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RENARD CONSTRUCTIONS (ME) PTY LTD V MINISTER FOR PUBLIC WORKS

Court of Appeal: Priestley JA, Meagher JA and Handley JA
19, 20 June, 30 October, 25 November 1991; 12 March 1992

Contracts -- Building and engineering contracts -- Construction and interpretation -- Power to cancel or vary -- Notice to contractor to show cause -- Whether power to be exercised reasonably or merely honestly -- Whether terms to be implied -- General Conditions of Contract NPWC Ed 3 (1981), cl 44.1.

Contracts -- Construction and interpretation -- Implied terms -- Ad hoc implied terms -- Terms implied by law -- Relevance of good faith and fair dealing -- Discussion of.

Contracts -- Building and engineering contracts -- Remuneration -- Recovery of quantum meruit -- Not subject to ceiling.

Arbitration -- Construction of reference -- Effect of wide arbitration clause -- Decision of proprietor to cancel contract -- Whether arbitration "appeal" -- -- General Conditions of Contract NPWC Ed 3 (1981), cl 44.1.

The General Conditions of Contract NPWC Ed 3 (1981), cl 44.1, provided for a procedure to be followed on default of a contractor:

> "if the contractor defaults in the performance or observance of any covenant, condition or stipulation in the Contract or refuses or neglects to comply with any direction as defined in clause 23 but being one which either the principal or the Superintendent is empowered to give, make, issue or serve under the Contract and which is issued or given to or served or made upon the contractor by the principal in writing or by the Superintendent in accordance with clause 23, the principal may suspend payment under the Contract and may call upon the contractor, by notice in writing, to show cause within a period specified in the notice why the powers hereinafter contained in this clause should not be exercised."

The clause conferred power to take over the whole or any part of the work or to cancel the contract.

Held: (1) (By Priestley JA and Handley JA) The powers conferred on the principal under cl 44.1 were to be exercised reasonably:

(By Priestley JA) Clause 44.1 was to be construed as containing ad hoc implied terms and terms implied by law that the principal would give reasonable consideration to both the question of failure to show cause against the exercise of the power and whether one or more of the powers should be exercised. (257C-263D, 279C)

> *Meehan v Jones* (1982) 149 CLR 571, *Progress & Properties (Strathfield) Pty Ltd v Crumblin* (1984) 3 BPR 9496 and *Castlemaine Tooheys Ltd v Carlton & United Breweries Ltd* (1987) 10 NSWLR 468, considered.

Discussion (By Priestley JA) of "good faith" (263G-268G) and equitable interference in the exercise of legal rights (268G-270B) relative to considerations of reasonableness.

(By Handley JA) Clause 44.1 should be construed as requiring the principal

to act reasonably as well as honestly in forming the opinion that the contractor had failed to show cause to his satisfaction and thereafter in deciding whether or not to exercise the powers conferred; this derived from the ordinary implication of reasonableness, the provision for the contractor to be given an opportunity to show cause against the exercise of the power and the provision enabling disputes to be referred to arbitration. (279C-280F)

> *Amann Aviation Pty Ltd v Commonwealth of Australia* (1990) 22 FCR 527 at 532, 542-544; 92 ALR 601 at 607, 606-618 and *The Commonwealth v Amann Aviation Pty Ltd* (1991) 66 ALJR 123; 104 ALR 1, applied.

(By Handley JA, and semble Priestley JA) An arbitration under a wide arbitration clause provided for an "appeal" against the proprietor's decision to exercise a power such as that conferred by cl 44.1.

(Per Meagher JA) The powers conferred by cl 44.1 may be exercised by the principal in his own interests provided he understands what he is doing. (275E-276E)

(2) A quantum meruit claim by a contractor is not subject to any ceiling to be

derived from the terms of the contract under which it is claimed. (271F, 276E-278B, 283B)

Note:

A Digest -- CONTRACTS (3rd ed) [259], [271], [105]; BUILDING AND ENGINEERING CONTRACTS (2nd ed) [3], [14]; ARBITRATION (3rd ed) [7]

CASES CITED

The following cases are cited in the judgment:
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Armstrong v State of Victoria [No 2] (1957) 99 CLR 28.
BP Refinery (Westernport) Pty Ltd v Hastings Shire Council (1977) 52 ALJR 20; 16 ALR 363.
Boomer v Muir 24 P (2d) 570 (1933).
Brodie v Cardiff Corporation [1919] AC 337.
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Codelfa Construction Pty Ltd v State Rail Authority of New South Wales (1982) 149 CLR 337.
Commonwealth, The Amann Aviation Pty Ltd (1991) 66 ALJR 123; 104 ALR 1.
Docker v Hyams [1969] 1 WLR 1060; [1969] 3 All ER 808.
East Ham Corporation v Bernard Sunley & Sons Ltd [1966] AC 406.
Godfrey Constructions Pty Ltd v Kanangra Park Pty Ltd (1972) 128 CLR 529.
Gullett v Gardner (1948) 22 ALJ 151.
Harris v Byerley [1918] QSR 177; affirmed (1918) 25 CLR 55.
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Hohenzollern Agt Fur Locomotivban and City of London Contract Corporation, Re (1886) 54 LT 596.
Hospital Products Ltd v United States Surgical Corporation (1984) 156 CLR 41.
Hughes Bros Pty Ltd v Trustees of the Roman Catholic Church for the Archdiocese of Sydney (Giles J, 21 September 1989, unreported).
Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd [1989] QB 433.
Jennings Construction Ltd v Q H & M Birt Pty Ltd (Cole J, 16 December 1988, unreported).
John Grant and Sons Ltd v Trocadero Building and Investment Co Ltd (1938) 60 CLR 1.
Johnson v Agnew [1980] AC 367.

KBH Constructions Pty Ltd v PSD Development Corporation Pty Ltd (1990) 21 NSWLR 348.
Kirsch v H P Brady Pty Ltd (1937) 58 CLR 36.
Lodder v Slowey [1904] AC 442.
McDonald v Dennys Lascelles Ltd (1933) 48 CLR 457.
Meehan v Jones (1982) 149 CLR 571.
Mellish v Motteux (1792) Peake 115; 170 ER 113.
Minister Trust Ltd v Traps Tractors Ltd [1954] 1 WLR 963; [1954] 3 All ER 136.
Mitchell and Brassey, Re an Arbitration Between [1939] VLR 371.
Montgomery's Estate, Re 6 NE (2d) 40 (1936).
Neale v Richardson [1938] 1 All ER 753.
P & M Kaye Ltd v Hosier & Dickinson Ltd [1972] 1 WLR 146; [1972] 1 All ER 121.
Pavey & Matthews Pty Ltd v Paul (1987) 162 CLR 221.
Pierce Bell Sales Pty Ltd v Frazer (1973) 130 CLR 575.
Piggott v Townsend (1926) 27 SR (NSW) 25; 44 WN (NSW) 26.
Prestige & Co Ltd v Brettell [1938] 4 All ER 346.
Progress & Properties (Strathfield) Pty Ltd v Crumblin (1984) 3 BPR 9496.
Public Works, Minister for v Renard Constructions (ME) Pty Ltd (Cole J, 26 October 1989, unreported).
Public Works, Minister for v Renard Constructions (ME) Pty Ltd (No 1) (Brownie J, 15 February 1989, unreported).
Rover International Ltd v Cannon Film Sales Ltd [1989] 1 WLR 912; [1989] 3 All ER 423.
Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd (1979) 144 CLR 596.
Slowey v Lodder (1901) 20 NZLR 321.
Stadhard v Lee (1863) 3 B & S 364; 122 ER 138.
Suttor v Gundowda Pty Ltd (1950) 81 CLR 418.
United States v Zara Contracting Co 146 F 2d 606 (1944).
United States Surgical Corporation v Hospital Products International Pty Ltd [1983] 2 NSWLR 157.
Wigand v Bachmann-Bechtel Brewing Co 118 NE 618 (1918).

The following additional cases were cited in argument and submissions:
Aboriginal Affairs, Minister for v Peko-Wallsend Ltd (1986) 162 CLR 24.
Amann Aviation Pty Ltd v The Commonwealth (1988) 80 ALR 35.
Australian Broadcasting Commission v Australian Performing Right Association Ltd (1973) 129 CLR 99.
Blackpool and Fylde Aero Club Ltd v Blackpool Borough Council [1990] 1 WLR 1195; [1990] 3 All ER 25.

Bolot v Capper (1957) 75 WN (NSW) 316.
Braunstein v Accidental Death Insurance Co (1861) 1 B & S 782; 121 ER 904.
Brooks Robinson Pty Ltd v Rothfield [1951] VLR 405.
Comco Constructions Pty Ltd v Westminster Properties Pty Ltd (1990) 2 WAR 335.
Commonwealth, The v Tasmania (1983) 158 CLR 1.
Cutter v Powell (1795) 6 Tr 320; 101 ER 573.
DTR Nominees Pty Ltd v Mona Homes Pty Ltd (1978) 138 CLR 423.
Financings Ltd v Baldock [1963] 2 QB 104.
Freedom v AHR Constructions Pty Ltd [1987] 1 Qd R 59.
Heimann v Commonwealth of Australia (1938) 38 SR (NSW) 691; 55 WN (NSW) 235.
Horton v Jones (1935) 53 CLR 475.
Jennings Construction Ltd v Q H & M Birt Pty Ltd (Court of Appeal, 31 January 1989, unreported).
Main Roads, Commissioner for v Leighton Contractors Pty Ltd (Smart J, 4 July 1986, unreported).

Manfal Pty Ltd v Longuet (1986) 8 IPR 410; 3 BCL 105.
Najjar v Haines (1990) 7 BCL 145.
National Australia Bank Ltd v Sproule (1989) 17 NSWLR 505.
Nepean District Tennis Association Inc v Penrith City Council (1988) 66 LGRA 440.
O'Dwyer v Smith 77 NYS 88 (1902).
Parsons v Sexton (1847) 4 CB 899; 136 ER 763.
Petelin v Deger Investments Pty Ltd (1976) 133 CLR 538.
Petraco (Bermuda) Ltd v Petromed International SA [1988] 1 WLR 896; [1988] 3 All ER 454.
Roberts v Bury Improvement Commissioners (1870) LR 5 CP 310.
Shepherd v Felt and Textiles of Australia Ltd (1931) 45 CLR 359.
Smith v Sadler (1880) 6 VLR (L) 5.
Stern v McArthur (1988) 165 CLR 489.
Stevenson v Hook (1956) 73 WN (NSW) 307.
Summers v The Commonwealth (1918) 25 CLR 144.
Sunbird Plaza Pty Ltd v Maloney (1988) 166 CLR 245.
Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd [1986] AC 80.
Update Constructions Pty Ltd v Rozelle Child Care Centre Ltd (1990) 20 NSWLR 251.
White and Carter (Councils) Ltd v McGregor [1962] AC 413.
Woodar Investment Development Ltd v Wimpey Construction UK Ltd [1980] 1 WLR 277; [1980] 1 All ER 571.

APPEAL

This was an appeal and a cross-appeal from a decision of Cole J in the Commercial Division in which he granted leave to appeal from an award of

an arbitrator for errors of law.

B W Walker and *M Christie*, for the appellant.

G T W Miller QC and *J R Wilson*, for the respondent.

Cur adv vult

12 March 1992

I. Introduction:

PRIESTLEY JA. This appeal is the latest step in proceedings which began as an arbitration between a principal (the Minister for Public Works) and a contractor (Renard Constructions (ME) Pty Ltd). The arbitrator made an award in favour of the contractor.

Cole J granted leave to appeal to the principal under s 38 of the *Commercial Arbitration Act* 1984 on certain questions of law. Cole J's decision on the appeal was that the arbitrator's award should be set aside, and the matter remitted to him to enter an award in favour of the principal: see*Minister for Public Works v Renard Constructions (ME) Pty Ltd* (Cole J, 26 October 1989, unreported).

The contractor then applied to this Court for leave to appeal against Cole J's orders. Leave was granted, the appeal later argued and the Court reserved judgment.

In considering the matters argued, members of the Court looked more closely at what had happened before the arbitrator than there had been opportunity to do during the oral argument. This was done in an effort to

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understand why the arbitrator did not appear to have dealt with the question upon which he was reversed by Cole J. A reading of the transcript made it seem possible that this had happened because the arbitrator had not in fact been asked to deal with that question. If this were so, real problems, not argued before the Court, would need to be considered, possibly before embarking on the questions which the parties had asked the Court to decide. To explain how this came about, and then to describe the step taken by this Court after the initial oral argument I will set out in some detail what happened in the various stages of the proceedings.

II. The arbitration:

Events leading to the arbitration. The contractor entered into two contracts at about the same time in 1985 with the principal. The one with which this appeal is concerned was contract No 85231 (CN 85231); the other was contract No 85311 (CN 85311). Both were for the construction of pumping stations, parts of a sewerage project in the Gosford/Wyong area. In each case the general conditions of contract were in a form known as NPWC Edition 3 (1987). The construction of the required works under the contracts went ahead at the same time. Employees of the contractor worked on both contracts, moving from site to site as required.

CN 85231 was a schedule of rates contract with an estimated final value of $208,950. At first, "time for practical completion" was 17 January 1986. Liquidated damages were fixed at $1,000 per week.

After the contractor commenced work, extensions of time were asked for and partly granted. The time for practical completion was extended to 3 March 1986.

On 28 February 1986, the contractor applied for a further extension of time.

On 4 March 1986, the principal gave notice to the contractor under subcl 44.1 of the contract calling upon it to show cause before 5 pm on 18 March 1986 why the principal should not take over the work or cancel the contract. On 17 March 1986, the contractor, in showing cause, stated inter alia that the principal had not yet supplied materials which under the contract it was required to supply; subject to certain qualifications the contractor expected the work would be complete by the end of April 1986.

On 26 March 1986, after discussions between representatives of the contractor and the principal, the contractor was instructed, inter alia, to proceed to complete the work at a rate and in a manner considered satisfactory to the superintendent (Mr Bagust), appointed under the contract.

By letter dated 2 April 1986, the principal granted an extension taking the extended date for practical completion to 7 March 1986. The principal had not at 2 April yet supplied all the materials it was required to supply under the contract.

Mr Hall, the principal's assistant project manager, Gosford/Wyong, was concerned by what he considered the delay and poor workmanship of the

contractor in regard to both contracts. On 15 May 1986, he recommended to Mr Bagust that the contractor be called upon to show cause under subcl 44.1, in respect of both contracts. On 20 May 1986, Mr Bagust acted accordingly, causing notices to be served calling upon the contractor to show cause before 5 pm on 26 May 1986 at the office of the principal why the

principal should not proceed either to take over the whole of the work remaining to be completed, pursuant to subcl 44.1(a), or cancel the contract, pursuant to subcl 44.1(b).

Subclause 44.1 was in the following form:

> **"Procedure on Default of Contractor**
>
> If the Contractor defaults in the performance or observance of any covenant, condition or stipulation in the Contract or refuses or neglects to comply with any direction as defined in clause 23 but being one which either the principal or the Superintendent is empowered to give, make, issue or serve under the Contract and which is issued or given to or served or made upon the Contractor by the principal in writing or by the Superintendent in accordance with clause 23, the Principal may suspend payment under the Contract and may call upon the Contractor, by notice in writing, to show cause within a period specified in the notice why the powers hereinafter contained in this clause should not be exercised.
>
> The notice in writing shall state that it is a notice under the provisions of this clause and shall specify the default, refusal or neglect on the part of the Contractor upon which it is based.
>
> If the Contractor fails within the period specified in the notice in writing to show cause to the satisfaction of the principal why the powers hereinafter contained should not be exercised the principal, without prejudice to any other rights that he may have under the Contract against the Contractor, may --
>
> (a) take over the whole or any part of the work remaining to be completed and for that purpose and in so far as it may be necessary exclude from the site the Contractor and any other person concerned in the performance of the work under the Contract; or
> (b) cancel the Contract, and in that case exercise any of the powers of exclusion conferred by sub-paragraph (a) of this paragraph.
>
> If the contractor notifies the Superintendent in writing that he is unable or unwilling to complete the Works, or to remedy the default,

> refusal or neglect stated in the notice in writing referred to in the first paragraph of this sub-clause, the principal may act in accordance with the provisions of sub-paragraph (a) or sub-paragraph (b) of the last preceding paragraph, as he thinks fit."

On 26 May 1986, the Contractor delivered a letter which said, in regard to CN 85231, inter alia: it was willing and able to complete the contract within a reasonable time; it had twenty employees ten hours a day, six and in some cases seven days a week; it considered the action contemplated would be repudiation of contract and said that it would claim for payment on a quantum meruit basis for work carried out if the principal took the threatened action; it preferred to be left alone to complete the works. The reference to the number of employees was to those employed under both contracts. In the circumstances there can be little doubt that the relevant officers of the principal understood this.

On 27 May 1986, Mr Hall informed Mr Bagust of certain matters concerning the contract but did not give him a complete picture of the extent

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of the work which had been done in the days following the service of the notice to show cause; also, his advice was given on the footing that the extended date for practical completion was 7 March 1986. Mr Hall recommended cancellation of both contracts.

Mr Bagust in turn prepared a recommendation for Mr Connor. He was the officer, senior to the superintendent, who had an appropriate delegation of authority from the Minister to make final decisions to terminate contracts and sign the appropriate notices.

Mr Connor, in considering Mr Bagust's recommendation was not aware of the bearing that the non-supply, until mid-April 1986, of parts required to be supplied to the contractor by the principal would necessarily have upon the extended date for practical completion nor was he aware that since the service of the notices to show cause the contractor had increased the work force, was working longer hours and had brought in a new, highly experienced foreman.

Mr Connor signed notice to the contractor dated 29 May 1986 stating that the principal took over the whole of the work remaining to be completed and excluding the contractor from the sites. The notice concerning CN 85231 was apparently served on the contractor on 30 May 1986. Later that day the contractor vacated the site.

In regard to each contract the contractor treated the action by the principal as a wrongful repudiation of the contract, advised that it accepted the repudiation, itself then asserted that it rescinded the contract, and then began arbitration proceedings under cl 45 of the contract.

Arbitration of CN 85311 and appeal. The arbitration CN 85311 went ahead first. The arbitrator published an award in favour of the contractor on 10 September 1987. Smart J granted leave to appeal. The appeal was heard by Brownie J, who delivered judgment on 12 February 1989. (I will call this unreported decision *Renard No 1 (Minister for Public Works v Renard Constructions (ME) Pty Ltd (No 1)* (Brownie J, 15 February 1989, unreported).) In his reason Brownie J considered a number of questions going to both the technicalities and substance of the matter.

One of these was whether consideration of the validity of the relevant notice involved a question of law or of fact. If the latter, no appeal lay. It was submitted that there was an implied condition in the contract that a notice to show cause under cl 44 would only be given by the principal acting reasonably. It was said that to decide whether there had been breach of this condition was not to decide any question of law.

Brownie J rejected this argument on the footing that the alleged implied term could not be implied, but went on to say (at 11):

> "... That is not to say that the principal may issue a notice under cl 44 and then, eg, cancel the contract for any trivial breach by the contractor of the provisions of the contract. The clause authorises the giving of a notice upon 'any' default, refusal or neglect as there defined, but it is at the next stage, when the principal decides whether or not to exercise its further powers, that the principal is required to act reasonably. Putting it another way, there is an implied condition that the principal will act reasonably, but only at the point where the decision is made whether or not to exercise the further powers there granted."

Later in his reasons Brownie J returned to the matter of reasonableness

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The contractor, in anticipation that Brownie J would find (as he did) that the arbitrator had erred in law in a number of respects, had argued that notwithstanding such errors, the award should stand. The basis on which this was put appears from the following passage in Brownie J's reasons (at 19):

> "The parties were in argument that a decision by the principal to

> cancel the contract, under the provisions of cl 44, must be made on a reasonable basis. It was submitted that the award could be justified was the basis that the Arbitrators had decided that the plaintiff's decision was not made reasonably. The Arbitrator did say that, but his decision to that effect is tainted by the errors of law already mentioned, and I do not see how I can take the existing finding and, as it were, substitute a finding of fact on my part, or a finding of mixed fact and law that the plaintiff acted unreasonably."

Brownie J remitted the proceedings to the arbitrator for reconsideration. Subject to one possible qualification, in view of Brownie J's reasons and the way the proceedings had been conducted, the arbitrator, when further considering the matter, would inevitably regard himself as required to decide whether the principal had validly taken over the work under cl 44.1(a), by reference to the reasonableness (or not) of the principal's decision to do so.

The possible qualification is that it may have been open to the parties to ask the arbitrator to decide the remitted issues on some other basis, or for one party to try to persuade the arbitrator, notwithstanding that the other party opposed the proposal, to use a different criterion. In the latter event, it may not have been right for the arbitrator to accept such a submission, but it is unnecessary, for purposes of the present appeal to decide the point. The position I am looking at is where there is no request of either kind.

Similarly, the same arbitrator, when dealing with CN 85231, in view of the identity of the parties and high degree of similarity in the facts and the issues, could only rationally approach that arbitration on the same basis, unless he could, for good reason, be persuaded to do otherwise.

Arbitration of CN 84231. The hearing of the arbitration in regard to contract No 85231 began on 5 June 1989.

Although at a preliminary conference the parties had agreed there should be no legal representation at the arbitration, when the hearing began the principal applied for leave to have such legal representation. This was opposed by the contractor. The arbitrator refused the application.

Nevertheless, an employee of the principal named Mr Byrne, who was a solicitor, was permitted to be present at the proceedings and help the engineer who was conducting them for the principal. From time to time, rather than require the engineer, Mr Shestovsky, to relay things that Mr Byrne was saying to him, the arbitrator permitted Mr Byrne to address him directly on legal matters.

Mr Shestovsky had the principal conduct of the proceedings for the principal, examining and cross-examining witnesses and making submissions on factual matters as the proceedings went along as well as dealing with a number of legal questions.

In the arbitration of CN 85211, some technical questions concerning the form of the notices to show cause and of exclusion had been decided in favour of the contractor by the arbitrator and, in the appeal, in favour of the principal by Brownie J. Because of this, in the arbitration of CN 85231 the

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contractor, who was principally represented by one of its directors, Mr L Rutherford, conceded that the notices had been properly signed and served. He then asked Mr Byrne a question about whether the notices were to be treated as valid. The transcript records the reply:

> "MR BYRNE: No, that is a matter for the arbitration. The validity of the notice was on the basis of whether or not the circumstances justified us issuing those notices, not so much who signed them. That is what we are here to decide, whether or not it was appropriate for the department, bearing in mind what was happening on the site, to issue those notices.
>
> ARBITRATOR: That is a matter for the arbitration. However, the matter of signing and service is cleared up. Do you want to say anything else by way of preliminary matters?" (Transcript (T) 11, Appeal Book (AB) 38).

This took place on 5 June 1989, immediately before the contractor began to give evidence in its case in chief. Mr Byrne's response seems to me to have been fully appropriate in light of the way the proceedings before Brownie J had been conducted and decided; and in the proceedings as they went forward from that point, the issue of "appropriateness" (stated in different forms) was fought. This appears clearly from the record of the evidence and also from what happened on 13 June when various amendments were permitted by the arbitrator to be made to the statement of claim.

One of these was the inclusion of a new par 25. This alleged that at the time of what the statement of claim called "The Act of Exclusion", the principal was in breach of fundamental terms of the contract in that, inter alia, by failing to accept that the contractor's rate of progress during the month of May constituted due diligence, he acted unreasonably and that it was:

> "... unreasonable for The Respondent [the Principal] to allow The Claimant [the Contractor] to carry out the works of The Contract for months during which the most difficult, unprofitable and tedious part of the works were constructed and then allege an unsatisfactory rate of progress and exclude him from the site during the final weeks of the works, when it was quite evident to a reasonable person that The Claimant was willing and able to complete the works, and would do so within four to six weeks. This exclusion, which prevented him from completing that which he had bargained for, was unreasonable and lacking in 'good faith'."

Mr Shestovsky objected to this amendment on the ground (inter alia) that it was totally new. The arbitrator agreed, but overruled the objection, saying that the new paragraph pleaded matter "basically covered by the evidence that the claimant already has gone through in his evidence so far". This observation was factually correct.

Indeed, that both parties had been treating what was raised by the new par 25 as one of the central parts of the arbitration is abundantly clear from the transcript of the evidence and proceedings. Evidence and opinion were given throughout the proceedings about the reasonableness of the principal's actions of both 20 and 30 May: see, for example, T 113, AB 133; T 119, AB 139, where Mr Shestovsky cross-examined one of the contractor's witnesses

about his opinion of the unreasonableness of the principal's actions; T 123, AB 143; T 129, AB 149; (these are references to some of the evidence on 6 and 7 June 1989). The same theme appears at T 188, AB 206 (8 June); again at T 302, AB 320 (15 June).

It was on 15 June that the contractor completed its case and Mr Shestovsky very briefly opened the case for the principal. Amongst other things he said:

> "The respondent will be leading evidence to establish that its conduct in the administration of the contract was professional and reasonable; that it made fair and reasonable decisions in granting extensions of time; that it gave the contractor every reasonable opportunity to complete on time and for a reasonable period after the date of practical completion.
>
> We will also seek to establish that the respondent had more than reasonable grounds for deciding to issue a show cause notice as the result of the contractor's poor progress in completing the works, and that the contractor failed to show cause in that he offered no sufficient reasons to generate confidence of a date for practical completion of the

> works, thus leaving the principal with no reasonable alternative but to take over the works." (T 303-4, AB 321-2).

One of the principal's witnesses was Mr Bagust, the superintendent. On 23 June, in his evidence in chief, he explained why he thought the circumstances "warranted the issue of the further show cause notice" and why he came to the conclusion that the contractor did not show cause. Mr Shestovsky asked him what he understood the contractor was required to do to show cause to which he replied: "By some demonstration that he had proceeded with the work at a rate and in a manner that was satisfactory."

Extensive parts of this evidence were directed to showing that there were sound reasons for Mr Bagust's conclusion that the contractor had not shown cause.

In cross-examination, Mr Rutherford began to ask Mr Bagust questions concerning the administrative practices in his office. Mr Byrne questioned the relevance of this, as did Mr Shestovsky. The arbitrator then said:

> "ARBITRATOR: The question of administrative practices in the department concerned with the administration of this contract is relevant. What needs to be decided is whether the contract was repudiated or not, or whether it is still on foot. One of the factors that need to be taken into account is whether the contractor was excluded from the site reasonably."

This was on the ninth full day of the hearing of the arbitration (23 June). The arbitrator's remark reflected a principal issue to which evidence and argument had throughout been directed, and no objection or query concerning his remark is recorded in the transcript.

The remainder of the hearing continued on the same footing.

The evidence came to an end on the next day of the hearing, 26 June 1989. Mr Shestovsky then handed up written submissions in a sixteen page document about which the arbitrator asked questions. Some were answered by Mr Shestovsky, some by Mr Byrne. To Mr Byrne the arbitrator said that he had difficulty with the following paragraph (on p 4 of the principal's written submissions):

> "The Respondent says that the decision of the Principal to take over

> the work was made on a reasonable basis but that is not a condition of its validity. The respondent says that on a strict interpretation of the Contract, the Principal has a right to take over the work if the Contractor fails to satisfy the Principal as required by clause 44.1 of NPWC3. The test is a *subjective test* not an objective test. It is only if the Arbitrator decides that it is an objective test that the Arbitrator proceeds to decide the reasonability issue."

The arbitrator's difficulty was with the idea of the "subjective test". He asked what was meant by "a subjective test, and not an objective test?":

> "MR BYRNE: I think that we had to nominate one or the other.
>
> ARBITRATOR: You have to explain what you mean.
>
> MR BYRNE: When you look at the general conditions of the contract, clause 34.1 talks in terms of ...
>
> ARBITRATOR: Do not you mean clause 44.1?
>
> MR BYRNE: Yes, I understand that, but the takeover notice has to be interpreted in the context of slow progress. Clause 34.1 deals with the matter of progress. In the first sentence of clause 34.1 it provides, 'The contractor shall proceed with the work under the contract at a rate of progress and in a manner satisfactory to the superintendent.' The word 'satisfactory', we argue, is a subjective test as opposed to an objective test. In the event that you find it is not subjective, Mr Arbitrator, we would say that it has to be an objective test. The submission says that if it is an objective test, the question of 'reasonable' has to be considered.
>
> ARBITRATOR: Can you describe what an objective test might be?
>
> MR BYRNE: An objective test would be what another person might consider-- not your own personal view, but taking advice from a range of others to form an objective test.
>
> ARBITRATOR: All right. I hear what you say, but I must say that I am not much wiser.
>
> MR BYRNE: Can I put it this way: I might have a view about a certain thing. That is my subjective view. However, if I form that view after taking a consensus of opinion from everyone else and moderated my initial view, that would become an objective view.
>
> ARBITRATOR: You could only do that if you set out to take opinions from X number of persons, where there is an odd number of people, and you accept whatever the majority says. Is that what you mean?
>
> MR BYRNE: Yes."

The arbitration award in CN 85231. In July 1989, the arbitrator published his award, dated 17 June 1989. The facts I have so far stated are all based directly or indirectly on facts found by him in his award with the exception of the matters from the transcript of the proceedings that I have extracted, paraphrased or referred to. I have mentioned the transcript matters only to show how the question of reasonableness arose in the proceedings and the way in which the parties treated it as an issue.

In his award, the arbitrator set out the history leading to the dispute between the parties, which I have partly abstracted earlier.

Having recounted the history, he then considered, as during the hearing he had repeatedly said he was going to do, without objection or demur by either

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party, whether the principal had repudiated the contract as the contractor alleged. His reasoning and ultimate fact finding were as follows:

> "So far as communications between the Gosford office and Mr Bagust in Sydney in relation to the desirability of issuing show cause notices is concerned, the running from Gosford seems to have been taken up almost exclusively by Mr Hall. Mr Bagust seems to have relied very much on Mr Hall for information needed to assist him in the performance of his contractual duties as Superintendent. Attention should be drawn to a number of matters which have been raised in this arbitration.
>
> 1. In evidence Mr Bagust indicated that he understood that both caissons had been completed by 19 February 1986. The facts are (Ex C35):
>
>   The plug in the caisson at WS 13 was poured on 21 March 1986.
>
>   The plug in the caisson at WS 12 was poured on 8 April 1986.
>
>   As a result of that misunderstanding Mr Bagust would have had a completely inaccurate picture of the progress which could reasonably have been expected from the Contractor by the date of issue of the second show cause notice, 20 May 1986.
> 2. The Principal was required under the Contract to supply certain materials to the Contractor. Some of those materials were not made available to the Contractor until 15 April 1986. Under those circumstances the Contractor was entitled to a significant extension of time, say, to at least 30 April 1986. Under clause 35.4 of the General Conditions of Contract the Superintendent had power to grant such an extension of time, even in the absence of an application being made therefor by the Contractor. Under circumstances where the issue of a show cause notice is being

considered those facts should have been brought to the attention of Mr Bagust who believed that the extended date for completion had been properly determined by the Superintendent's Representative to be 7 March 1986.

3. In his letter to the Superintendent of 15 May 1986 Mr Hall advised that he considered it unlikely that the work under the Contract would be completed by the Contractor before late July/early August 1986. In order to present a balanced picture Mr Hall should in my opinion have provided Mr Bagust with an estimate of how long it might take to complete the work under alternative arrangements. He neglected to do that. It is a matter of record now that the work was not completed until on or about 20 August 1986.

4. In his letter to the Superintendent dated 15 May 1986 Mr Hall also stated that standard of materials and workmanship was being compromised by the Contractor. In view of Mr Nasser's evidence to the effect that any criticisms of the Contractor's workmanship contained in the Site Instructions issued to it were promptly rectified, Mr Hall's comment would appear to have been unfairly prejudicial to the Contractor.

5. *Events on site subsequent to the issue of show cause notice*

   (i) I have already alluded to the fact that Mr Hall provided Mr Bagust with an incomplete picture of the steps taken by the Contractor to

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   increase the number of men employed on the Contract during the period immediately following the issue of the show cause notice. There was also evidence before me that longer hours were being worked. Mr Hall made no reference to that in his Report.

   (ii) Nor did Mr Hall mention in his Report to Mr Bagust that the Contractor had brought onto the site, in the person of Mr Dermot Dempsey, a very experienced general foreman who had taken charge of the work. Perhaps Mr Hall was unaware of that. However in the circumstances of that time he should have ensured that he became fully aware of all such developments and that he reported fully thereon to Mr Bagust.

As mentioned earlier in these Reasons, Mr Bagust, on 29 May 1986, wrote a memorandum to Mr Connor recommending, in the first instance, that the Contract be *cancelled*, but later in the day after Mr Davenport had proffered some legal advice, that the work be *taken over* by the Principal and the Contractor excluded from the site.

Mr Connor accepted Mr Bagust's recommendation on the same day and signed the requisite notice.

At the arbitration hearing I was informed that the Principal has internal procedures whereby one of its officers, senior to the Superintendent, but having an appropriate delegation of authority from the Minister, makes final decisions to terminate contracts and sign the appropriate notices. I regard that as an admirable procedure. But

implicit in those arrangements is that the delegated officer makes sufficient independent enquiries of his own before committing the Minister to such a drastic step which he must well know will cause lasting damage to a Contractor's reputation.

As mentioned above Mr Bagust's recommendation to Mr Connor was based to some extent on his own misunderstanding of certain relevant matters, and also very largely on unfairly misleading, incomplete, and prejudicial information supplied to him by Mr Hall. Under the circumstances, Mr Connor, without conducting some enquiries of his own, had no chance of coming to a just decision.

Some of the questions I believe Mr Connor should have asked are, for example,

1. Have we granted the Contractor all the extensions of time to which it may be entitled? (The answer should have been 'No'.)
2. How much sooner, if at all, will the work be completed if we take the work away from the Contractor? (The answer to this unasked question, with the great advantage of hindsight, would have been 'No sooner'.)
3. Do we have any evidence of the Contractor's unwillingness to comply with our reasonable Site Instructions concerning standards of workmanship? (The answer should have been 'No'.)
4. What evidence do we have, if any, of attempts by the Contractor to lift its performance on site subsequent to the issue of our show cause notice? (The answer should have been 'He has increased the workforce, is working longer hours, and has brought in a new, highly experienced foreman.')

Had he continued further with his enquiries, Mr Connor would

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perhaps have discovered that the Contractor had almost completed all the difficult and tedious work and was about to enter the home straight, so to speak.

He would also no doubt have discovered that the Contractor knew it was behind time and accepted that it would be subject to the imposition of liquidated damages. Notwithstanding that, it had expressed a strong desire to be allowed to complete the work.

Having regard to all the above facts and circumstances I have concluded that the principal was unreasonable in exercising its power to take over the work and exclude the Contractor from the site. The Principal's action under the circumstances amounted to a repudiation by it of the Contract."

The arbitrator went on to hold that the contractor was entitled to recover on a quantum meruit. After explaining how he calculated the sum to be

awarded on this basis, inclusive of interest to the date of the award, and dismissing the principal's cross-claim, he made an award in the contractor's favour of $285,024.60 plus interest at the rate of 17 per cent per annum on so much of that sum as remained unpaid after the date of the award. He ordered the principal to pay the costs of the award to the contractor.

III. Appeal to Cole J:

Application for leave to appeal granted by Cole J. The principal, by summons dated 10 August 1989, sought to set aside the arbitrator's award, pursuant to s 42(1)(a) of the *Commercial Arbitration Act* 1984, for technical misconduct; the principal also sought leave under s 38(4) of that Act to appeal from the award. Cole J heard the summons. He declined to set aside the award under s 42.

However, he granted leave to appeal in regard to a number of questions which the principal had submitted were questions of law arising out of the award and substantially affecting the rights of the principal. This needed to be made out, pursuant to s 38(5) of the *Commercial Arbitration Act*, before the Court could grant leave to appeal.

Cole J upholds appeal. The questions argued in the appeal to Cole J came under two heads. The first concerned the arbitrator's conclusion that the principal was unreasonable in exercising its power to take over the work and exclude the contractor from the site; this conclusion meant the arbitrator took the view that the unreasonable exercise of the power was in breach of contract. The second head concerned the proper method of calculation of the amount to be paid to the contractor under its quantum meruit claim.

Cole J upheld the principal's appeal under the first head. The steps in his reasoning were: 1. Clause 44.1 did *not* carry an implied obligation upon the principal that the power to take over the work and exclude the contractor from the site must be exercised reasonably; 2. The provision *did* require the principal to give to any representations by the contractor in answer to a show cause notice "bona fide, proper and due consideration" (at 18 of his reasons); but no more: he said a little later "All that is required is a bona fide consideration of such submissions" (also at 18); 3. The contractor did not submit there had not been a bona fide exercise by the principal of the powers under cl 44.1, this concession including the principal's consideration of the contractor's response to the show cause notice (at 24); 4. It followed the principal was not in breach of any contractual obligation.

It is also possible that Cole J accepted a further argument of the principal to the effect that so long as the principal had not decided abusively or in bad faith to exercise the cl 44.1 power, then even if the exercise was unreasonable, that could not amount to repudiatory behaviour (see at 15 and at 23).

On Cole J's view of the first head of appeal, the contractor was not entitled to any recovery against the principal, and the point concerning the method of calculation under the quantum meruit claim did not arise. In regard to this however, Cole J recorded that he would have been against the principal if he had had to decide the point. He referred to detailed reasons he had given for this opinion in *Jennings Construction Ltd v Q H and M Birt Pty Ltd* (Cole J, 16 December 1988, unreported).

Because of the opinion he had reached on the principal's first point, Cole J remitted the award to the arbitrator for reconsideration, directing him to enter an award in favour of the principal upon the contractor's claim, and to consider further the principal's cross-claim against the contractor.

IV. Appeal to the Court of Appeal -- First Point:

A preliminary problem emerges. Leave to appeal to this Court was granted on 19 February 1990. The appeal came on for hearing on 19 June 1991. Argument centred on the proper construction of cl 44, as it had done before Cole J. The Court reserved its decision on 20 June 1991.

As I earlier mentioned, in subsequently reviewing the construction arguments the Court became curious about why it was that the arbitrator did not seem to have dealt with the question on which the subsequent appeal from him was decided. That curiosity led to an examination of the course of the hearing before the arbitrator which I have outlined. That then prompted the question whether, before leave to appeal was granted in the first place, against the use by the arbitrator of the criterion of reasonableness that he adopted, consideration should have been given to the question whether such a contention was open to the principal in any appeal.

It seemed to the Court to be at the very least strongly arguable that the point upon which the principal succeeded before Cole J had never been taken before the arbitrator. On the contrary, the materials previously set out indicated that the basis upon which the arbitrator decided the question of reasonableness reflected a principal issue joined between the parties before him; that is, it seemed that the parties actively asked the arbitrator to decide the question on the basis upon which he did, each party adducing all

evidence it chose relevant to the issue, no submission ever being made tending to indicate to the arbitrator that either party contended there was anything wrong with that approach. If this were correct, then the case would seem to be a classical example where the point should not have been allowed to be taken on appeal.

This concern of the Court was complicated by the fact that, so far as the Court could see, the objection which suggested itself as arguable was not put to Cole J; neither had it been raised in this Court. Nevertheless, if the objection had merit, then it would seem to be one that, notwithstanding its not having been raised before Cole J or this Court, should be looked into by this Court. By proper procedures under the *Commercial Arbitration Act* a lengthy arbitration had been heard by the arbitrator, the parties having chosen to do without legal representation. If the parties did join in asking the

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professional engineer non-lawyer arbitrator to decide their dispute by reference to a particular criterion, it would seem singularly inappropriate for one of them later to approach the court and claim to be entitled to the opposite result from that reached by the arbitrator by complaining that the criterion agreed to by the parties, by which he decided a significant part of the case, was a wrong criterion.

On the other hand, there might well be materials in the appeal papers that the court had missed, or matters extraneous to the appeal papers of which the court was not aware, explaining why the point was not taken before Cole J or in this Court and why, perhaps, this Court should not be concerned with it.

Further argument on the preliminary point. The Court therefore communicated a number of questions to the parties with a view to finding out what the position was on the matters mentioned. As a result, further written submissions were lodged with the Court, and there was further oral argument on 30 October 1991, followed by an application by the Minister, heard on 25 November 1991, for the reception of further evidence in the appeal.

In the course of argument on 30 October 1991, the following things happened:

1. The contractor and the principal agreed that, contrary to the impression the Court had tentatively formed, before the arbitrator the principal had submitted that there was no obligation upon him to act reasonably in exercising the power under cl 44 of the contract to take the works out of the

hands of the contractor. However, neither party was able to point to anything in the hearing before the arbitrator indicating such a submission was being relied on prior to 26 June 1989, when the principal's written submissions were handed up, which contained the paragraph on p 4 which I have earlier set out in full. Nor was either party able to point to any discussion of that submission other than Mr Byrne's answers to the arbitrator's questions, which I have also earlier set out in full.

2. It also became clear that no objection had been raised by the contractor before Cole J to the principal's seeking leave to appeal on the footing that reasonableness of the principal's decision to take over the works was not a condition of its validity.

3. Counsel for the principal was then asked whether, if (a) the Court concluded that at the arbitration the point which Cole J subsequently decided in the principal's favour was either not litigated or not sufficiently litigated to make it safe for leave to be granted for the point to be argued on appeal; and (b) the contractor had not made any such submission to Cole J, it would be open to this Court in the appeal from Cole J to examine the question whether leave should have been granted by Cole J on that point. Counsel answered that it must be open to this Court to examine that question, because to do otherwise would be to deny justice to the contractor. I record counsel's answer, not with a view to treating it as a concession upon which the Court should operate, because I have reached the same opinion independently, and will be acting on my own opinion rather than any concession, but to explain why I do not think it necessary to examine the matter in any depth, and also to give appropriate acknowledgement to what seems to me to have been a fair and honest answer on the principal's part.

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At the end of the submissions put on 30 October 1991, the Court was still concerned to be sure that all materials relevant to the "no obligation to be reasonable" point had been drawn to the Court's attention, and invited the parties to go through all the materials recording what took place before the arbitrator and to give the Court any further relevant references by 4 pm on 4 November 1991.

Notice of motion by principal. It was the parties' response to this invitation which led to the filing, on 13 November 1991, of the notice of motion by the respondent principal which was returnable, and heard, on 25 November 1991. This asked that the hearing of the appeal be re-opened and that the principal be granted leave to adduce further evidence, being that contained

in an affidavit of Mr Shestovsky sworn 4 November 1991.

The principal was prompted to do this in the following circumstances. The contractor filed, on 4 November 1991 a short note dated 3 November 1991 headed"Appellant's additional references", in which two pages of the appeal books were drawn to the Court's attention, which did not add materially to the Court's understanding of the matter. Also on 4 November there was filed with the Court by the principal a document entitled "Respondent's further submissions". These referred to an affidavit sworn by Mr Shestovsky on 4 November 1991, which, as it happened, was filed on the following day. To this affidavit there were annexed copies of the notice of reference to arbitration dated 26 June 1986, the original points of claim, dated 8 May 1987, and eight letters between the parties which, in the main, requested particulars and answered such requests and contained some argumentative material. The latest of the letters was dated 29 October 1987. These documents showed what the issues were between the parties in a general way, although the overall result of the documents was not in all respects clear.

The principal's further submissions of 4 November, based on Mr Shestovsky's affidavit, were that: (i) the principal had claimed in its defence that even if the exclusion of the contractor from the site was not in exercise of a right under cl 44 it was an erroneous but bona fide view on the construction of the contract and therefore did not amount to repudiation; (ii) in the correspondence concerning particulars the contractor had asserted (in effect) that it was not open to the principal to rely upon a bona fide but erroneous construction of the contract to which the principal had responded by asserting that in excluding the contractor from the site the principal had at all times acted bona fide; and (iii) that Cole J had adopted that argument of the principal in his reasons when he had said that a bona fide and purported exercise of the power indicated reliance upon, rather than repudiation of the contract.

When the contractor became aware of the principal's latest submission, it objected that Mr Shestovsky's affidavit of 4 November 1991 contained new evidence. It was to overcome this objection that the principal filed the notice of motion which was before the Court on 25 November 1991.

At this hearing, the Court indicated that it would give its decision on the matters raised by it at the same time as giving judgment in the appeal. The parties were not in full agreement about how much of the material in Mr Shestovsky's affidavit had been before Cole J, but counsel indicated they

should be able to agree on that matter. Leave was given to file an agreed

document by Friday, 29 November, together with any final submissions the parties might wish to put in writing.

In the event no agreed note was filed. However, both parties lodged brief written submissions.

The contractor's submission of 29 November asserted that except for the amended points of claim the materials annexed to Mr Shestovsky's affidavit were not tendered before Cole J. This submission then elaborated reasons why the material should not be taken into account by the Court. The main point was that the documents could not assist in helping the Court decide what it was that was actually fought before the arbitrator. A submission was also made concerning a concession which the principal contended had been made by the contractor before Cole J. I will come back to this matter later.

The principal's submissions of 29 November 1991 did not assert that the material which the contractor claimed had not been before Cole J had in fact been put before him. It pointed out that the material was being put before the Court in response to the Court's concern about the nature of the issues argued before the arbitrator, and it also referred to the matter of the concession which I will come back to later.

From what the Court was told on 25 November about what had been before Cole J, and in light of what happened on that day and what was later contained in the written submissions of 29 November, it seems to me that the appropriate inference is that, as the contractor contended, the materials annexed to Mr Shestovsky's affidavit of 4 November 1991 were not tendered before Cole J, except for the amended points of claim.

Orders pursuant to notice of motion. I also think the contractor was correct in asserting that the material the subject of the principal's application did not fulfil the requirements usually necessary for the admission of evidence under s 75A of the *Supreme Court Act* 1970; however, I nevertheless think that the orders sought in the principal's notice of motion should be made, so that the Court can consider the documents in question.

This is not because the documents are evidence in the usual sense, but because they are material which enables this Court to form a clearer and more certain view of what happened in the proceedings before the arbitrator. Since the Court is considering the question whether a point which proved to be decisive before Cole J was properly open to be taken before him by the

principal in view of what had happened concerning that point before the arbitrator, it seems to me that it must be right for the Court to be able to inform itself as fully as possible of the way the matters which were in issue before the arbitrator came to be the subject of contest between the parties and also to inform itself of what matters were not the subject of contest before the arbitrator.

Effect of further materials. However, once the disputed material is looked at, it seems to me to confirm the soundness of the contractor's submission that it does not support the principal's argument that the no obligation to be reasonable point was really in contest before the arbitrator as the evidence and argument before him fell out. I think the further materials show that up to the date in October 1987 when the last of them went from the principal to the contractor the no obligation to be reasonable point was certainly potentially available to the principal. It was after that date that the appeal concerning CN 85211 went forward before Brownie J in the way and with

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the result earlier summarised. Then followed the course of events once the hearing of the arbitration of CN 85231 got under way which, consistently with what had happened before Brownie J, narrowed the issues in the way I have earlier set out. In the result, the point was not mentioned in the hearing involving CN 85231 until after the evidence in that arbitration was complete, and then only in the very limited way that appeared on p 4 of the principal's written submissions set out at AB 817 and in the brief discussion which I have earlier reproduced.

One particularly significant thing about the short and obscure submission then so belatedly made is that it did not question Brownie J's statement in *Renard No 2* that there was an implied condition that the principal act reasonably in deciding whether or not to exercise his powers under cl 44.1. It bears repeating that this was said in regard to the same clause as that under consideration in the arbitration of CN 85231, the parties were the same, the arbitrator was the same, and the arbitration of CN 85231 came on for hearing some months after Brownie J's decision. Further, that decision and the reasons for it were mentioned during the arbitration of CN 85231, it is plain from various observations appearing in the transcript that the arbitrator thought he should act on what Brownie J had said, and, in the principal's written submissions reliance was placed in various aspects of them upon a number of things that had been said by Brownie J.

Conclusion on preliminary point. Having now had the benefit of the parties' submissions on the way the proceedings were conducted before the

arbitrator, and having reviewed the transcript of what took place before the arbitrator, the opinion I have reached is that from the time the hearing began before the arbitrator and the contractor opened its case to him, one of the issues which the arbitrator, by the conduct of the parties, was led to believe he must decide in order to determine whether the contractor had made good its case, was whether the principal had acted reasonably in deciding whether or not to exercise the powers under cl 44.1 after considering whether the contractor had shown cause in response to the notice under that clause. The arbitrator was led to consider this issue, in my opinion, by the entire conduct of the proceedings by both parties, the arbitrator and the parties accepting for the purpose that what Brownie J had said in his reasons of 15 February 1989 provided the relevant criterion.

The reason why the decision of the issue was a matter essential to the determination of the contractor's claim was that the arbitrator took the view that if the power to exclude the contractor had not been exercised reasonably, then it was not open to the principal to rely upon his exercise of the power with the result that the purported exercise of the power was repudiatory conduct on the part of the principal which the contractor was entitled to accept, thus putting the contract at an end because of the principal's wrongful conduct and entitling the contractor to claim damages from the principal because of the coming to an end of the contract. Further, in my view, the only sign in the arbitration proceedings of the point upon which the principal subsequently succeeded before Cole J was what I have previously mentioned, that is, the paragraph in the principal's written submissions put before the arbitrator on 26 June 1989, and the brief discussion of it on that day.

In my view, in light of what had happened in the two arbitrations prior to

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26 June 1989, the reference to the subsequently successful appeal point and the discussion of it on that day were quite inadequate to bring the point to the arbitrator's attention; his attempt to ascertain from Mr Byrne what was involved in the relevant paragraph in the written submissions led to answers which in my opinion were a long way from making clear the point which later succeeded before Cole J. Had the point then been made clear the most obvious thing for the arbitrator to say would have been: "How can you raise that point now?".

To put the matter bluntly and briefly, the question of the reasonableness of the principal's decision was fully contested, at length, by evidence and argument, in contrast to the treatment of the subsequently successful appeal

point, which was never relied on or contested, except in the perfunctory and unsatisfactory way I have mentioned, with the result that it was never grasped by the arbitrator or dealt with by evidence before him. One result of this was that the arbitrator never had the opportunity to consider the evidence before him in light of the test as it was later formulated by Cole J. Had the possibility of some such test being the correct test ever been raised in any timely and comprehensible way before the arbitrator, not only would he have been obliged to consider the result of applying such a test to the material before him, the contractor would have had to consider whether it would conduct its case differently, whether it would seek to adduce evidence both from its own witnesses and those of the principal going to the alternative criterion and what argument should be put concerning it.

It is quite possible to imagine circumstances in which one party raises a point not understood either by the party's opponent or the tribunal dealing with the matter and yet its being held in some subsequent appeal proceeding that it was not the fault of the party seeking to rely on the point that neither the opponent nor the tribunal had dealt with it, and further, that a party could not be deprived of an entitlement to rely upon a particular point, properly raised, because of the imperfect comprehension of others.

However, that would only be the situation in circumstances where, upon a review of all the materials before the tribunal, the appellate tribunal was satisfied that the particular point had been sufficiently clearly raised as to be comprehensible by a reasonably alert tribunal and opponent. As I have earlier indicated, in my view that was not the position in the present case. I do not think it can be said that either the arbitrator or the contractor should have been aware, from what was said on the principal's behalf in written and oral submission that the point which subsequently succeeded before Cole J was a live issue before the arbitrator.

These conclusions lead to a very awkward situation. On the view I have formed, it was not open to the principal to seek leave to appeal on the point on which the principal was granted leave by, and succeeded before Cole J. Equally clearly, the contractor did not raise this objection before Cole J, who was not directed to the materials from which the point becomes clear. There can be no criticism of Cole J for not investigating a point which was neither argued, nor so far as I understand it, even hinted at, before him. As I earlier explained, this Court only became aware of the point because curiosity as to how it came about that the arbitrator decided the proceedings before him in the way that he did, led the Court to read the whole of the materials

available to it and then to ask the parties further questions about them, with the results I have earlier set out.

On my understanding of the case there has been a most unfortunate sequence of events. The arbitrator was in effect reversed by Cole J for not having decided the case on a particular basis, when, unknown to Cole J, the arbitrator not only had never been asked to decide the case on that basis, but had, because of the way the case was conducted by both parties before him, had no alternative but to decide the case on the basis that had been fought before him. Then, before this Court, the point I have been concerned with was not raised by the contractor in its appeal. It only emerged in the manner I have described.

It is a far reaching step to set aside Cole J's decision on a point not raised before him nor raised before this Court until this Court had drawn the matter to the parties' attention. Nevertheless, I have come to the conclusion that the Court should take the step, for two principal reasons, both of which I have already touched on.

The first is that a lengthy arbitration was conducted before the arbitrator on a basis that did not permit the point subsequently to be raised. The second and equally important reason, is that in the context of arbitrations of the kind now in question the first reason has even greater force than in ordinary litigation. That is because when parties commit themselves to an arbitration before an arbitrator who is not a professional lawyer but chosen primarily because of his expertise in another field, and also commit themselves to conducting that arbitration without being represented by professional lawyers, they are deliberately aiming at reaching finality by an approach intended to be dominated by practicalities and to keep legalities to the minimum properly possible.

The purpose of such an approach can only be fulfilled if the Courts to whom application must be made for leave to appeal from the resulting awards, are particularly careful to confine any appeals to matters of law that were in real and substantial dispute between the parties. The object of such arbitrations as that in the present case would be quite defeated if an unsuccessful party could subsequently raise in an appeal a point that had never been substantially dealt with in the arbitration, through no fault of the arbitrator or the successful party.

It follows, in my opinion, that the appeal from Cole J should be upheld and his order, having the effect of directing the arbitrator to make an award

in favour of the principal, itself set aside. This means that the arbitrator's decision to make an award in favour of the contractor is to be restored; the amount of it will depend upon what happens to the principal's cross-appeal concerning the calculation of the amount recoverable on a quantum meruit basis.

V. Appeal to the Court of Appeal -- Second Point:

Should the court consider the original ground of appeal? Although I think it would be entirely appropriate to uphold the contractor's appeal upon the ground and for the reasons given in the preceding section if that could be done without unfairness to the parties, I do not think it is possible to follow that course. One inescapable reason is that if the appeal were decided solely on the basis already dealt with, it seems to me inevitable that the contractor would have to pay all the costs of the proceedings before Cole J and at the

least a considerable part of the costs of the proceedings in this Court. On the other hand, if the contractor were to succeed on the basis that Cole J was in error on the ground asserted in the notice of appeal, then the contractor would be entitled to a much more favourable costs order.

Implied obligation of reasonableness. The first step in Cole J's reasoning was that subcl 44.1 did not carry an implied obligation upon the principal that the power to take over the work and exclude the contractor from the site must be exercised reasonably. In this he disagreed with the construction of the same clause apparently adopted by Brownie J, which I have earlier set out.

This point has been considered by three judges at first instance. The first was Brownie J in *Renard No 1*, the third Cole J in the present case. The second was Giles J in *Hughes Bros Pty Ltd v Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (21 September 1989, unreported).

The actual point decided in *Hughes Bros* was different from that dealt with by Brownie J and Cole J. It concerned not only the operation of subcl 44.1 of NPWC Edition 3 (1981) but the interaction with that provision of subcl 44.7. This said the principal "may exercise the power conferred by subcl 44.1" if (inter alia) any proceeding were taken against the contractor, being a company, which might result in its winding up.

The facts were that a subcontractor had such a proceeding on foot against the contractor. The contractor was contesting that proceeding. The principal exercised the power under subcl 44.7.

The contractor claimed that as a matter of construction the power was not conferred in regard to a *disputed* winding up proceeding. Giles J held against the contractor on this argument.

The contractor's next submission was that it was an implied term of the contract that t:he power could only be exercised reasonably. *Renard No 1* was referred to.

Giles J found against the contractor on this argument also. In his view there was no implied obligation that the power derived from subcl 44.7 be exercised reasonably. He pointed out that different considerations applied to subcl 44.1 and subcl 44.7, saying that in regard to such subcl 44.1 situations as had arisen in *Renard No 1* he did "not doubt that, in deciding whether or not the contractor had shown cause to his satisfaction, the principal must act reasonably" but he defined "reasonably" as confined to the sense "that the principal can not in the face of good cause shown nevertheless decline to be satisfied and thence exercise the powers".

I have already set out (at 247F) what Cole J in his turn said in the present case he thought the obligation upon the principal was under cl 44.1.

It is interesting that all three judges thought that subcl 44.1 carried *some* implied obligation, although each arrived at a formulation of the obligation somewhat different in form from the others.

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

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they emerge from the language and in the circumstances. This has been called implication ad hoc (see Professor Lucke "Ad Hoc Implications in Written Contracts" (1973-1976) 5 Adelaide Law Review 32) a usage I will adopt.

It has become accepted that the rules governing implication ad hoc are those stated by the Privy Council in *BP Refinery (Westernport) Pty Ltd v Hastings Shire Council* (1977) 52 ALJR 20; 16 ALR 363, and the High Court in*Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596 and *Codelfa Construction Pty Ltd v State Rail*

Authority of New South Wales (1982) 149 CLR 337. Those rules are that the implied term must be reasonable and equitable; necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; so obvious that "it goes without saying"; capable of clear expression; and must not contradict any express term of the contract: see *United States Surgical Corporation v Hospital Products International Pty Ltd* [1983] 2 NSWLR 157 at 196, and in the same case on appeal, *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 at 66 per Gibbs CJ.

The other kind of implication I have mentioned is that which is said to be implied by law. This was analysed by Hope JA, with whom Samuels JA and I agreed, in *Castlemaine Tooheys Ltd v Carlton & United Breweries Ltd* (1987) 10 NSWLR 468 at 486-490. Hope JA pointed out that implication of this kind is different from implication ad hoc in that the latter occurs in the circumstances of particular individual contracts, whereas implication by law is based on imputed intention as opposed to actual intention, and implies a term as a legal incident of a particular class of contract. Hope JA also said that the requirements for an implication by law had not been as closely investigated as those for implication ad hoc; such authoritative discussion as had taken place indicated that probably a Court, in deciding whether an implication by law attached to a particular class of contract which had not previously been held to be subject to such an implication, should only adopt the implication if it could be seen that the type of contract required such implication as a matter of necessity and also of reasonableness; however, he left this opinion as a tentative one, open to further examination in later cases.

Because of the way the case was decided, it was not necessary to decide whether necessity was an essential ingredient of the test to be applied in determining whether, in regard to a class of contract not previously recognised as one to which a particular implied term attaches, should be held to be subject to such a term.

In the present case I think both kinds of implication need to be considered.

Implication ad hoc. The particular words of subcl 44.1 in question in the present case were:

> "If the Contractor fails within the period specified in the notice in writing to show cause to the satisfaction of the Principal why the powers

hereinafter contained should not be exercised the Principal ... may

(a) Take over the whole ... of the work ... and ... exclude from the site the Contractor ... or
(b) cancel the contract. ..."

(1992) 26 NSWLR 234 at 257

Brownie J had decided against any implication concerning the way the principal should approach the matter of "satisfaction" under the clause but thought the principal must act reasonably in deciding, in the event of non-satisfaction, whether to exercise any of the powers. Cole J took a different view with regard to both these aspects. He was not prepared to recognise any implication concerning the exercise of the powers but thought the principal could not reach a conclusion the contractor had failed to show cause to the principal's satisfaction, in a case where the contractor had attempted to show cause, without giving bona fide proper and due consideration to the contractor's submissions and to the conclusion that should be reached upon them.

For myself, I cannot see why a term should not be implied at both stages; that is, it seems to me relatively obvious that an objective and reasonable outsider to this contract upon reading subcl 44.1 would assume without serious question that the principal would have to give reasonable consideration to the question whether the contractor had failed to show cause and then, if the principal had reasonably concluded that the contractor had failed, that reasonable consideration must be given to whether any power and if any which power should be exercised.

In the case of the implication at each stage it seems to me that all the accepted criteria for an implication ad hoc, set out above, are clearly satisfied, with one possible exception. That is the requirement that the implication must be necessary to give business efficacy to the contract so that no term will be implied if the contract is effective without it. Although I think this requirement also is satisfied, it is one about which minds may differ, and it should be given explicit consideration.

In particular, the content of the word "effective" in the requirement must be considered. Obviously, the contract in the present case could have been fully carried out to the satisfaction of the parties without any reference to or thought of the terms which in my opinion are implied in it. That is, in some circumstances the contract will be effective, in one sense, without any

reference to situations said to require implied terms.

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

In the present case for example, the contractor, using the arbitrator's findings would say that there was no business efficacy in a contract which permitted a principal to decide, basing himself on misleading information, to exclude the contractor from completing the contractual work, with no advantage to the principal and considerable detriment to the contractor. The principal would reply by saying (along no doubt with many other things) that his object was to get the particular public works done, he did get them done and the contract worked appropriately for him, and in the way he had bargained for, without the need for implying the terms contended for by the contractor.

(1992) 26 NSWLR 234 at 258

Although this way of putting the views of the opponents in the present case may be rather rough and ready, it serves to illustrate some of the difficulties in the idea of "business efficacy" and also to prompt the question whether that term may not be directed to business efficacy from the point of view of *both* parties to the contract. (If the term is so directed, it would not in all cases reduce the difficulties of its meaning, because there is no reason why one competent party to a contract might not, for good reason, expressly or impliedly agree in the contract to subordinate that party's interests in the outcome of the contract to those of the other party; it would however simplify the idea in many cases.)

However, notwithstanding the attraction of following the course mentioned in the previous paragraph, I think it is appropriate to answer the "business efficacy" question by looking at cl 44 in a more general way.

It seems clear that the words of the clause empower the principal to give a notice to show cause upon *any* default in carrying out any requirement in the contract. Thus for a completely trivial default the principal can give a notice to show cause. It is possible to imagine many situations in which, if a notice

for some trivial breach were given the contractor might fail, as a matter of fact, to show cause within the specified period to the satisfaction of the principal why the powers should not be exercised against him. (One obvious example would be where, through some mistake, the contractor's attempt to show cause was delivered late.)

For the principal, in such circumstances, to be able then to exclude the contractor from the site and/or cancel the contract would be, in my opinion, to make the contract as a matter of business quite unworkable. One way of explaining this view is to say that no contractor in his senses would enter into a contract under which such a thing could happen. The reasonable contractor, the reasonable principal and the reasonable looker-on would all assume that such a result could not come about except with good reason.

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

Such a reading does not in my opinion detract from the usefulness of the subclause to the principal, to whom it is of obvious practical importance, and for whose benefit it is. If, on the approach I take, there is some significant default by the contractor then the principal can give the notice to show cause. In some cases events from that point will unarguably clearly entitle the principal to exercise one or more of the powers. There will be other cases in which there will be tenable arguments both ways whether the contractor had failed to show cause to the satisfaction of the principal why the powers should not be exercised. In such cases the way the clause is drafted leaves the matter in the hands of the principal; if the principal, acting reasonably, is in fact not satisfied, then the principal has the power to decide whether one or

more of the powers should be exercised. On the approach I favour, it will only be if the non-satisfaction of the principal does not have a reasonable basis or the decision to exercise a power or powers has no reasonable basis that the exercise of one or more of the powers will be in breach of one or both the implied obligations. It seems to me that if in such a case (that is,

where there is no reasonable basis at either stage) the principal was contractually entitled to exercise one or more of the powers, and did so, the very exercise itself would deprive the contract of its business efficacy.

I think the same point can be made in regard to the example supplied by the facts in *Hughes Bros*. There can be no doubt that subcl 44.7 is one which a prudent principal would want to have in a contract such as NPWC Edition 3 (1981). One reason is that the contract involves subcontractors and thus potentially all the difficulties that can beset a principal from that quarter if the contractor gets into financial trouble. The protection of the principal is achieved by the way subcl 44.7 works with subcl 44.1.

Yet this protection is only necessary if the contractor is in fact in financial trouble, and the clause also gives the power (if there is no implied term of limitation) to a principal whose contractor is *not* in financial trouble, but is a company against which a winding up proceeding has been instituted for some reason (simple mistake, or some ulterior motive) by a third party not associated with principal or contractor, and such proceeding is bound to fail. My understanding is that, like it or not, such proceedings are not uncommon.

I find it hard to think either that a contractor would agree to giving a principal the unqualified right to exercise the powers in subpar (a) or subpar (b) of subcl 44.1 in the event that a third party instituted a groundless proceeding or that a principal would have the hardihood to insist on such a completely unqualified right.

In explanation of the preceding paragraph I should make it clear that I recognise that the institution even of a groundless winding up proceeding can have consequences for the luckless company respondent to it which will be important to someone in contractual relations with that company. One of the best known consequences is that the default provisions of many types of securities may be activated by the commencement of such proceedings. I can therefore imagine a principal saying to a contractor that it was essential for the principal to have a subcl 44.7 right, but I also feel sure that the principal would tell the contractor that the contractor could rely on the principal not to exercise it except for a good commercial reason -- why should a reasonable businessman insist on anything more? If my reasoning is sound, then it seems to me to follow that there is an implied obligation on the principal to use the subcl 44.7 power reasonably.

This does not mean that a principal who learns of the institution of winding up proceedings against the contractor is obliged to make any

detailed inquiry about the likelihood of success of such proceedings. The nature of the problems that subcl 44.7 protects the principal from is such that quick action by the principal will be highly desirable if the power is to be used.

The obligation of reasonableness would usually be discharged, for example, by some inquiry from principal to contractor about the proceedings, and it would require some very conclusive response from the contractor before it could be said the principal was not reasonable in then exercising the

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power; nevertheless it would not be reasonable, in my opinion, for the principal to exercise the power because of the bare fact of the proceedings having been instituted, *and nothing more*. More would often be supplied by knowledge the principal had of the contractor's financial position from sources independent of the contractor. In many cases the principal would be quite justified in relying on hearsay information, in some cases perhaps not.

The point is that, in my opinion, the principal would have to consider the matter before acting. The fact that in the case of the subcl 44.7 power, it would not be difficult for the principal to show it had been reasonable in exercising it, is not a reason for saying the obligation does not exist. In *Hughes Bros*, for example, while I respectfully agree with the result reached by Giles J, I would myself reach that result by saying the principal had been subject to the obligation of reasonableness, but that in the circumstances of the case, the obligation had been complied with.

There is nothing in the slightest novel in the implication of terms requiring reasonableness by parties to a contract in implementing terms of the contract. Two comparatively recent examples of this to which the Court was referred by the appellant are *Meehan v Jones* (1982) 149 CLR 571, a decision of the High Court, and *Progress & Properties (Strathfield) Pty Ltd v Crumblin* (1984) 3 BPR 9496, a decision of this Court, in which *Meehan* was relied on for concluding that a clause in a contract for sale entitling the purchaser to rescind if finance was not obtained within a stated period carried with it an implied term that the purchaser would do all that was reasonable to obtain satisfactory finance.

Certainly in the present case, where subcl 44.1 alone is concerned, the possibility clearly exists of the sort of case mentioned earlier where it would be unreasonable to exercise an otherwise available power; in such a case, it seems to me, the exercise of the power, far from supporting the business efficacy of the contract, would be destructive of its principal purposes and

promises.

On the view I take of the implied terms which attach to subcl 44.1, the findings of fact made by the arbitrator were more than sufficient to justify his conclusion that the principal was not entitled to exercise any power under subcl 44.1 in the events that happened after service of the notice to show cause. The principal's announcement to the contractor that the contractor was to be excluded from the site and the remaining work was to be taken over by the principal was therefore a position the principal was not entitled to adopt and was in my opinion undoubtedly repudiatory conduct entitling the contractor to take the step which it then took bringing the contract to an end.

Implication by law. Although the authorities discussed by Hope JA in *Castlemaine Tooheys* seem to require a sharp distinction to be drawn between implication ad hoc and by law, assigning the former to the facts of a particular contract, and the latter to the legal incidents of contracts of different classes, consideration of the contract in the present case shows there may be a good deal of overlap between the two categories.

In my view the particular contract in this case contains the terms implied ad hoc that I have already discussed. The particular contract however is in a standard form, and there is no reason why the same conditions would not be implied in every contract in that form. Further, the standard form contract

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NPWC Edition 3 (1981) is itself an example of a wider and common class of contract. This is the class of contract in which one party promises to build a work of some size for the other party for a price fixed by the contract, which sets out to regulate the carrying out of the contract, and in doing so provides for a number of eventualities (slow work, unsatisfactory work, financial problems of the contractor, method of payment, settlement of disputes, to name a few) which experience has shown it is prudent to provide for in advance.

Treating the present case as falling in this class, and approaching it on the basis discussed by Hope JA in *Castlemaine Tooheys*, the matters I have mentioned in dealing with ad hoc implication seem to me to support the view that the law would attach the same implication as a necessary incident of such contracts. In saying this, I need to explain what I mean by necessary.

In *Castlemaine Tooheys*, Hope JA left open the question whether an implied term will be held to be an incident to contracts of a particular class

only when it is both reasonable and necessary for the working of that class of contract. As Hope JA showed in his discussion, all the authorities agree that reasonableness is necessary for the implication, but also say that something more is needed. What that something more is has been described as necessity, but in contexts where what is meant by that word is rather equivocal, and has not been given much consideration.

In regard to the class of contract presently being considered, I can see no possible argument against the implication of the term as a matter of reasonableness. If necessity in an absolute sense is also required, for the same reasons I gave concerning business efficacy when dealing with implication in fact, I would think that requirement is fulfilled. But if I am wrong in that opinion, and necessity in an absolute sense does not require the implication of the terms presently in question in contracts of the class being discussed, then the question arises whether it is right to say those terms will only be implied if it is necessary, (in that sense) to do so.

It seems to me that the word necessity, when used in the cases analysed by Hope JA, was not being used in the absolute sense. In regard to classes of contract to which particular implications have been recognised as attaching, it is not possible to say that the implication was always necessary, in the sense that the contracts could not have worked without the implied term. Contracts of sale, contracts of employment, and leases are three classes of contract to which such terms have been attached. In all cases it would have been possible for the main purposes of the contracts to have been attained without the implications the judges have held they include. The rules in regard to each of them have come into existence not because in the particular cases giving rise to recognition of the implication it has been thought that it would be impossible for such contracts to be made and carried out without the implications, but because the Court decided it would be better or more appropriate or more reasonable in accordance with the contemporary thinking of the judges and parties concerned with such contracts that the term should be implied than that it should not. The idea is conveyed I think by Holmes's phrase "The felt necessities of the time" where necessity has the sense of something required in accordance with current standards of what ought to be the case, rather than anything more absolute.

This seems to me to be the approach that should be adopted when

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considering implication by law, and, applying it to contracts of the class now being considered, requirements of reasonableness on the part of the principal should in my opinion be implied in subcl 44.1 both at the stage

when the principal is considering whether the contractor has failed to show cause within the period specified to the satisfaction of the principal and also at the stage when the principal, the contractor having failed to show cause etc, is considering whether to exercise one or more of the powers.

If the kind of contract I have been talking about does not really qualify as a class of contract in the sense used by Hope JA in *Castlemaine Tooheys*, that may nevertheless not be a fatal objection to implying, as a matter of law, an obligation of reasonableness. There are some very interesting passages in the reasons of Dixon J in *Gullett v Gardner*, a case partly and indirectly reported in (1948) 22 ALJ 151. He there dealt with the implication of a term in a contract that was in no sense a member of a regular class of contracts. Although the case is thus one of ad hoc implication, the method used seems to be close to, if not the same as, that now recognised as used for implication of law.

Dixon J stated the method of implication in the first paragraph of his reasons:

> "This appeal depends upon the interpretation that should be placed upon a transaction of a somewhat curious nature between the two parties, the plaintiff and the defendant. It depends upon its interpretation in the wide sense; not the mere construction of the language in which it is expressed, but the extraction from the documents and the circumstances to which they refer and in which they were made of the full intention which the parties had or *are to be considered as having* with reference to the question now arising from the events that have occurred." (Emphasis added: this and the later passage are taken from the original typescript in the High Court archives.)

The case concerned a man who retired from managing a company and was then appointed as consultant for life at a handsome salary. A question arose whether this appointment bound the appointee to retain it for life. Dixon J said:

> "The defendant's contention is that, in as much as the respondent was appointed for life, it must be taken that he was bound to serve for life. In ordinary circumstances the agreement by which one party agrees to employ another for a specific term naturally imports that the party employed agrees to serve for a like term. It is upon this implication that the defendant's contention must depend. But, after all, it is an implication and not an express term.
>
> It is readily made when the relationship is that of master and servant,

> which this is not. The circumstances make it only too evident that the chief purpose of the appointment was to provide the plaintiff with an annual sum and that the services expected of him were, if not unreal, at least of a nominal character. Implications are made because they appear almost inevitably to spring from the situation the parties have expressly created. They are the logical inference from the stipulations contained in an agreement or from the terms in which it is expressed. The inference that the parties must have intended to bind themselves in the manner sought to be implied should arise from the circumstances and
>
> *(1992) 26 NSWLR 234 at 263*
>
> from the contract as a rational deduction of such cogency that another intention can hardly be supposed. The intention is to be gathered from what they have said and done, and concerns what each party to the contract had the right to expect, but it does not necessarily mean an enquiry into their actual mental state. The question is one of interpretation in the sense of ascertaining the full scope and bearing of their contractual intent. In such a question it is not only permissible, it is requisite, to consider the circumstances in which the parties contracted."

This passage seems to go clearly on the basis that in this particular unclassed kind of contract, the court would find an implication by reference to an intention deduced from the full scope and bearing of their contractual intent, not the parties' mental state, and in one sense as a matter of interpretation, and upon considering the circumstances in which the parties contracted. This could all be looked at as an example of the Court deciding what implied obligation would be attached to a contract, irrespective of the actual intention of the parties and thus either implication by law rather than ad hoc, or at least as a hybrid between the two. It may also illustrate that the sharp distinction between the two kinds of implication may, at least in some cases be more a matter of form than substance.

My conclusion that reasonableness in performance is implied in subcl 44.1 is based on what I have said so far. There are other considerations which confirm me in my opinion, but although they were touched on in argument, they were not fully argued, and I have therefore put them to one side in my conscious reasoning to this point. However, I think I should mention them.

Statutory analogy. One is that there seems to me to be a useful analogy between the incidents judicially attached to various classes of contract and those attached by statute. There are many instances of Acts of Parliament imposing terms upon particular classes of contracts and forbidding or limiting the variation of those terms by the parties. These have much the same effect as the attaching of implied conditions to contracts by courts as

an incident of law. In these instances the Acts have been passed not because it was necessary for those contracts to include such terms so the contracts could be effective, but because it was thought the terms were needed to make the contracts work more fairly between the parties.

There are examples of the common law of contract being modified for this purpose in the law of leases, mortgages, options, hire purchase agreements (as they used to be called). In each case the legislation made alterations to contracts commonly used in commercial and other situations, and which worked quite effectively before parliament changed the law, but worked in a way which parliament thought it necessary to change on grounds of fairness.

The two other matters which I think should be mentioned are related topics, but are usually dealt with separately. The first is that of good faith performance in contract, and the second is that of equitable interference in exercise of legal rights.

Good Faith. The kind of reasonableness I have been discussing seems to me to have much in common with the notions of good faith which are regarded in many of the civil law systems of Europe and in all States in the United States as necessarily implied in many kinds of contract. Although this implication has not yet been accepted to the same extent in Australia as part

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of judge-made Australian contract law, there are many indications that the time may be fast approaching when the idea, long recognised as implicit in many of the orthodox techniques of solving contractual disputes, will gain explicit recognition in the same way as it has in Europe and in the United States.

The relevant factors in this area were elucidated last year by Steyn J in a lecture at Oxford University called "The Role of Good Faith and Fair Dealing in Contract Law" (16 May 1991). Although he recognised in that address (with some regret I think) that the position in England was not the same, in this respect, as in the civil law and in the United States, and although he showed why the difference existed and could continue, he also pointed out a number of reasons why that situation might well change. The chief of these were: (a) that the common law jurisdictions in the United States had in recent times moved decisively towards recognition of the good faith principle; (b) Australian and New Zealand jurisdictions seemed to him to be moving in the same direction; (c) in English law itself it seemed to him that the doctrine of consideration had, in commercial cases, receded in importance; (d) in England also the Law Commission was investigating

whether the privity rule should be mentioned in its rigid form; (e) remarks made by Bingham LJ in the Court of Appeal Division *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] QB 433 at 445 suggesting a fairness approach to the question whether a party should be held to be bound by contractual terms; (f) the ratification by a great many countries of the*United Nations Convention on Contracts for the International Sale of Goods*, art 7(1) of which requires regard to be had to the observance of good faith in international trade in the interpretation of the convention; (g) the probable impact of the EEC on English contract law from (as scheduled at the time of his lecture) December 1992; (h) instances where in regard to particular contracts, English Courts had implied good faith obligations; and (i) the passage of statutes such as the *Unfair Contract Terms Act* 1977 (UK), which empower courts to grant remedies to the affected party to an unreasonable contract. (In regard to this he pointed out the similarity between the concepts involved in the ideas of (i) good faith and fair dealing, and (ii) reasonableness.)

All the matters he mentioned have their counterparts in Australian contract law, some operating more obviously, and some possibly having less weight, than in England. Item (g) for example is likely to have a less direct effect here than in England. I will deal in a little more detail with the weight in Australia of some of the factors identified by Steyn J, but before doing so, I note that one matter which he thought was a significant impediment to an adoption in England of the good faith obligation does not operate here, at least not in New South Wales or Victoria. (I have not checked the position in other jurisdictions.) This is the point he mentions in regard to the Model Law of Arbitration published by UNCITRAL in 1985.

The Model Law permits parties to an arbitration agreement to stipulate that the arbitrator shall settle their differences ex aequo et bono or by amiable composition. Steyn J says that the orthodox view in England is still that such clauses have no legal effect as being against English public policy. Both New South Wales and Victoria however, in 1984 passed a *Commercial Arbitration Act* adopting the UNCITRAL provision. Subsection 22(2) of the

New South Wales Act originally permitted the parties to an arbitration agreement to agree that the arbitrator might determine any question "as amiable compositeur or ex aequo et bono". The subsection was amended in 1990 to say that the arbitrator (if the parties had agreed in writing) might determine any question "by reference to considerations of general justice and fairness".

For the moment I make only two points about this. One is that the existence of sections such as s 22 in New South Wales and Victoria makes it impossible to argue that the inclusion of ex aequo et bono clauses (to call them that for short) in contracts in those States could be against public policy. The other is that the translation of the French and Latin phrases into English in the 1990 New South Wales version underlines the considerable degree of interchangeability between the expressions fairness and good faith, (in Roman Law the ideas involved in the phrase ex aequo et bono had much in common with the underpinnings of the ex fide bona formula: for a useful glimpse of the topic see the entries under "Bona fides" and "Bonum et aequum" in the *Encyclopedic Dictionary of Roman Law* (Berger) (1953) at 374 and 377), and leads on to the thought that in ordinary English usage there has been constant association between the words fair and reasonable. Similarly, there is a close association of ideas between the terms unreasonableness, lack of good faith, and unconscionability. Although they may not be always co-extensive in their connotations, partly as a result of the varying senses in which each expression is used in different contexts, there can be no doubt that in many of their uses there is a great deal of overlap in their content, particularly in the kind of situation being discussed in the present case.

I now come back to mention the current significance in Australia of some of the factors identified by Steyn J as likely to be influential in making contract law in England more receptive to the idea that contracts generally will be subject to an implied obligation of good faith. (He mentioned this obligation both in regard to the formation and performance of contracts. I am dealing with it only in regard to performance.)

The first in the above list drawn from his lecture is the position that has been reached in the United States. This is instructive in a number of ways which appear from even a summary description of some salient points in the course of the obligation's history in that country.

The New York Court of Appeals said in 1918, "Every contract implies good faith and fair dealing between the parties to it": *Wigand v Bachmann-Bechtel Brewing Co* 118 NE 618 (1918) at 619. In his article "Good Faith Performance and Commercial Reasonableness under the Uniform Commercial Code" (1963) 30 University of Chicago Law Review 666, Professor Farnsworth made what seems a good case for saying that the court in *Wigand* was continuing to enforce an obligation long accepted as implied at common law, and which in New York and California was never departed from (see at 671); there are many other examples in the cases. (In England

Lord Mansfield had made it plain, in *Carter v Boehm* (1766) 3 Burr 1905 at 1910; 97 ER 1162 at 1164, that good faith was a principle "applicable to all contracts and dealings" and Lord Kenyon in *Mellish v Motteux* (1792) Peake 156 at 157; 170 ER 113 at 113-114 had said: "... But in contracts of all kinds, it is of the highest importance that courts of law should compel the

observance of honesty and good faith"). Professor Farnsworth recognised that the implied obligation, prior to the promulgation of the *Uniform Commercial Code*, had become "neglected" in States other than New York and California (at 671).

The *Uniform Commercial Code* was first promulgated in 1951 by a National Conference of Commissioners on Uniform State Laws and the American Law Institute who hoped it would be made law in each State. It dealt with various aspects of commercial law, but by no means all of it. There were a great many references to "good faith" throughout and I here mention only those particularly relevant for present purposes. Sections 1-203 said:"Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement." However "good faith" was defined in ss 1-201 as meaning "honesty in fact in the conduct of transaction concerned". This, arguably, had a limiting effect on the extent of the obligation, particularly when in the Sales article (which dealt with "transactions in goods" as described in ss 2-102), "good faith in the case of a merchant" was defined as meaning "honesty in fact and reasonable standards of fair dealing in the trade".

The Code was at first only slowly enacted by State legislatures. The history and reasons for this are explained in *Uniform Commercial Code* (3rd ed) J J White and R S Summers vol 1 (1988) 1-7. Revised Official Texts were promulgated in 1957, 1958, 1962, 1972 and 1978. Then, by 1968, the *Uniform Commercial Code* had in one text or another been made law in forty-nine States. This remained the position, so that as at 1988, the 1962 Official Text had been enacted in three States, the 1972 in fourteen, and the 1978 in thirty-two; the missing State, Louisiana, had enacted the greater part of the 1972 Official Text: White and Summers (ibid at 5).

By 1968 an enormous number of cases, from both before and after the *Uniform Commercial Code*, had accumulated. An attempt to synthesise them, afterwards very influential, was made by R S Summers in "'Good Faith' in General Contract Law and the Sales Provisions of the *Uniform Commercial Code*", (1968) 54 Virginia Law Review 195. Among many points, he made two particularly relevant for present purposes.

One was the possible limiting effect of the definition of "good faith" in ss 1-201 of the *Uniform Commercial Code* upon the obligation stated in ss 1-203.

The other was that, in his view, the expression "good faith" as commonly (and sometimes vaguely) used by judges is best understood as an "excluder"; that is, it "has no general meaning or meanings of its own, but ... serves to exclude many heterogeneous forms of bad faith" (at 196). In his view this understanding of the expression explained how the concept had come to be used flexibly by judges so as "to do justice *and* do it according to law" (at 198). Although this approach is open to powerful logical criticism (see particularly Burton in (1980) 94 Harvard Law Review 369; (1981) 67 Iowa Law Review 1 and (1984) 69 Iowa Law Review 497) it has the great merit of being workable, without involving the use of fictions often resorted to by courts where the good faith obligation is not available, and reflects what actually happens in decision making. I think Summers was quite accurate when he said "... the typical judge who uses this phrase is primarily

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concerned with ruling out specific conduct, and only secondarily, or not at all, with formulating the positive content of a standard" (at 202).

The importance of this for immediate purposes is that Summers' views seem to have been given considerable recognition in the *Restatement of the Law Second* of Contracts which after years of preparation and well-publicised discussion was adopted by the American Law Institute in 1979 and published in 1981. Section 205 of the *Restatement (Second)* says: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement."

Although the Restatement does not have statutory force in any jurisdiction, it is continually resorted to by judges in the United States as having great persuasive authority. Section 205 applies to *all* contracts, and there is no restriction on its meaning, such as the *Uniform Commercial Code* definition of good faith in ss 1-201. The cases collected on s 205 in, for example,*Case Citations to the Restatement of the Law* (published by the American Law Institute) and the Cumulative Supplements to it, show how widely the obligation has been accepted (or re-established as Professor Farnsworth would see it) in the many jurisdictions in that country.

In Canada, s 205 has had favourable attention. In its *Report on Amendment of the Law of Contract* (1987) the Ontario Law Reform Commission, after noting (at 166) that:

> "... while good faith is not yet an openly recognized contract law doctrine, it is very much a factor in everyday contractual transactions. To the extent that the common law of contracts, as interpreted and developed by our Courts, reflects this reality, it is accurate to state that good faith is a part of our law of contracts.
>
> In this vein, a great many well-established concepts in contract law reflect a concern for good faith, fair dealing and the protection of reasonable expectations, creating a legal behavioural baseline";

and that Professor Farnsworth thought s 205 of the *Restatement Second* reflected a substantial body of pre-Code case law (at 172), recommended "that the proposed statutory good faith provision should take the form of section 205" (at 175).+

The importance of these developments in the United States for Australian purposes is the cumulative effect of the following: (i) they grew out of the same common law background as that of Australian law; (ii) under the stimulus first of academic systematisation of the accumulation of good faith cases and second the interaction of that with the *Uniform Commercial Code*, general contract law came quickly to recognise (or reinstate) the pervasive principle of the good faith obligation; (iii) despite the difficulties in precise statement of the obligation its use seems to have been generally accepted in a highly commercial country -- throughout the period of the modern revival of the obligation the business of America has largely been business -- and (iv) there has been little if anything to indicate that recognition of the

+ Professor Farnsworth has recently published the third edition of his work *Farnsworth on Contracts* (1990). The footnotes to pars 7-17 and pars 7-17a and the Table of Authorities contain up to date and extensive references to the literature on these topics. Two further articles not referred to, which have had considerable influence, are Powell, "Good Faith in Contracts" in [1956] CLP 16, and Lucke, "Good Faith and Contractual Performance" in *Essays on Contract*, ed P Finn (1987) at 155.

obligation has caused any significant difficulty in the operation of contract law in the United States. When the broad similarity of economic and social conditions in Australia and the United States is taken into account the foregoing matters all seem to me to argue strongly for recognition in Australia of the obligation similar to that in the United States.

Item (b) in the list taken from Steyn J's lecture was his understanding that Australian and New Zealand jurisdictions seemed to be moving towards recognition of a good faith obligation. The continuance of this trend has recently been demonstrated in *The Commonwealth v Amann Aviation Pty Ltd* (1991) 66 ALJR 123; 104 ALR 1, in which both in the Full Federal Court (*Amann Aviation Pty Ltd v Commonwealth of Australia* (1990) 22 FCR 527; 92 ALR 601), and in the High Court, there seems to have been approval of

the basic ideas of the good faith obligation: see Davies J (at 532; 607); Sheppard J (at 542; 616) and the joint reasons of Mason CJ and Dawson J (at 135; 21). The point was not precisely the same as the one I am considering and was not discussed at length, but is worth recording because of the status of the Courts involved and because what they said seems indicative of the trend noticed by Steyn J.

The final matter I wish to mention particularly from those I have listed from Steyn J's lecture is the last in the list; that is, the effect of certain statutes. This development is a very strong one in this country if the New South Wales experience is typical of all the States, as, broadly speaking, I believe it is. In New South Wales, since 1900 there has been an ever-growing number of statutes permitting Courts to remould particular kinds of contract in the interests of fairness. This is an oversimplified description; for the detail the statutes themselves must be read. The principal ones have been the*Money-lenders and Infants Loans Act* 1905, the *Hire Purchase Agreement Acts* of 1941 and 1960, s 88F of the *Industrial Arbitration Act* 1940, inserted in 1959 and expanded in 1966, the *Contracts Review Act* 1980, the *Credit Act* 1984 and s 51A of the *Trade Practices Act* 1974 (Cth), inserted to operate from 1986.

Although each of these statutes dealt with carefully defined types of contract, in their totality they covered contractual situations affecting a great many people, so that, to repeat something I have said elsewhere, "a very large area of everyday contract law is now directly affected by statutory unconscionability provisions carrying with them broad remedies".* As the words used in the sequence of statutes show, the ideas of unconscionability, unfairness and lack of good faith have a great deal in common. The result is that people generally, including judges and other lawyers, from all strands of the community, have grown used to the courts applying standards of fairness to contract which are wholly consistent with the existence in all contracts of a duty upon the parties of good faith and fair dealing in its performance. In my view this is in these days the expected standard, and anything less is contrary to prevailing community expectations.

Equitable interference in the exercise of legal rights. The statutory recognition in s 22 of the New South Wales and Victorian *Commercial*

* See "Unconscionability as a Restriction on the Exercise of Contractual Rights" in *Rights and Remedies for Breach of Contract* ed J Carter (1986) 57 at 73, where much more detail is given than I have given here: see also "Contract -- the Burgeoning Maelstrom" in (1988) 1 Journal of Contract Law 15, at 19-21, 24, 28 and 30.

Arbitration Acts of the power of parties to agree to have their disputes

resolved ex aequo et bono, even although the statute limits the possibility to particular situations, must, together with the other factors mentioned, in due course have an effect on the broader perception of general public policy and on the way in which the courts will determine what parties are obliged to do in the performance of their contractual obligations. Section 22 is, after all, only another manifestation of exactly the same ideas that, speaking generally, have led to equitable interference in the exercise of legal rights. Judges in all common law jurisdictions have become more familiar with the rules and techniques of this process during the last century or more. Even in New South Wales all common law judges are chancellors now.

One particular and relevant example of the process was explained by Stephen J in *Godfrey Constructions Pty Ltd v Kanangra Park Pty Ltd* (1972) 128 CLR 529 at 548. What he was there dealing with was the way in which the courts have controlled the operation of the common condition of sale in sales of land entitling a vendor to rescind the contract if unable or unwilling to comply with or remove objections or requisitions insisted upon by the purchaser. Stephen J commented that over the years the potentially wide operation of such conditions had been kept within narrow limits by the Courts. The important points he made, for present purposes, were that that result had been achieved simply by judicial decision and that the object of the judges had been to prevent the use of the condition by vendors for improper and extraneous purposes. He said the vendor had been denied the right to rescind under the clause by the judges using one of two techniques (at 549):

> "... the vendor has been denied the right to rescind either upon the basis that, as a matter of construction, the circumstances of the particular case do not fall squarely within the terms of the clause or else because, although on its proper construction, the clause applied, nevertheless, the vendor having attempted to use the rights conferred upon him for an improper purpose, he could not be permitted to rely upon its terms."

In *Pierce Bell Sales Pty Ltd v Frazer* (1973) 130 CLR 575, Barwick CJ, in referring to the way in which the courts had restricted the use of such conditions, said (at 587): "... Broadly it may be said that the vendor will not be allowed to use his contractual right if it would be unconscionable in the circumstances to do so."

The passage from Stephen J shows how the same reaction by a court to what is felt to be unfair use of a contractual right can manifest itself in two

apparently quite different forms: one by saying the right does not exist in the particular circumstances, the other by saying it is wrong to use it. The passage from Barwick CJ illustrates a frank use of the latter and often more straightforward method. The implication of terms importing reasonableness, good faith, fairness and the like is a convenient way of allowing this latter process to work.

This Court's decision in *Champtaloup v Thomas* [1976] 2 NSWLR 264 may be thought to be inconsistent with what I have been saying. To the extent that it is, I think it is legitimate nevertheless to rely on the general rules which I think are seen operating in *Godfrey Constructions* and *Pierce Bell*

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rather than the particular denial of one instance of those rules which, on one view, is involved in *Champtaloup*.

Another way to deal with the three cases would be to say that the two High Court cases recognised that, in some circumstances, exercise of legal rights will be restrained; in *Champtaloup*, this Court said the circumstances did not require any such restraint. Further, the way the decisions have been going since *Champtaloup* indicates that it should now be treated very much as confined to its own facts.

The obligation as stated by Cole J. The matters I have been dealing with under the headings of implication ad hoc and by law are in areas in which differences of opinion cover a wide range. This is particularly so as to implication by law, the theory of which is clearly in a state of development. I will therefore consider the present case from yet another point expressed by Cole J when he said that he thought the obligation upon the principal in the present case was to give bona fide, proper and due consideration to the contractor's submissions and bona fide to reach a conclusion upon whether proper cause had been shown.

Adopting this approach, I would, with some hesitation, reach a different conclusion from Cole J. One reason is that I think if the words "proper and due" are given full weight, a position is reached not very different from that in which an obligation of reasonableness is implied.

Then, applying Cole J's view it is necessary to ask who it is who must actually give the bona fide and proper consideration to the contractor's submissions. The answer, as a matter of fact, in the present case is that it was Mr Connor. The findings of fact made by the arbitrator in my opinion require the conclusion that his consideration of the contractor's submissions

did not fall within the expression "bona fide, proper and due".

This is not because it could be said that he did not give honest consideration to the submissions. No such submission could be justified and no such submission was made. This brings me back to the matter of the concession mentioned on p 251B.

The concession made by the contractor before Cole J cannot have gone to the length of conceding that Mr Connor's consideration of the decision to be made by the principal led to that decision being the result of bona fide proper and due consideration. The concession can only have been going to the honesty of Mr Connor. The contractor made it plain that it was not contending that Mr Connor was acting from dishonest or improper motives. Any greater concession than that was completely inconsistent with the main point in the contractor's case. A submission to this effect was put in argument to this Court and persuasively developed by reference to various matters in the appeal papers. I think it must be correct.

Using the test adopted by Cole J, it seems to me to follow from the arbitrator's findings of fact that Mr Connor was simply not in a position to give bona fide and proper consideration to the contractor's submissions in the light of what the arbitrator characterised as recommendations he had from his subordinates based on "unfairly misleading, incomplete, and prejudicial information".

On the facts found by the arbitrator, which it was common ground in the appeal must be accepted for the purposes of the appeal, I think the arbitrator was right in saying that: "Under the circumstances, Mr Connor,

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without conducting some enquiries of his own, had no chance of coming to a just decision." Equally, those factual findings lead to the conclusion that Mr Connor, without conducting some inquiries of his own, could not give bona fide and proper consideration to the contractor's submissions. On this approach also therefore I come to the conclusion that the appeal should be upheld.

Postscript. Since preparing these reasons I have had the benefit of reading what Handley JA has written. He brings to light cases which both bear directly on the principal question of substance in this case and provide illustrations of my general theme of the anxiety of courts, by various techniques, to promote fair and reasonable contract performance. His materials, and his analysis of them lead directly and powerfully to the

conclusion I more laboriously reached when considering implication. However, I will still restrict the reasoning upon which I base my own conclusion about the implied term to that preceding the heading "Statutory Analogy". The only reason for not enthusiastically incorporating Handley JA's opinion as part of my own ratio decidendi is that it may raise matter not fully argued by the parties, although my feeling is that the substance was probably sufficiently covered to make my caution unnecessary.

VI. Cross-appeal:

Should the principal be allowed to argue its cross-appeal points? The amount awarded by the arbitrator was approached on a quantum meruit basis. Taken with amounts paid under the contract, it resulted in the contractor being paid more than if it had carried out the contract. The principal contended that the contractual sum must form the upper limit of the total receivable by the contractor (the "ceiling" point). Alternatively, the principal submitted that the arbitrator should have found not an amount representing a reasonable remuneration to the contractor but the value to the principal of the work performed by the contractor (the value to principal point). Although, because of his other findings in the appeal, it was not necessary for Cole J to decide these points, he indicated that his opinion was that the position adopted by the contractor and accepted by the arbitrator was correct.

When the appeal came on for hearing, there was some discussion whether the principal could raise this matter as of right by notice of cross-appeal or whether leave to appeal was necessary. I do not see any point in exploring these questions because it seems to me to be obvious that the principal ought to be allowed to argue the point in this Court. Accordingly I would propose that leave, to the extent that it is necessary, be granted permitting the principal to rely upon his notice of cross-appeal raising this particular matter.

The "ceiling" point. In stating his opinion on this point Cole J incorporated the detailed reasons he had given for it in his earlier decision of *Jennings Construction Ltd v Q H & M Birt Pty Ltd* (see earlier at 248B). I agree generally with those reasons, and in particular with his understanding of the position on the point indicated by Mason J and Wilson J (jointly) and Deane J in *Pavey & Matthews Pty Ltd v Paul* (1987) 162 CLR 221. I also agree with what Meagher JA says about it in the present case.

The value to the principal point. Again, I agree with Cole J and Meagher JA.

Conclusion on cross-appeal. Beyond stating my agreement with Cole J and

Meagher JA on the two cross-appeal points, I add only that on the view expressed by Deane J in *Pavey & Matthews*, it would have been possible for further issues to have been explored before the arbitrator concerning the amount recoverable by the contractor than were in fact gone into. No point was raised about this in the cross-appeal (I do not think it could have been) so that the only two points argued were those I have mentioned.

In my opinion the principal fails on both points and the cross-appeal should be dismissed.

VII. Orders:

The overall result of the appeal and cross-appeal is to show that the arbitrator's award, dated 17 June 1989, (see at 15 and 19) should not have been disturbed. The Court's orders should lead to the restoration of that award.

I agree with the orders proposed by Meagher JA.

MEAGHER JA. This is an appeal from a judgment of Cole J delivered on 26 October 1989 in which his Honour granted leave to the Minister for Public Works (the principal), the present respondent, to appeal from an award made by Mr T I McCreery on 17 June 1989, an arbitrator acting under the *Commercial Arbitration Act* 1984, in favour of Renard Constructions (ME) Pty Ltd (the contractor), and directed that an award be entered in favour of the principal in lieu thereof: see *Minister for Public Works v Renard Constructions (ME) Pty Ltd* (Cole J, 26 October 1989, unreported).

The contract, dated 27 September 1985, was a Schedule of Rates Contract with an estimated final value of $208,950, for the construction of two reinforced concrete pumping stations at Wyong. The contract completion date was 17 January 1986. The "Superintendent" under the contract was the principal's employee, an engineer named Mr L J Bagust. The most difficult and tedious work involved was the construction and sinking of two caissons. The contractor's progress was somewhat tardy, which led it from time to time to seek extensions of the completion date. Several extensions were granted, the last of these extending the completion date to 7 March 1986.

The principal was required under the contract to supply the contractor

with certain materials. Unfortunately, the evidence is scanty about what those materials were, or when they were needed, or precisely how the delivery of them contributed causally to the delay in the completion of the works. But it is not in dispute that the last materials to be supplied were not ready for delivery until 15 April 1986 and were not actually delivered until 22 April 1986. The arbitrator found that: "Under these circumstances, the contractor was entitled to a significant extension of time, say, to at least 30 April 1986." That is a finding of fact that the principal's conduct prevented the contractor from completing its work before that date.

By 20 May 1986, the works were still not complete. At all times during this litigation the contractor has accepted that it was in default under the contract. On the arbitrator's findings this default could only have commenced at some time between 1 May 1986 and 20 May 1986. The principal contended that the contractor had been in default at all times after 7 March 1986, but on the arbitrator's findings this clearly could not be so.

On 20 May 1986, the principal issued a "notice" to the contractor, which should be quoted in full. It is in the following terms:

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"NOTICE TO SHOW CAUSE UNDER CLAUSE 44 OF THE GENERAL CONDITIONS

By letter dated 27th September 1985, the Minister for Public Works and Ports accepted the tender of Renard Constructions (ME) Pty Ltd ("the Contractor") to construct two pumping stations ("the Works") at Ourimbah as part of the Wyong Shire Sewerage Scheme.

The Contractor has --
not proceeded with the work at a rate of progress and in a manner satisfactory to the Superintendent, thereby contravening clause 34.1 of the General Conditions of Contract.

The Contractor must Show Cause before 5.00 pm on 26th May, 1986 at the Office of the Minister for Public Works and Ports, at floor 30, State Office Block, Phillip Street, Sydney, why the Minister for Public Works and Ports should not proceed under clause 44.1 of the General Conditions of Contract and either --

(a) take over the whole of the work remaining to be completed and for that purpose and insofar as may be necessary exclude from the site the contractor and any other person concerned in the performance of the work under the Contract; OR

(b) cancel the Contract and in that case exercise any of the powers of exclusion conferred by subparagraph (a) of this paragraph."

As can be seen, it purported to be issued under cl 44 of the "General Conditions". This is a reference to the General Conditions of Contract, NPWC Edition 3 (1981), which were part of the contract. Clause 44.1 should also be set out in full. It is as follows:

"44.1 Procedure on Default of Contractor

If the Contractor defaults in the performance or observance of any covenant, condition or stipulation in the Contract or refuses or neglects to comply with any direction as defined in clause 23 but being one which either the Principal or the Superintendent is empowered to give, make, issue or serve under the Contract and which is issued or given to or served or made upon the Contractor by the Principal in writing or by the Superintendent in accordance with clause 23, the Principal may suspend payment under the Contract and may call upon the Contractor, by notice in writing, to show cause within a period specified in the notice why the powers hereinafter contained in this clause should not be exercised.

The notice in writing shall state that it is a notice under the provisions of this clause and shall specify the default, refusal or neglect on the part of the Contractor upon which it is based.

If the Contractor fails within the period specified in the notice in writing to show cause to the satisfaction of the Principal why the powers hereinafter contained should not be exercised the Principal, without prejudice to any other rights that he may have under the Contract against the Contractor, may

(a) take over the whole or any part of the work remaining to be completed and for that purpose and in so far as it may be necessary exclude from the site the Contractor and any other person concerned in the performance of the work under the Contract; or

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(b) cancel the Contract, and in that case exercise any of the powers of exclusion conferred by sub-paragraph (a) of this paragraph.

If the Contractor notifies the Superintendent in writing that he is unable or unwilling to complete the Works, or to remedy the default, refusal or neglect stated in the notice in writing referred to in the first paragraph of this sub-clause, the Principal may act in accordance with

> the provisions of sub-paragraph (a) or sub-paragraph (b) of the last preceding paragraph, as he thinks fit."

On 29 May 1986, by which time the works had still not been completed, the principal notified the contractor in writing that it took over the whole of the work remaining to be completed and excluded the contractor from the site. The contractor has submitted that this action constituted a repudiation by the principal of the contract, which repudiation it accepted. The principal submitted that it was a valid exercise of its contractual powers. The arbitrator found for the contractor and ordered the principal to pay it the sum of $285,024.60 on a quantum meruit. Cole J, in effect, reversed the arbitrator. In my view the arbitrator was correct.

The principal contention before Cole J was whether the principal, in exercising its powers under cl 44, had "acted reasonably", the principal contending that he had, and the contractor denying he had. His Honour's analysis of the problem appears from the following extract of his judgment (at 17-18):

> "... Put another way, the pre-existing default, refusal or neglect of the Contractor, each of which constitutes a breach of contract, permits the Principal to suspend payment under the contract, or to take over the whole or part of the works or cancel the contract. However, these latter two courses may only be taken by the Principal if he has given the Contractor an opportunity to show cause why such last two courses should not be adopted by the Principal. The representations of the Contractor must be of such weight as to satisfy the Principal that he should not exercise either of the last two powers. In considering the written representations of the Contractor, the Principal must give bona fide, proper and due consideration to them. A pretended consideration will not suffice.
>
> The mind of the Principal must truly be applied to the question whether the written facts or circumstances referred to the Principal by the Contractor, as reasons why the powers of taking over the whole or part of the work or cancelling the contract should not be exercised, are sufficient to satisfy him that he should not exercise such powers. In reaching his decision the Principal may have regard to the Principal's interests. He is not obliged to act 'reasonably' in the sense of seeking to balance the interests of the Principal and the contractor. This flows from the existing default, refusal or neglect, of the contractor. All that is required is a bona fide consideration of such submissions.
>
> If, after such proper consideration, he is satisfied that he should not exercise either of the latter two powers, his right to exercise them never arises. If he is not satisfied that the powers should not be exercised, his

> potential right to exercise the last two powers crystallises."

Reference was also made to *Minister for Public Works v Renard Constructions (ME) Pty Ltd (No 1)* (15 February 1989, unreported), a decision of Brownie J, in which counsel conceded that the principal was under a duty to act "reasonably" before taking action to take over the works and exclude the contract under cl 44. Reference was also made to the decision of Giles J in *Hughes Bros Pty Ltd v Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (21 September 1989, unreported) on the same clause, where Giles J said (at 17):

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> "Under cl 44.1 there has been a show cause notice and the exercise of the powers is conditioned upon the contractor's failure to show cause to the satisfaction of the principal why the powers should not be exercised. I do not doubt that in deciding whether or not the contractor had shown cause to his satisfaction, the principal must act reasonably, in the sense that the principal cannot in the face of good cause shown nonetheless decline to be satisfied and thence exercise the powers. It is, I suspect, to this that the observations of Brownie J were addressed."

In relation to this decision, his Honour commented (at 22):

> "I respectfully agree if 'reasonably' is understood in the sense indicated by Giles J. I prefer to state the obligation upon the Principal as being to give bona fide and proper consideration to the contractor's submissions, and bona fide to reach a conclusion upon whether proper cause has been shown, rather than to state the obligation as an obligation to act 'reasonably'."

It is not in dispute in the present case that the principal acted "honestly". He was not corrupted by any pecuniary consideration and he believed he was entitled to do what he did. In that sense he acted "bona fide".

Cole J rejected any submission that reasonableness could be imported as a limitation on the exercise of cl 44 powers. In my opinion he was right to do so. Such a limitation, if it existed, could only arise either from the express words of the contract or by way of an implied term. Obviously enough it does not arise as a matter of construction of cl 44. It is not referred to expressly in that clause, nor is it to be discerned as a matter arising by necessary implication from the words used. Nor, in my view, is there any room to imply a term. Any such attempt could not survive the tests adumbrated by the High Court in *Codelfa Construction Pty Ltd v State Rail Authority of New South*

Wales (1982) 149 CLR 337 and *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* (1979) 144 CLR 596. Moreover, it suffers a more basic defect: it is difficult, if not impossible, to ascribe any sensible meaning to such a concept in this connection. As Taylor J said in a very different context:

> "... But reasonableness, alone, is an abstract concept and does not by itself provide a test for determining what charges may or may not be made; it is a useful guide if, and only if, we are aware of the various matters which must be considered where the necessity arises of determining whether particular charges are or are not reasonable"

(*Armstrong v State of Victoria [No 2]* (1957) 99 CLR 28 at 88-89.)

In the present case the parties apparently interpreted the concept of reasonableness as involving the balancing "of the interests of the principal against those of the contract". There is no possible basis for inflicting such a duty on the principal, and his Honour was correct to repudiate it. There is no reason why the principal should have regard to any interests except his own.

(1992) 26 NSWLR 234 at 276

Eventually, Mr Walker, who appeared for the contractor, conceded that the principal was not burdened by any element of altruism. However, in my view it does not follow that the principal's actions in the present case can be justified. The pivotal fact found by the arbitrator -- which, so far as I can see from the materials referred to by him is amply justified -- is that the principal's decision was based on a fundamental misunderstanding of relevant matters (principally, that the contractor had been in default since 7 March 1986) and was grounded on "misleading, incomplete and prejudicial information". Clause 44.1 provides that action to take over the contract and exclude the contractor can only be taken if the principal is "satisfied" as to certain matters, namely why the powers referred to should not be exercised. Inherent in the notion of being "satisfied" is an ability to comprehend the factual background on which satisfaction is required. If, for example, as Mr Miller QC senior counsel for the principal conceded, the principal were disabled by drunkenness, insanity or illiteracy from understanding the basic facts of the case, he could never reach an appropriate degree of satisfaction. Likewise here, in my view, when the principal's mind, on the arbitrator's findings, was so distorted by prejudice and misinformation that he was unable to comprehend the facts in respect to which he had to pass judgment. Since he was unable to be "satisfied" -- and, if it matters, that inability arose solely through his own fault -- his action in taking over the contract and excluding the contractor lacked contractual justification and amounted to a

repudiation.

The principal's cross-appeal attacked the arbitrator's award of damages based on quantum meruit in favour of the contractor. In view of his Honour's finding there was no breach of contract it was unnecessary for him to deal with this point, although, in deference to counsel's wishes, he did so. His Honour did not accede to the principal's complaint. In my view his Honour was correct in doing so.

The cross-appellant really raised two distinct points. The first is that the arbitrator (and his Honour) was wrong to calculate the quantum meruit claim on the basis of what would be a reasonable remuneration for the contractor; he should have essayed that task of inquiring what was the value to the principal of the work performed. Quantum meruit was now perceived, so the argument ran, to be based on concepts of unjust enrichment; it followed, according to this argument, that since the principal should not be unjustly enriched, he should pay to the contractor the value to him of the works performed as distinct from the reasonable cost to the contractor of performing the works. His Honour had already rejected such an argument in *Jennings Construction Ltd v Q H and M Birt Ltd* (Cole J, 16 December 1988, unreported). That decision is precisely in point and, in my view, entirely correct. His Honour was therefore justified in applying it.

The second point is that the amount of the arbitrator's award (particularly when aggregated with payments already made under the contract whilst it was on foot) exceeds the amount payable to the contractor under the contract, which latter amount must provide a "ceiling" on any quantum meruit claim. This point should also, in my view, be rejected. In the first place, it is contrary to what authority exists on the question. The Court of Appeal in New Zealand, in *Slowey v Lodder* (1901) 20 NZLR 321, held that an innocent party who terminates a contract by acceptance of the defaulting

party's repudiation may sue on a quantum meruit for the value of work done before repudiation, and that the fact that a judgment on this basis exceeds the amount which would have been payable under the contract is irrelevant. That decision was affirmed on appeal to the Privy Council: see *Lodder v Slowey* [1904] AC 442. In the United States, there is abundant authority to the same effect: see, eg, *Boomer v Muir* 24 P 2d 570 (1933), *United States v Zara Contracting Co* 146 F 2d 606 (1944), *Re Montgomery's Estate* 6 NE (2d) 40 (1936) and *Williston on Contracts* (3rd ed) (1970) vol 12 s 1485 at 304. Certainly those United States authorities are tainted by the view that acceptance of a repudiation effects a rescission ab initio, a view regarded in

Australian as heretical since *McDonald v Dennys Lascelles Ltd* (1933) 48 CLR 457 and now recognised as such by the House of Lords in *Johnson v Agnew* [1980] AC 367; but this reasoning on this point still remains unimpaired. Of these cases, *Boomer v Muir* is the most spectacular, because in that case a sub-contractor on a construction project was awarded the sum of $258,000 as the fair value of the work he had performed for the defendant, even though only $20,000 remained as an outstanding debt due by the defendant under the contract. In so far as it is relevant, the decision of the Court of Appeal in England in *Rover International Ltd v Cannon Film Sales Ltd* [1989] 1 WLR 912; [1989] 3 All ER 423 -- which has attracted the attention of Professor Birks in (1990) 2 *Journal of Contract Law* 227, Mr Beatson in (1989) 105 LQR 179 and Dr Carter in Finn (ed) *Essays on Restitution* (1991) at 206 -- is to the like effect. I say "in so far as it is relevant" because it is a case dealing with a contract which was void ab initio, not a case of a contract terminated by the acceptance of a repudiation.

The cases to which I refer have been received with somewhat lukewarm enthusiasm by certain academic writers (see Goff and Jones *The Law of Restitution*, 2nd ed (1978), at 379-380, Greig and Davis *The Law of Contract*, 1st ed (1987), at 1286-1287) on the apparent ground that they are "anomalous". But to my mind this criticism of them is superficial. They are right in principle as well as justified by authority. The law is clear enough that an innocent party who accepts the defaulting party's repudiation of a contract has the option of either suing for damages for breach of contract or suing on a quantum meruit for work done. An election presupposes a choice between different remedies, which presumably may lead to different results. The nature of these different remedies renders it highly likely that the results will be different. If the former remedy is chosen the innocent party is entitled to damages amounting to the loss of profit which he would have made if the contract had been performed rather than repudiated; it has nothing to do with reasonableness. If the latter remedy is chosen, he is entitled to a verdict representing the reasonable cost of the work he has done and the money he has expended; the profit he might have made does not enter into that exercise. There is nothing anomalous in the notion that two different remedies, proceeding on entirely different principles, might yield different results. Nor is there anything anomalous in the fact that either remedy may yield a higher monetary figure than the other. Nor is there anything anomalous in the prospect that a figure arrived at on a quantum meruit might exceed, or even far exceed, the profit which would have been made if the contract had been fully performed. Such a result would only be anomalous if there were some rule of law that the remuneration arrived at

contractually was the greatest possible remuneration available, or that it was a reasonable remuneration for all work requiring to be performed. There is no such rule of law. Nor can one say that as a matter of observable fact there is any such rule. The most one can say is that the amount contractually agreed is evidence of the reasonableness of the remuneration claimed on a quantum meruit; strong evidence perhaps, but certainly not conclusive evidence. On the other hand, it would be extremely anomalous if the defaulting party when sued on a quantum meruit could invoke the contract which he has repudiated in order to impose a ceiling on amounts otherwise recoverable.

The orders which I propose are therefore:

On the appeal:

1. Orders 1, 2, 3, 4, 5 and 6 made by his Honour, Mr Justice Cole, on 26 October 1989, set aside.

2. In lieu thereof order that the respondent's appeal to the Supreme Court unders 38 of the *Commercial Arbitration Act* be dismissed.

3. Set aside the arbitrator's award dated 11 November 1989, made pursuant to the decision of his Honour Mr Justice Cole.

4. Restore the arbitrator's original award in favour of the appellant dated 17 June 1989.

5. The costs of the hearings in the court below, before the arbitrator and of this appeal to be paid by the respondent, the respondent if qualified to have a certificate under the *Suitors' Fund Act* in respect of the costs of the appeal to this Court.

On the cross-appeal:

Cross-appeal dismissed with costs.

HANDLEY JA. In this matter I have had the advantage of reading the reasons for judgment of Priestley JA and Meagher JA.

I agree with Priestley JA that the question of law raised by the principal in its application to Cole J for leave to appeal from the arbitrator's award was a new point which had not been properly raised before the arbitrator. The

point was one which affected the whole conduct of the arbitration. It was one which might possibly have been met by further evidence and by amendments to the contractor's points of claim. Accordingly, leave to appeal should not have been granted to raise such a point, and even if granted the appeal should have been dismissed: see *Suttor v Gundowda Pty Ltd* (1950) 81 CLR 418.

In fairness to Cole J, I should say that this objection was not raised before him either on the application for leave to appeal or on the appeal itself. Indeed the point was raised before us by the Court rather than by the respondent as Priestley JA has demonstrated in his judgment.

The failure of the respondent to take the point before us until it was taken by the Court, is explained in part by the fact that the arbitrator would not allow the parties to be legally represented in the arbitration. However in the end, somewhat unfairly perhaps, he allowed a departmental legal officer to be present during the arbitration to assist the departmental engineer who was actually conducting the case on behalf of the Minister. On occasions the arbitrator allowed the departmental legal officer to address him directly. The contractor had no such advantage.

Clearly the lack of legal representation for the contractor during the

arbitration made it more difficult for its legal advisers to later recognise that the point on which leave to appeal was sought from Cole J was a new point which consistently with established principle could not be taken for the first time on appeal. I agree therefore with Priestley JA that the appeal should succeed on this ground alone.

I agree generally with much of what Priestley JA has written on the other issues in the appeal. I also agree with the conclusion by Meagher JA that the principal's "decision was based on a fundamental misunderstanding of relevant matters ... and was grounded on misleading, incomplete, and prejudicial information". Meagher JA concludes that these findings demonstrate that the principal could not have given bona fide consideration to the contractor's submissions and therefore could not have been satisfied that the power which had arisen should be exercised. For myself I prefer to regard these matters as demonstrating that the principal's decision, however honest, was objectively unreasonable and therefore an invalid exercise of the power. In agreement with Priestley JA, I would hold that as a matter of construction the power must be exercised reasonably. However I have reached this conclusion by a somewhat different route to those on which he prefers to

base his judgment.

I am conscious that with the possible exception of *Meehan v Jones* (1982) 149 CLR 571 the cases that I will be citing in the reasons which follow were not referred to during the course of argument. However, the validity of an implication of reasonableness in cl 44.1 was central to the whole argument on both sides and the possible relevance of the arbitration clause was referred to. Accordingly I am satisfied that if I decide the case in the way I propose I will be doing so within the four corners of the arguments presented by the parties and that neither party will be denied procedural fairness.

The power conferred on the principal by cl 44.1 is to vary ("take over the whole or any part of the work") or cancel the contract. The power arises on the happening of any breach, however minor, and whenever the breach occurs. It also arises upon the contractor neglecting to comply with any direction given by the principal, however minor, accidental or temporary that neglect might be, and regardless of the importance or otherwise of the subject matter. This express power therefore covers many cases where the principal would have no power to rescind the contract for breach under the general law.

Apart from the great width of these powers, there are three other matters which support the existence of some restraint on their exercise apart from the normal requirement of honesty. The power may only be exercised after the principal has given the contractor "notice in writing to show cause ... why the powers ... should not be exercised". The notice must state that it is given under the clause and "shall specify the default, refusal or neglect ... upon which it is based". It is clear that the power is only exercisable for "cause" and after the contractor has been given an opportunity to be heard. This is some indication that the contractor is entitled to appeal to objective considerations including questions of reasonableness in showing cause against the exercise of the powers. The very notion of showing cause seems inconsistent with the view that the principal will be entitled to act, within the limits of honesty, on his own idiosyncratic opinion.

(1992) 26 NSWLR 234 at 280

The second matter depends on whether "the satisfaction of the principal" in cl 44.1 refers to an opinion which is reasonable or to one which is merely honest. The implication of reasonableness is readily made: see *Hillas and Co Ltd v Arcos Ltd* [1932] All ER Rep 494; (1932) 38 Com Cas 23, where (at 507; 43-44) Lord Wright referred to: "... the legal implication in

contracts of what is reasonable, which runs throughout the whole of modern English law in relation to business contracts."

Where the question has arisen in the context of conditions precedent or subsequent the courts have sometimes held that honest dissatisfaction has been sufficient: see *Meehan v Jones* and *Docker v Hyams* [1969] 1 WLR 1060; [1969] 3 All ER 808. In the context of certification clauses Devlin J said in *Minister Trust Ltd v Traps Tractors Ltd* [1954] 1 WLR 963 at 973; [1954] 3 All ER 136 at 145:

> "... there may be a question (again depending upon the implication to be drawn from the contract) whether the dissatisfaction must be reasonable, or whether it can be capricious or unreasonable so long as it is conceived in good faith ... The tendency in modern cases seems to be to require the dissatisfaction to be reasonable."

In *Stadhard v Lee* (1863) 3 B & S 364; 122 ER 138, the question arose in the context of a power in a head contractor if the sub-contract works did not proceed"as rapidly and satisfactorily as required" for he or his agent to enter into possession of the works and employ whatever number of men they considered necessary at the expense of the sub-contractor. Cockburn CJ, delivering the judgment of the court (at 371-372; 141), said:

> "... stipulations and conditions of this kind should, where the language of the contract admits of it, receive a reasonable construction, as it is to be intended that the party in whose favour such a clause is inserted meant to secure only what was reasonable and just ... where the language of the contract will admit of it, it should be presumed that the parties meant only what was reasonable, yet, if the terms are clear and unambiguous, the Court is bound to give effect to them ..."

It was held in that case that the particular contract only required the head-contractor to act honestly. However there was no provision for the sub-contractor to be given an opportunity to show cause against the formation of the opinion and there was no arbitration clause.

It seems to me that cl 44.1 should be construed as requiring the principal to act reasonably as well as honestly in forming the opinion that the contractor had failed to show cause to his satisfaction and thereafter in deciding whether or not to take over the whole or any part of the remaining work or to cancel the contract: see generally *Amann Aviation Pty Ltd v Commonwealth of Australia* (1990) 22 FCR 527 at 532, 542-544; 92 ALR 601

at 607; 616-618 and *The Commonwealth v Amann Aviation Pty Ltd* (1991) 66 ALJR 123; 104 ALR 1.

Having reached that conclusion there is no need for me to consider whether or to what extent the principal was bound by an implied obligation to accord procedural fairness to the contractor in the course of reaching a decision under cl 44.1 and whether the findings of the arbitrator sufficiently establish that the principal failed to do so.

The third matter is that the contract contains a comprehensive provision for arbitration. Clause 45 covers "All disputes or differences arising out of

the Contract or concerning the performance or the non-performance by either party of his obligations under the Contract whether raised before or after the execution of the work". After certain intermediate procedures such disputes may be the subject of a notice in writing to the principal requiring the matter at issue to be referred to arbitration.

Disputes "concerning the performance or the non-performance" by the contractor of "his obligations under the Contract" prior to the completion of the work would commonly concern the exercise by the principal of his powers under cl 44.1. The clause does not restrict the powers of the arbitrator to determine such disputes and no decision of the principal or the superintendent is protected from arbitral review. Accordingly disputes concerning the exercise by the principal of the powers conferred by cl 44.1 are subject to arbitration.

The provision for arbitration of disputes arising under cl 44.1 is a further indication that the powers it conferred are subject to some limitations other than honesty. An arbitrator could always determine whether the principal had complied with the necessary formalities and whether the other conditions precedent to the exercise of the powers had arisen. However these matters would often not be in dispute. The matter most likely to be in dispute would be whether the principal had validly exercised the power. Is it to be supposed that the parties intended that the only issue for the arbitrator in such a case would be the honesty or good faith of the principal? Is it not rather to be supposed that the parties intended that an expert lay arbitrator should determine whether the principal had acted reasonably?

There have been a number of cases in which the courts have had to determine the scope of an arbitrator's powers in the light of contractual provisions authorising an engineer, architect, auditor or principal to make a

decision having consequences for the parties.

Brodie v Cardiff Corporation [1919] AC 337 concerned disputes as to work directed by the corporation's engineer. The contractor contended that this was extra work and asked for written orders. The engineer refused on the ground that the work was covered by the contract. A written order was a condition precedent to any right in the contractor to additional payment. The arbitrator found for the contractor but the corporation declined to pay relying on the absence of any written order. The contractor succeeded in the House of Lords. Lord Finlay LC held (at 350) that "the arbitration is an appeal from the refusal by the engineer to give such an order". Lord Atkinson (at 357) said that the parties by the provision for arbitration "intended that that arbitration should have a reach and operation adequate to solve the matters in dispute, and not an arbitration so restricted in its scope as to be absolutely abortive". He added (at 358-359) that his earlier conclusion did not involve the implication of an additional term but merely a construction of the terms of the contract as a whole. Lord Wrenbury (at 367) said that "the arbitration clause is paramount to every provision of the contract other than the excepted matters which that clause provides shall be 'in the absolute and final discretion of the engineer'".

Similarly, in *Harris v Byerley* (1918) 25 CLR 55, affirming [1918] QSR 177 at 191-193, the High Court held that accounts certified by an auditor which were to be "conclusive and binding on both parties" did not bind an arbitrator. Griffith CJ, in a judgment concurred in by the other justices,

(1992) 26 NSWLR 234 at 282

rejected the appellant's submission that the auditors, by their accounts, could determine the rights of the parties. He said (at 59):

> "It is impossible, reading the agreement as a whole, especially in face of the unlimited terms of the Arbitration Clause, to hold that the auditor had such an unlimited power."

In *Piggott v Townsend* (1926) 27 SR (NSW) 25; 44 WN (NSW) 26, the court had to consider whether an architect's certificate which was "conclusive evidence" of the works having been duly completed bound an arbitrator. Ferguson J, giving the judgment of the Full Court (at 28; 28) approved the statement of Collins MR in an earlier case that "if something which purports to be conclusive is made subject to revision, it loses its quality of finality. That is the case here where the decision of the architect is made subject to the decision of an arbitrator". Earlier he had said (at 28; 27): "... As soon as

a dispute had arisen and been notified, the matter by agreement became one for decision, not by the architect, but by the arbitrator."

Similarly, in *Re an Arbitration between Mitchell and Brassey* [1939] VLR 371 at 374, Mann CJ said: "... in introducing the provision in the arbitration clause, relating to any dispute 'as to the withholding by the architect of any certificate', the framers of the contract ... did not ... intend to convey that there might only be referred to arbitration disputes as to the good faith of the architect": see also *KBH Constructions Pty Ltd v PSD Development Corporation Pty Ltd* (1990) 21 NSWLR 348 at 357-358 and *Amann Aviation Pty Ltd v The Commonwealth* (at 543-544; 618-619).

There has been no High Court decision since *Harris v Byerley* on the effect of a wide arbitration clause on earlier provisions authorising one party or his agent to make decisions having consequences for the parties. However, in *Kirsch v H P Brady Pty Ltd* (1937) 58 CLR 36 at 50, Latham CJ said: "The arbitration clause ... must be regarded as controlling ... prior provisions in the contract": see also *John Grant and Sons Ltd v Trocadero Building and Investment Co Ltd* (1938) 60 CLR 1 at 26-27 per Starke J and (at 31) per Dixon J.

In view of the High Court decision in *Harris v Byerley* it is not necessary for this Court to consider the effect of more recent decisions of the House of Lords which may have departed from the earlier principle that paramount effect is to be given to a wide arbitration clause: see *East Ham Corporation v Bernard Sunley & Sons Ltd* [1966] AC 406 and *P & M Kaye Ltd v Hosier & Dickinson Ltd* [1972] 1 WLR 146; [1972] 1 All ER 121.

Earlier authority to the same effect as *Harris v Byerley* includes *Re Hohenzollern AGT fur Locomtivben and City of London Contracts Corporation* (1886) 54 LT 596 where it was held that a provision that locomotives were to be built "to the satisfaction and approval of the purchaser's engineer" who was to provide a certificate to that effect did not bind an arbitrator who had power to settle "all disputes": see also the Court of Appeal decisions in *Neale v Richardson* [1938] 1 All ER 753, *Prestige & Co Ltd v Brettell* [1938] 4 All ER 346 and *Docker v Hyams*.

These cases demonstrate that a contractual provision that a decision by the principal to exercise a power conferred by cl 44.1 should be binding and conclusive would not have bound an arbitrator appointed under this arbitration clause. It would be strange then if the language of cl 44.1

restricted an arbitrator to determining whether or not the principal had acted honestly.

It seems to me therefore that the proper conclusion, to adopt the language of Lord Finlay LC in *Brodie v Cardiff Corporation* previously referred to, is that this arbitration was an "appeal" from the refusal of the principal to be satisfied by the cause shown by the contractor, and from his decision to exercise the powers conferred by cl 44.1. On that "appeal" the arbitrator was entitled, as he did, to review those decisions on their merits and to decide whether they were unreasonable and therefore invalid. Accordingly, I would allow the contractor's appeal on this ground as well.

In relation to the cross-appeal I agree with Meagher JA and for the reasons he has given that this fails and should be dismissed with costs.

I agree therefore with the orders proposed by Meagher JA.

Appeal allowed

Solicitors for the appellant: *Allen Allen & Hemsley*.

Solicitor for the respondent: *H K Roberts* (State Crown Solicitor).

N J HAXTON,
Barrister.

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