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Editors: Lindsay Lau and Claire MacMillan

Painting a clearer picture: Enforceability of agreements to negotiate in good faith

The enforceability and validity of contractual clauses requiring parties to 'negotiate in good faith' has long been a vague area of Australian contract law. This is largely the result of ambiguity in contractual clauses, problems of contractual interpretation, the factual matrix, and contentions as to the object, scope and purpose of the original agreement. A recent decision of the New South Wales Court of Appeal in *United Group Rail Services Limited v Rail Corporation New South Wales* [2009] NSWCA 177 (3 July 2009) has clarified the Australian position and provides practical guidance as to the meaning and enforceability of "good faith clauses".

Facts

- The case involved an engineering contract between United Rail Group Services Ltd (United) and Rail Corporation New South Wales (Railcorp) for the design and construction of rail infrastructure.

- The dispute concerned the content and operation of a detailed dispute resolution clause which required both parties to send a senior representative to "*meet and undertake genuine and good faith negotiations with a view to resolving the dispute or difference*". The clause expressly contemplated negotiation as a part of the contract's dispute resolution mechanism, and that if representatives failed to resolve the dispute within 14 days, recourse would later be made to arbitration.
- United challenged the validity of this dispute resolution clause on the basis that it lacked certainty and was thus void and unenforceable.
- The court dismissed United's appeal, holding that the clause contained an express mutual promise by both parties to undertake "genuine and good faith negotiations" to resolve disputes arising under the rights and obligations of the contract.

*Painting a clearer picture:
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(continued)*

Effect of agreement to negotiate in good faith

The realities of commercial practice necessitate that negotiation is a self-interested activity. Interestingly, the NSWCA recognised that a contractual obligation to negotiate in good faith is not incompatible with commercial self-interest, nor does it require that one party must act in the interests of the other contracting party. The court noted that the composite phrase “genuine and good faith” involved an *“honest and genuine commitment to the [existing] bargain...and to the process of negotiation for the designated purpose”*. The decision also identified the following useful examples where a party may not be seen as acting in good faith:

- Threatening a breach of contract in order to bargain for a lower settlement sum than it genuinely recognises as due, and
- Pretending to negotiate, having decided not to settle what is recognised to be a good claim, in order to drive the other party into expensive arbitration that it believes the other party cannot afford.

“genuine and good faith” involved an “honest and genuine commitment to the [existing] bargain...and to the process of negotiation for the designated purpose”

What are the practical implications?

- **Drafting:** Many commercial contracts contain language similar to a good faith negotiation clause as a basis for dispute resolution, yet the parties to the contract may not intend that language to be enforceable. Following *United v Railcorp*, good faith negotiation clauses will be held to be enforceable and given certainty.
- **Interpretation:** When interpreting a clause in a commercial contract, the court will give commercial efficacy to its terms, having regard to the context and framework of the contract as a whole. The court emphasised the unsuitability of “sweeping generalised rules” of contractual interpretation, noting instead that “certainty and content of a contract will depend on its specific terms and context”.
- **“Genuine and good faith negotiation”:** Commercial dispute resolution clauses requiring parties to “negotiate in good faith” are to be construed as meaning an “honest and genuine approach to settling a contractual dispute, giving fidelity to the existing bargain”. *United v Railcorp* is likely to have broad application to the interpretation of dispute resolution clauses in commercial contracts.

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*Painting a clearer picture:
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- **Ask:** does the "good faith" clause contain express constraints on your conduct? A dispute resolution clause should contain express obligations to negotiate in good faith. This will enhance its certainty, validity and enforceability. For example, this may include the requirement that negotiations are be conducted by senior representatives; the imposition of a time constraint; or recourse to arbitration as a final resort. Without such constraints, a good faith negotiation clause risks being so vague as to be unenforceable.
- **Recognition of modern commercial reality:** The negotiation of contractual disputes will ordinarily be conducted in accordance with commercial self-interest. This does not preclude the existence of genuine and good faith negotiations between contracting parties.

¹ The Honourable Chris Bowen, Assistant Treasurer and Minister for Competition Policy and Consumer Affairs 3 December 2007 — 8 June 2009, "The National Unfair Contract Terms Law" (Press Release No 060, 5 June 2009)

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Unfair contract terms – national consumer law

The Trade Practices Amendment (Australian Consumer Law) Bill 2009 (Bill) containing the proposed new unfair contract terms law was introduced into Parliament in June 2009. When enacted, the Bill will bring about some significant changes to the way in which businesses approach standard form consumer contracts, and will also affect enforcement of contract terms that are deemed by the new law to be unfair.

The Government has explained that

"[it] is committed to ensuring that consumers and small businesses can access protection from unfair contract terms".¹

What is the proposed unfair contracts law?

Broadly speaking, the unfair contract terms law will:

- apply to any standard form contract where there is no negotiation as to the terms of a contract (i.e: a contract that is presented on a "take it or leave it" basis).
- void an unfair contract term.
- expose a supplier to liability for one of the new remedies included in the Bill.

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Unfair contract terms – national consumer law (continued)

What is an unfair term in a contract?

An unfair term is a term in a standard form consumer contract that:

- causes a significant imbalance in the parties rights and obligations under the contract, and
- is not reasonably necessary to protect the legitimate business interests of the supplier.

The Bill provides some examples of terms that are likely to be unfair under the unfair contract terms provisions, including terms that:

- allow a supplier to unilaterally vary a contract
- prevent a consumer from cancelling a contract
- require payment even if a service is not provided by a supplier
- exclude liability from harm resulting from a supplier's actions
- allow a supplier to unilaterally vary its performance
- limit one party's rights to bring proceedings against the other party

Who will the law apply to?

The unfair contracts law will apply to standard form consumer contracts. In other words:

- contracts for supply of goods or services to an individual wholly or predominantly for personal, domestic or household use.

- contracts for financial products, or for the supply or possible supply of financial services wholly or predominantly for personal, domestic or household use.

Significantly, the new unfair contracts terms provisions will not apply to some specified terms of a contract:

- terms that contain the main subject matter of a contract,
- terms that set the price payable under the contract, and
- terms that are required or expressly permitted by a law of the Commonwealth, a State or Territory

Business to business contracts are, for the time being, outside the scope of the new law, as are shipping contracts, and contracts that establish a company constitution, a managed investment scheme or other body.

What will happen if my standard form contract includes unfair terms?

The unfair contract terms law will also introduce some new penalties and enforcement powers for Australian Securities and Investments Commission (ASIC) and the Australian Competition and Consumer Commission (ACCC), as well as options for consumer redress in relation to consumer protection laws.²

² Commonwealth, *Parliamentary Debates*, House of Representatives, 24 June 2009, 6981 (Craig Emerson, MP)

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These reforms are very significant, and include giving Courts new enforcement powers allowing a Court to:

- impose a civil penalty on an individual or a corporation. The maximum penalty will be \$1.1 million for a corporation and \$220,000 for an individual.
- make disqualification orders prohibiting a person from managing a corporation or participating in the management of a corporation.
- make orders against a company requiring it to redress loss or damage suffered by third parties or consumers. For example, order that a supplier provide a refund, vary a contract, make repairs or honour representations made by it to consumers.

Both ASIC and the ACCC will have new powers including the power to:

- issue a notice which requires a supplier to provide substantiation for a representation made by the supplier in relation to the supply of goods or services,
- issue infringement notices imposing fines of up to \$6,600 for a company and \$1,320 for an individual,
- issue a public warning notice in relation to certain conduct if a supplier does not comply with a substantiation notice.

What do I do?

Given the serious penalties that may apply in the event that the unfair contract terms provisions are breached, it would be prudent to review any standard form consumer contracts, and any compliance procedures that may be affected by the Bill.

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COAG audit: Directors exposure to criminal liability

Creditors voted on 24 August 2009 to liquidate the failed investment group Babcock & Brown (B&B). The vote followed a recommendation made by Deloitte, B&B's voluntary administrator, to place the company into liquidation. Some serious questions have been raised by Deloitte as to the conduct of B&B's directors.

Questions raised about B&B's directors' conduct serve as a timely reminder of the significance of director's duties and the potential exposure to personal civil and criminal liability that accompanies a breach of those duties, particularly given the Federal Government audit of laws imposing criminal liability on directors, due to take place this year.

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COAG audit: Directors exposure to criminal liability (continued)

A quick lesson — B&B

At its peak in 2007, B&B had a share price around the \$34 mark, market capitalisation of \$10 billion, and assets under management of \$70 billion around the world. However, by December 2008, the share price had taken a dive to about \$0.14 and B&B shares were suspended from trading in January 2009. In March this year the company was placed into voluntary administration.

Having sailed to such extraordinary heights, only to come crashing to such an extraordinary low, Deloitte is asking some very serious questions about decisions made by the company's directors. In particular, Deloitte is investigating:

- whether there were any conflicts of interest between B&B's directors and B&B International.
- having found B&B was insolvent in November 2008, whether B&B traded whilst insolvent.
- what consideration B&B's directors gave to the interests of noteholder's and creditors when making business decisions.

Mr David Lombe, Deloitte liquidator is reported as saying

"Liquidation will allow us to investigate the matter in great depth, conduct public examinations and, as a liquidator, receive increased powers to commence recovery actions".³

If B&B's directors are found to have breached their duties, or to have breached certain laws, they are likely to be exposed to both criminal and civil liability in respect of those breaches.

Personal liability imposed on directors

Currently, there are over 600 state and territory laws that hold directors personally liable for corporate breaches.⁴ These range from liability under the Corporations Act 2001 (Cth) to new provisions of the Trade Practices Act 1974 (Cth) that allow a Court to send a director who is involved in serious cartel conduct (such as tender fixing or price fixing) to jail.⁵

Obviously, the intention of laws imposing personal liability is to act as a deterrent to individuals. However, some questions have been raised as to the effectiveness of those laws. There is a suggestion that the extent and breadth of laws imposing personal liability on directors acts to deter potential company directors from taking on a directorship or remaining a director. The Federal Treasury conducted a survey of top 200 listed companies in December 2008 and determined that more than 71% of those interviewed had turned down an offer to join a board because of the risk of personal liability.⁶

³ Scott Murdoch, "Liquidator to probe B&B directors", The Australian, 25 August 2009

⁴ Australian Institute of Company Directors, "AICD welcomes Commonwealth Review of Directors Liability" (Media & Communications: Media

⁵ Corporations and Markets Advisory Committee, "Personal liability for corporate fault," September 2006

⁶ Corporations and Markets Advisory Committee, "Personal liability for corporate fault," September 2006

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COAG audit: Directors exposure to criminal liability (continued)

- 7 Australian Institute of Company Directors, "AICD welcomes Commonwealth Review of Directors Liability" (Media & Communications: Media Release 17 April 2009)
- 8 Senator The Honourable Nick Sherry, Minister for Superannuation and Corporate Law, 3 December 2007 – 8 June 2009, "Commonwealth to Conduct Audit of Laws Impacting on Directors' Liability" (Press Release No 034, 17 April 2009)
- 9 Australian Institute of Company Directors, "AICD welcomes Commonwealth Review of Directors Liability" (Media & Communications: Media Release 17 April 2009)
- 10 The 'designated officer' approach is to impose statutory responsibility on at least one individual in a company to guarantee compliance with the statute and ensure that relevant remedial steps are taken by the company; Corporations and Markets Advisory Committee, "Personal liability for corporate fault," September 2006
- 11 The 'modified accessorial' or extended liability approach subjects corporate personnel, in exceptional circumstances, to liability for corporate misconduct and extends beyond the principles of ordinary accessorial liability. CAMAC suggests three criteria for assessing extended liability – practicality and fairness, suitability and enforceability. These criteria balance the liability of directors against the size of the company, the level of control of day to day activities and adequate defences for directors with service of the public interest in prosecuting directors; Corporations and Markets Advisory Committee, "Personal liability for corporate fault," September 2006
- 12 Senator The Honourable Nick Sherry, Minister for Superannuation and Corporate Law, 3 December 2007 – 8 June 2009, "Commonwealth to Conduct Audit of Laws Impacting on Directors' Liability" (Press Release No 034, 17 April 2009)

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Does the threat of personal liability ensure that we have the best people leading companies?

The Australian Institute of Company Directors (AICD) argues that:

- provisions imposing criminal liability on company directors are objectionable and unfairly discriminate against directors.
- the laws as they currently stand have a negative affect on board recruitment, retention and decision-making.

The AICD is pushing for legislative reform that will result in consistent and reasonable laws that make clear directors' roles and responsibilities, as well as any defences available to directors.⁷

Audit

The Council for Australian Governments (COAG) will conduct an audit of laws imposing liability on directors with an aim of developing nationally consistent regulation of directors' liability.⁸ At this stage, the audit will only extend to those laws that impose criminal liability on directors. It is understood that the AICD will push for an audit of laws imposing civil liability on directors in the future.⁹

Potential for change

The COAG audit will be conducted in light of the following set of principles, developed by COAG:

- 1) where companies contravene statutory requirements, liability should be imposed in the first instance on the company itself;
- 2) personal criminal liability of a corporate officer for the misconduct of the corporation should generally be limited to situations where the officer encourages or assists the commission of the offence (accessorial liability); and
- 3) in exceptional circumstances, where there is a public policy need to go beyond the ordinary principles of accessorial liability, a form of deemed liability could be imposed on a corporate officer only using a 'designated officer'¹⁰ approach (for minor offences) or a 'modified accessorial' approach¹¹ (for more serious offences).¹²
- 4) The desired final outcome of the audit is a nationally consistent set of laws regulating personal liability of directors such that there is a positive affect on board recruitment, retention and decision-making.

We will provide a full report of the audit findings once the Government releases the results.

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Ritualism and Divine Rites



CBP is currently holding its fourth art exhibition in the firm's reception area. The "Ritualism and Divine Rites" exhibition is a photographic exhibition by Sydney based photographer Tamara Dean.

Tamara, a photographic journalist with the Sydney Morning Herald was Highly Commended in this year's "Moran Contemporary Photographic Prize", with "The Bride", one of her photographs from the current exhibition on display at CBP.

This exhibition is a study in feminine beauty as Dean is concerned with a sense of womanhood much ignored in Australian art.

Tamara is represented by Agence VU in Europe, Redux Pictures in America and in Australia by Charles Hewitt Gallery. She has shown at the Art Gallery of NSW, the Australian Centre for Photography, Stills South Gallery and Customs House. Her work is held by the Australian Centre for Photography, the State Library of NSW and various private collections. The Ritualism exhibition was recently on display at Charles Hewitt Gallery in Darlinghurst.

The CDR Team gets creative

The CDR team recently explored its creative side at artêscape in St Leonards. The team, led by our fearless leader Antony Riordan was decked out head to toe in painting coveralls — booties, overalls, gloves and goggles. Individual masterpieces were created in addition to two team canvasses all without the aid of paint brushes. We bonded whilst using alternative painting devices ranging from kitchen implements to toilet brushes to barbie dolls! The two team works of art (Exhibit A and B) hang in our office on level 43.

Exhibit A



Exhibit B



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Q&A with David Miller



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Q: What is your role at CBP?

A: I am a Partner in both the Insurance Group and the Commercial Dispute Resolution Group.

Q: That must mean a varied practice. What sort of matters do you work on?

A: With my feet in both "camps" I get to advise on a number of interesting matters dealing with Trade Practices Act issues and commercial and public liability disputes. Most recently I have been advising clients in relation to complying with

the National Greenhouse and Emissions Reporting Act 2007 and the impact it will have on not only a range of contractual arrangements but for CEOs who fail to comply. There has been so much recent media attention on the Act and the much debated draft Carbon Pollution Reduction Scheme legislation; it is great to be at the forefront of discussions with clients about the impact of regulation reform in Australia.

Q: Where were you working before CBP?

A: Prior to joining CBP, I was Legal Counsel for a major Australian industrial company.

Q: On a Sunday I like to...

A: Spend time with my children, Kate (7), Archie (5) and James (3).

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