intention of conferring rights on a third party, it is important ensure that the contract is structured in a way that will give effect to that intention. This will require consideration of the various options mentioned above, and careful drafting to ensure that the selected option is implemented appropriately. Supplemental documents (e.g. agency agreements) may also be required to give effect to your chosen structure. Finally, you will need to think carefully about how other provisions in the agreement will work if there are multiple beneficiaries – in particular, you will need to consider how any liability caps and exclusions apply across all beneficiaries, such as whether they apply collectively or to each beneficiary individual.

WHAT IS THE DIFFERENCE BETWEEN FORCE MAJEURE AND FRUSTRATION?

WHEN DOES THIS QUESTION TEND TO ARISE?

In situations where a party to a contract is prevented from performing its contractual obligations by an event beyond their control, the concepts of force majeure and frustration come into play. However, there are key differences in:

- **the legal basis of the concepts;**
- **the situations in which they apply; and**
- **the outcome for each party in these situations.**

These differences should be considered at the outset, during the negotiation and drafting of the contract, so that the parties are aware of how risk will be allocated in the event of an unexpected disruption due to outside forces.

WHAT DOES THE LAW SAY?

Force majeure is a contractual mechanism, rather than a rule of law. For force majeure to apply, there must be a specific force majeure clause in the contract which sets out:

- the situations which amount to force majeure;
- the implications of a party being prevented from performing its contractual obligations due to a force majeure event (as defined in the contract), including the extent to which the affected party will be relieved from its contractual obligations and the steps which the affected party must take to rely on the relief position; and
- the rights that the other party will have if performance of the contract is prevented due to a force majeure event (including rights to terminate if the force majeure continues beyond a specified period, and whether fees will remain payable).

By contrast, frustration is a rule of law, rather than a contractual construct (although its application can be affected by the way that the contract is framed). It results in the automatic termination of a contract, and parties are (generally) required to bear their own losses.

The below table explains further distinctions between force majeure and frustration:

	FORCE MAJEURE	FRUSTRATION
Legal basis	Governed by contract and therefore varies based on drafting. Not separately recognised at common law.	Governed by common law (or statute in some jurisdictions).
Legal test	Performance is prevented by an event beyond the affected party's control (as defined in the contract).	Performance must be impossible.
Which situations?	Parties must specify the situations that will amount to a force majeure event (the term 'force majeure' itself is not a term of art that carries a special pre-defined meaning).	Defined by common law to cover situations fundamentally beyond the parties' contemplation at the time of contracting. For this reason, to the extent the situation is covered by a negotiated force majeure clause, it is unlikely that the doctrine of frustration will have much scope to apply as the parties will have already contemplated the position and agreed on the appropriate treatment via the force majeure clause.
Result	Parties must specify consequences and obligations which follow a force majeure event.	Frustration results in automatic termination of contract.
Allocation of loss	Allocation of loss is defined by the contract. The party affected by the force majeure event will typically be relieved of liability to the extent they are prevented from performing their contractual obligations.	Loss lies where it falls, unless it would be unjust for one party to retain the benefit of the other party's performance.

WHAT ARE THE IMPLICATIONS FOR YOUR CONTRACT?

While similar, force majeure and frustration will apply in different situations and will lead to different results for parties. While negotiating and drafting IT contracts, parties should:

- understand key supply and delivery risks and consider whether any should be addressed under a specific force majeure regime - these could include cybersecurity threats, government directives relating to COVID-19 or other pandemics, and international conflict;
- consider how broadly to draft the scope of force majeure events to which relief applies. Broad drafting is favourable to the party which is more likely to rely on the force majeure clause (typically in an IT contract this will be the supplier, as the supplier will be subject to more performance obligations);
- carefully craft the obligations of each party when a force majeure event occurs (as defined under the contract), including giving consideration to which party should bear the costs of mitigation steps, the interaction with any disaster recovery / business continuity provisions in the contract (which should usually continue to apply irrespective of the position, as they are fundamentally intended to help respond to unexpected interruptions) and the procedural requirements which must be met for a party to rely on the force majeure clause (including notifying the other party);
- consider the interaction of the force majeure clause with the rights of each party to terminate the affected service or the contract as a whole if the force majeure event continues for an extended period – a customer will typically resist the service provider having a right to terminate for the service provider's own continuing force majeure given the customer's reliance on the services being performed; and
- be aware of jurisdictional differences in frustration rules. As a common law concept, the law governing frustration varies between Australian states and internationally. The parties should also be aware that the doctrine of frustration may have limited application where a comprehensive force majeure regime has been negotiated and agreed. In most cases, that will be preferable as it will give the parties greater control over the outcome – where it applies the doctrine of frustration is a relatively blunt instrument, as it results in automatic termination even if that may not be the outcome that the parties most desire.

WHAT IS INDIRECT AND CONSEQUENTIAL LOSS?

WHEN DOES THIS QUESTION TEND TO ARISE?

An important function of many IT contracts is to allocate liability for certain types of loss between the parties. For these purposes, contractual liability provisions commonly distinguish between 'direct' losses and 'indirect' or 'consequential' losses. From a supplier perspective, a typical default position under an IT contract is that the supplier will only be liable for direct losses, and then subject to overarching liability caps and exclusions set out in the contract. Suppliers are generally less willing to accept liability for indirect or consequential losses. The rationale for this position is that anything beyond the direct impact of a breach by the supplier is a business risk that should remain with the customer and not be transferred by contract to the supplier.

To be able to negotiate the allocation of liability for direct vs indirect losses in a meaningful and effective way, it is important to be able to assess the types of losses that will fall into each category in the context of the specific IT contract.

WHAT DOES THE LAW SAY?

The law on indirect and consequential loss in Australia remains unsettled.

The traditional understanding, following an English line of authorities, was based on the rules regarding recovery of damages set out in the famous (at least for lawyers!) case of *Hadley v Baxendale* from 1854. That case established that loss caused by a breach of contract would be recoverable if the loss either:

- arose naturally (i.e. according to the usual course of things) from the breach (the '**first limb**'); or
- could be supposed to have been in the contemplation of both parties, at the time of entering the contract, as the probable result of a breach (the '**second limb**').

The assumption was that everything within the first limb of the *Hadley v Baxendale* test was 'direct' loss, while everything within the second limb was more removed and considered 'indirect' loss.

However, recent case law in Australia has cast doubt on that assumption. For example, in *Environmental Systems Pty Ltd v Peerless Holdings Pty Ltd* [2008] VSCA 26 the Victorian Court of Appeal found that 'consequential loss' referred to loss which is not a 'normal loss' (interpreted as anything beyond the normal measure, such as profits lost, or expenses incurred through breach). This test potentially excludes a broader scope of losses than under the *Hadley v Baxendale* approach (depending on the circumstances). In *Regional Power Corporation v Pacific Hydro Group Two Pty Ltd (No 2)* [2013] WASC 356 the WA Supreme Court indicated that consequential loss exclusion clauses should be interpreted according to their natural and ordinary meaning in light of the contract as a whole and that the words 'consequential' and 'indirect' exclude losses that are more removed when considered in the context of the contract as a whole.

In short, as things stand, the way in which references to 'indirect' or 'consequential' loss within a contract will be interpreted depends on the specific wording and context of the contract in question. In some contracts, references to 'indirect' or 'consequential' loss may be interpreted broadly so as to encompass losses that may traditionally have been assumed to be 'direct' losses - this means that a provision excluding liability for indirect or consequential loss may have a much broader effect than was intended. As a result, parties need to take particular care when drafting and negotiating such exclusions.

WHAT ARE THE IMPLICATIONS FOR YOUR CONTRACT?

Given the uncertainty in the position at law, there are broadly three options for how to deal with defining the scope of indirect and consequential loss in an IT contract (depending on whether you are the supplier or the customer):

1. Simply refer to 'indirect and consequential loss' and leave it to the courts to decide how to interpret those terms in the context of your contract should it ever be necessary to do so. This has the advantage of simplicity, but leaves significant uncertainty as to what the effect of your contract will be.

2. Include a specific definition of 'indirect and consequential loss' based on the traditional *Hadley v Baxendale* understanding (i.e. by defining indirect and consequential loss as any loss other than loss arising naturally, according to the usual course of things, from the relevant breach).

3. Combine either Option 1 or Option 2 with a list of specific categories of loss that should be excluded in all circumstances (even if they are caused directly by a breach). For example, a supplier will typically seek to exclude loss of revenue or profit, loss of business and loss of reputation or goodwill on the basis that these are inherent business risks that should remain with the customer and which the supplier is not in the position to appropriately manage.

   Whether the list of proposed exclusions is acceptable to a customer will depend on the nature of the contract. Exclusions for loss of data (for example) should be carefully considered by a customer depending on the nature of the IT solution being procured. From a customer perspective, it is also important to consider identifying those losses which will not be excluded and expressly setting those out as carve outs to the consequential loss exclusion. For example, the customer may wish to explicitly state that costs incurred in seeking to remedy or mitigate the impact of a breach should not be treated as indirect or consequential loss, and should be recoverable subject to ordinary common law principles.

In all cases, it is important to consider how any exclusion of indirect and consequential loss operates with other liability provisions under the relevant contract. For example, where certain breaches or claims are carved out of general liability caps, it is generally also worth considering whether they should also be carved out of any general exclusion of indirect and consequential loss, so as to allow the maximum recovery of damages permitted under ordinary common law principles.

WHAT ADDITIONAL PROTECTION DOES AN INDEMNITY PROVIDE?

WHEN DOES THIS QUESTION TEND TO ARISE?

Indemnities are often included in IT contracts as a way of allocating liability between the customer and the supplier. Depending on how it is drafted, an indemnity can offer broader protection and certainty to the indemnified party compared to simply relying on a claim for damages under a breach of contract. For example, an indemnity claim may not be limited by principles of causation, remoteness, and mitigation in the same way as a breach of contract claim would. Indemnities may also be used to allocate liability where there would be no underlying breach of contract (i.e. where there would otherwise be no basis to bring a claim to be compensated for loss or damage that has been incurred).

WHAT DOES THE LAW SAY?

An indemnity provision may be characterised in two different ways:

1. As an obligation to prevent loss or to 'hold harmless'

   If construed in this way, if a loss does occur then the indemnity will give rise to a right to claim for damages for a breach of contract. The usual rules for contractual damages would then apply, including as to requirements of causation, remoteness, and mitigation.

2. As an obligation to 'make good' or compensate for loss or harm that is suffered

   If construed in this way, if a loss does occur then the indemnity will give rise to an obligation to pay the amount of that loss. In this case, the indemnity is analogous to a debt claim and is not subject to limiting principles relevant to contractual damages.

The way that a particular indemnity is characterised may depend on the way that it is drafted (see below for drafting tips). If drafted as an obligation to compensate then the indemnity may offer a number of advantages over a breach of contract claim, principally in the form of greater certainty as to the scope of loss that will be recoverable:

	BREACH OF CONTRACT	INDEMNITY
Definition and scope	A breach of contract entitles an innocent party to seek compensation for loss or damage arising from the breach. Contractual damages seek to restore the plaintiff to the same situation as if the contract had been performed.	An indemnity is a contractual promise from one party to compensate another party in respect of a specific type of loss or from loss that arises from a specific trigger event. The scope of the obligation to compensate will depend on how the indemnity is drafted, but may extend to loss that would not be recoverable as contractual damages.
Supporting evidence	The claimant will need to establish that the defendant committed a breach of contract.	The claimant will need to establish that the relevant trigger event has occurred. The trigger event could be a breach of contract, but could also be an event that would not necessarily involve a breach, such as a claim brought by a third party.
Causation	The claimant will need to establish that the loss they are claiming was caused by the breach that has been established.	The claimant will likely need to establish some link between the trigger event and the loss is being claimed. However, depending on how the indemnity is drafted it may be less onerous than the legal standard of causation that will apply for a breach of contract claim.
Remoteness	Loss will only recoverable if it was foreseeable at the time of contract.	Remote losses will be recoverable if within scope of the indemnity, as the ordinary rules relating to recovery of damages will not apply. However, in some circumstances courts may still read limitations into broadly drafted indemnities. For example, in some cases broad indemnities that purported to cover 'all loss' have been read down so as to only apply to losses that were proximate to the trigger event.
Mitigation	The claimant will not be able to recover for loss or damage if they had knowledge of the breach but failed to mitigate the loss.	The claimant may be able to recover under the indemnity even where it has failed to mitigate its loss. However, there may still be some limitations where the claimant has been recklessly indifferent as to the loss – in that case, the loss may be attributed to the failure to take mitigating action rather than to the underlying trigger event. In addition, sometimes the indemnity will be drafted so that it only applies to loss that could not have been avoided by taking mitigating action (effectively incorporating a duty to mitigate as part of the scope of the indemnity).
Limitation period	Six years from the date of the breach.	Six years from the time of loss.

WHAT ARE THE IMPLICATIONS FOR YOUR CONTRACT?

When drafting an indemnity clause, it is important to use express and clear language. The courts will not rewrite a clearly drafted indemnity cause even if it is unfair. However, in a case of ambiguity, the court will usually construe the indemnity in favour of the indemnifier.

An indemnity construed as an obligation to compensate may provide greater protection for the indemnified party than an ordinary claim in damages for a breach of contract. Use of terms such as “reimburse” or “pay” is more likely to support the characterisation of the indemnity provision as an obligation to compensate. In contrast, use of terms, such as “hold harmless” or promising to “indemnify”, is likely to support a characterisation as an obligation to prevent loss. A claim under this type of indemnity will likely be treated much like a claim for damages breach of contract.

A customer under an IT contract may want to push on the inclusion of an indemnity when there are known foreseeable risks to the subject matter of the contract, and the supplier has better control over these risks. For example, if the supplier will contribute materials to a project, then the customer’s position will typically be that the supplier should bear all risk that those materials may infringe a third party’s IP rights as the supplier will be the one creating or sourcing the materials and so will clearly be best placed to control those risks. As such, it is typical in this scenario for the customer to expect the supplier to provide an indemnity against third party IP claims.

The drafting of indemnities needs to be carefully considered, with particular care taken to clearly specify the relevant trigger events, the scope of loss intended to be covered (including whether it should extend to loss incurred by related entities), whether there should be a contractual obligation for the indemnified party to mitigate their loss, and whether any exclusions or limitations of liability that apply under the contract should apply to indemnity claims. When drafting, always consider whether you would be comfortable giving an indemnity in the same terms, as counterparties will often ask that indemnities be reciprocal where there are similar risks to both parties.

WHAT IS PROPORTIONATE LIABILITY?

WHEN DOES THIS QUESTION TEND TO ARISE?

Questions about proportionate liability arise where loss or damage is caused by more than one wrongdoer. Proportionate liability deals with the ways in which liability can be allocated between different defendants who have all contributed to a plaintiff's loss. For example, this may arise in a multi-vendor environment where there are a number of contractors working on the same IT project and the overall outcome of the project is adversely impacted by different failures by different contractors. In this case, laws on proportionate liability will determine what loss and damage the principal is able to recover from each contractor.

WHAT DOES THE LAW SAY?

Traditionally the common law rules of 'solidary' or 'joint and several' liability meant that a party could recover its entire loss from any one concurrent wrongdoer. That wrongdoer could then seek contribution or indemnity from other concurrent wrongdoers who had also contributed to the loss. However, if that was not possible (e.g. because the other wrongdoer is insolvent), then the first wrongdoer would bear the full burden of meeting the overall liability, even if they were only partly responsible. This meant that often plaintiffs would simply pursue the wrongdoer with the 'deepest pockets' who would then bear the recovery risk on all other wrongdoers. This in turn put significant pressure on insurance premiums, particularly for professional services firms that were targeted with negligence claims even in situations where their overall share of responsibility was relatively small, simply because they were well-insured and likely to be able to pay out.

Proportionate liability legislation has been implemented in all Australian jurisdictions to replace the common law doctrines of joint and several liability in relation to claims for economic loss or damage to property, with the aim of more fairly apportioning liability between concurrent wrongdoers. Under this legislation, the liability of each concurrent wrongdoer in relation to an apportionable claim (whether in tort, in contract or otherwise) is limited to the proportion of the relevant loss or damage that the Court considers just, having regard to the extent of their respective responsibility for the loss or damage. In most cases, there are also anti-avoidance provisions to prevent wrongdoers from undermining the proportionate liability regime by requiring other wrongdoers to indemnify them against their share of any claimed loss or damage. Where it applies, the effect of the legislation is that plaintiffs will need to pursue all relevant concurrent wrongdoers in order to fully recover for any loss or damage they have suffered.

In NSW, Tasmania and Western Australia it is possible to 'contract out' of the proportionate liability regime. In Queensland, contracting out is prohibited. In other jurisdictions, the legislation is silent as to whether or not contracting out is permitted – in these cases, while the position is not clear, there is a significant risk that contracting out is not possible as it is arguably inconsistent with the public policy that underlies the proportionate liability regime. In any event, if the parties do contract out of the proportionate liability regime in a jurisdiction where that is permitted, then the effect is to revert to the traditional common law position where one concurrent wrongdoer can be held responsible for the full extent of any loss or damage suffered. Customers will often prefer this position, as it will enable them to hold their head contractor fully responsible for any loss or damage they have suffered, without also having to pursue any subcontractors that may have contributed to that loss or damage – it will then be up to the head contractor to seek appropriate contribution from any subcontractors who were at fault.

It is important to bear in mind that the proportionate liability legislation in each jurisdiction is similar, but different and so you cannot assume that the position is the same in all cases. If you have any particular concerns about how the regime in your jurisdiction works, it is always wise to seek advice.

WHAT ARE THE PRACTICAL IMPLICATIONS FOR YOUR CONTRACT?

If you are entering a contract as a customer with a service provider to work on a project that may involve contributions by others (e.g. separate service providers or subcontractors), then you may wish to expressly contract out of the applicable proportionate liability regime to the extent it is possible to do so. If something goes wrong under the contract, this will maximise your chances of being able to fully recover for any loss or damage that you may suffer as a result (subject of course to any liability caps or exclusions that apply under the contract). Conversely, if you are the service provider you would not want to contract out of any applicable proportionate liability regime, and it would likely be more favourable to simply remain silent on the topic in the contract.

If it is your intention to contract out of the proportionate liability regime, then it is usually preferable to include an express provision to that effect. However, it may be possible to do so in a less direct way, such as by including an indemnity that makes the head contractor liable for loss or damage arising from the acts or omissions of its subcontractors, or by expressly stating that the contract counterparty will be jointly and severally liable for certain conduct that may involve other parties. Noting that the position differs between jurisdictions, you may need to seek advice on whether or not it is possible to contract out of the proportionate liability regime that applies under the relevant governing law of your contract.

WHAT IS THE DIFFERENCE BETWEEN 'REASONABLE ENDEAVOURS' AND 'BEST ENDEAVOURS'?

WHEN DOES THIS QUESTION TEND TO ARISE?

If the achievement of a particular outcome is not entirely within a party's control (e.g. because it may depend on the actions of an independent third party), then that party may naturally be reluctant to accept an absolute contractual obligation to achieve that outcome. In these cases, the party in question may be more comfortable undertaking to use 'reasonable endeavours' or 'best endeavours' (or some similar permutation, such as 'reasonable efforts' or 'best efforts') to achieve that outcome. However, it is not always clear what the difference between these standards is.

WHAT DOES THE LAW SAY?

The words 'best endeavours' and 'reasonable endeavours' are not terms of art and, like all other words used in a contract, must be interpreted in accordance with usual principles of interpretation. That is, the answer depends on what a reasonable person would have understood the words of the contract to mean at the relevant time and in the relevant context in which the contract was entered into.

In practice, the terms 'reasonable endeavours' and 'best endeavours' tend to be given similar meanings, and are both qualified by concepts of reasonableness. For example, in *Electricity Generation Corporation (t/as Verve Energy) v Woodside Energy Ltd* (2014) 251 CLR 540, the High Court said that the nature and extent of an obligation to use 'best endeavours' was necessarily measured by what was reasonable in the circumstances. However, there are certainly shades of meaning and formulations such as 'best endeavours' or 'all reasonable endeavours' do tend to be interpreted as imposing a somewhat higher standard than 'reasonable endeavours'. For example, in New South Wales it has been suggested that 'best endeavours' imposes an obligation to do everything reasonably possible to bring about the contractual objective, while 'reasonable endeavours' only requires a party to take steps a reasonable person in the circumstances would take.

In any case, the Courts have consistently found that an obligation to use 'best endeavours' or 'reasonable endeavours' will not require a party to ignore its own commercial interests. That is, unless there is a clear contractual statement to the contrary, a party will not be required to elevate the other party's interests above its own in order to show that it has reached the 'best endeavours' or 'reasonable endeavours' threshold.

To limit scope for uncertainty, a contract may itself further define the standard of conduct required to discharge a 'best endeavours' or 'reasonable endeavours' obligation. For example, in the Verve Energy v Woodside case mentioned above, the Court emphasised the words of the contract as being paramount, holding that careful consideration will be given to any internal standard of reasonableness set out in the agreement as the clearest indicator of party intentions. For example, in that case, the contractual standard included an express entitlement to consider 'relevant commercial, economic and operational matters'

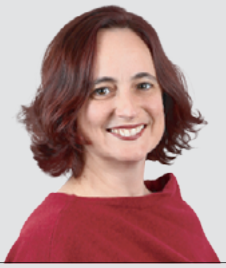
WHAT ARE THE PRACTICAL IMPLICATIONS FOR YOUR CONTRACT?

The main objective of a written contract is to provide the parties with certainty as to the bargain they are entering into. To provide absolute certainty, every aspect of the contract, and the respective obligations of each party, would be tightly and prescriptively defined. However, that is not always practical or even possible. Concepts such as 'reasonable endeavours' and 'best endeavours' are commonly used to bridge the gap and provide an appropriate degree of flexibility. To ensure that the use of such concepts does not create too much uncertainty, you should consider:

1. Including a specific interpretive provision in your contract to explain in more detail what will be required, or what will **not** be required, to satisfy the 'best endeavours' or 'reasonable endeavours' standard – for example, you could expressly state that in order to satisfy the relevant standard it will not be necessary for a party to pay money or provide any financial benefit to a third party, to enter into any contract or provide any undertaking that it considers to be detrimental to its interests, or to commence any legal action or proceeding.

2. Ensuring that the concepts are used consistently throughout your contract – if in some instances a contract uses 'best endeavours' while in others it uses 'reasonable endeavours' it will be hard to argue that the concepts were intended to have the same meaning, and the Courts will be more likely to interpret 'best endeavours' as imposing a different and higher standard.

KEY CONTACTS



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