

**The intersection between principles governing
construction of contracts and estoppel**

1. The focus of this seminar is on the construction of contracts and, in particular, the relevance of circumstances external to a contract in construing it. I wish to discuss today the intersection between rules of contract law and principles of estoppel in this context.
2. When the construction of a written contract is in issue, the parol evidence rule operates to exclude evidence of pre-contractual negotiations and conduct in order to subtract from, add to, vary or contradict the language of the instrument. Further, there is plenty of authority¹ for the proposition that the subsequent conduct of the parties cannot be relied upon for their purposes of construing their contractual bargain.
3. Some of the exceptions to these rules – particularly the former – as explored in the recent cases, have already been touched upon. I would like to focus on the way in which the doctrine of estoppel can get around or provide an alternative answer to the rules governing formation and construction of contract.
4. Since the High Court's seminal decision in *Waltons Stores (Interstate) Ltd v Maher* (1988) 164 CLR 387, we are, of course, all familiar with the way in which the conduct of a party in the context of negotiations for a contract can give rise to an estoppel preventing the party from denying that the contract has come into existence. In that case, of course, Waltons' failure to execute the contract for construction of its new store did not avail it when it changed its mind; it was bound by its solicitors' representation, made in the last stages of

¹ Eg, *FAI Traders Insurance Co Ltd v Savoy Plaza Pty Ltd* [1993] 2 VR 343; *Ryan v Textile Clothing and Footwear Union of Australia* [1996] 2 VR 235 at 238; *L Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235 at 261; *Australian Mutual Provident Society v Chaplin* (1978) 18 ALR 385 at 392 (PC). Cf *Spunwill Pty Ltd v BAB Pty Ltd* (1994) 36 NSWLR 290.

negotiations, that the contractual documents were in acceptable form for execution, and was estopped from denying the existence of the contract.

5. However, pertinently for present purposes, the operation of the doctrine of estoppel can extend further and effectively trump those principles like the parol evidence rule which otherwise operate to hold the parties to their written bargain.
6. Conventional estoppel is an area in which evidence of the subsequent or post-contractual conduct of the parties can be led in order to affect the construction or operation of their agreement in the absence of a formal variation. This is a handy tool in the barrister's armoury, for example, if there will be difficulty in establishing consideration for a variation. The seminal case on this topic is probably *Amalgamated Investment & Property Co Ltd v Texas Commerce International Bank Ltd*,² a 1982 case in which the first instance decision of Mr Justice Robert Goff was upheld by a Court of Appeal led by the venerable Lord Denning.
7. In that case, the plaintiff was an English company with a subsidiary in the Bahamas. The defendant, an English bank, lent money to the plaintiff and, through one of its own subsidiaries, also lent money to the plaintiff's Bahaman subsidiary. The question in the case was the application of a guarantee executed by the plaintiff before the loan to the subsidiary was made; specifically, did the guarantee cover loans made by the bank's *subsidiary* to the plaintiff's subsidiary? Goff J held that, on its proper construction, the guarantee was confined to moneys lent by the bank itself, and did not extend to moneys loaned by its subsidiary. Nevertheless, the evidence showed that at the time of the making of the loan and subsequently, the parties had conducted themselves as if the already executed guarantee applied to the loan from the bank's subsidiary. And, in reliance on the assumed application of the guarantee, the bank allowed the loan to remain on foot when it could have called it in.

² [1982] 1 QB 84.

8. Goff J held, and the Court of Appeal agreed, that the plaintiff was estopped from asserting that its obligations under the guarantee were confined to loans from the defendant and did not extend to the loan from the subsidiary.
9. Lord Denning summarised the applicable principle in this way (at 121-122):

“[W]hen the parties to a contract are both under a common mistake as to the meaning or effect of it – and thereafter embark on a course of dealing on the footing of that mistake – thereby replacing the original terms of the contract by a conventional basis on which they both conduct their affairs, then the original contract is replaced by the conventional basis. The parties are bound by the conventional basis. Either party can sue or be sued upon it just as if it had been expressly agreed between them.”³
10. A more recent, Australian example of the operation of conventional estoppel is *Moratic Pty Ltd v Gordon* [2007] NSWSC 5. That case concerned a hotel lease. The Gordons who owned the freehold of the Oaklands Hotel, leased it to the Danahers in 1993. The lease contained a covenant to pay a fixed amount of rent, which was subject to annual 4% increases. There was also a clause in the lease, clause 20, which required the lessee to pay, by way of what was called “additional rent”, an amount equivalent to 4% of the value of liquor delivered to the hotel. However, as a matter of practice, this latter covenant was never enforced or referred to by the lessor, and was never complied with by the lessee. In 1999, the Danahers sold the hotel business to Moratic Pty Ltd, which took a transfer of the lease. Presumably based on information from the Danahers, Moratic assumed that it would not have to pay the “additional rent” prescribed in clause 20 of the lease. Critically, over the years which followed,

³ Formerly, as appears from obiter comments by the High Court *Con-stan Industries of Australia Pty Ltd v Norwich Winerthur Insurance (Australia) Limited* (1986) 160 CLR 226 at 244-245, there was perceived to be a distinction in the area of conventional estoppel between assumptions of fact (which, so it was said, could support a estoppel of this kind) and assumptions of law (which, so it was said, could not). However, as *Amalgamated Investments* itself illustrates, this erstwhile perceived distinction no longer seems to apply: see the discussion in *Equuscorp Pty Ltd v Wilmoth Field Warne* [2007] VSCA 280 at [71], [73] per Buchanan, Ashley and Neave JJ; and further *Rydelar Pty Ltd v Euphoric Pty Ltd* (2007) 69 NSWLR 603 at [198], citing *The ‘Indian Grace’ (No 2)* [1998] AC 878 at 913 per Lord Steyn; *Ewing International LP v Ausbulk Ltd (No 2)* [2009] SASC 381 at [236] per Layton J; cf *Bofinger v Kingsway Group Limited* (2009) 239 CLR 269 at [75]. Even if it does, there is a view that an assumption as the existence of a contract or its terms is one of fact: see *Riseda Nominees Pty Ltd v St Vincent’s Hospital (Melbourne) Limited* [1998] 2 VR 70 per Callaway JA.

the Gordons, as lessors, never referred to or sought to enforce the additional rent clause against Moratic.

11. Then, in 2006, Moratic sought to sell some poker machine entitlements which were attached to the hotel licence. The Gordons tried to prevent the transfer, claiming that their consent for the transfer was required because they had a “financial interest” in it. In order to found this “financial interest” the Gordons claimed, for the first time, that Moratic owed them money under the additional rent clause, clause 20.
12. Moratic’s position was that clause 20 was unenforceable, contending for, in the alternative, an implied term, a variation of contract or an estoppel. Brereton J rejected each of its arguments, including a claim for a promissory estoppel, save for its alternative contention for a conventional estoppel. The conduct of the parties, from the time Moratic took over the lease, was consistent with an assumption that it was not required to comply with the additional rent clause. And, while there was no evidence of the Gordons having made any representation about enforcement of clause 20, or otherwise having induced Moratic to make the assumption it did, there was sufficient evidence that both parties adopted the assumption that clause 20 would not be enforced as their conventional basis of dealing. Moreover, according to Brereton J, Moratic acted to its detriment on the assumption. I have to say I do not find his Honour’s reasoning quite as persuasive on this issue, as he identifies as potential detriment Moratic’s acquisition of the hotel at a price it would not otherwise have been prepared to pay (at [41]). The difficulty with this was the paucity of evidence supporting a *mutual pre-contractual* assumption on the basis of which the parties entered into the transfer of the lease.⁴ However, more convincingly, his Honour pointed to the fact that Moratic would, if the clause was enforceable, have had to pay all of the back rent in one lump, rather than funding it incrementally out of cashflow.⁵ As has been pointed out from

⁴ Also referred to the fact that Moratic would have to pay *all* of the back rent, including pre-assignment back rent, although unclear why this would be so.

⁵ Citing *Je Maintiendrai Pty Ltd v Quaglia* (1980) 26 SASR 101; *Mineaplenty Pty Ltd v Trek 31 Pty Lte* [2006] NSWSC 1203 at [58].

time to time,⁶ while the relevant detriment to found an estoppel must not be speculative, it need not be great.

13. Brereton J⁷ summarised the elements of the conventional estoppel in that case as follows:

- “• Moratic assumed that the only rent payable by it under the lease was [the fixed rent] reserved by clause 4.1;
- The Gordons adopted the same assumption;
- Both parties have conducted their relationship on that basis;
- Each party knew that the other was conducting the relationship on that basis; and
- Departure from that assumption would occasion detriment to Moratic.”

14. As flagged, albeit in a subsidiary way, in *Moratic*, the *pre-contractual* conduct of the parties might also affect the meaning of the agreement through a conventional estoppel. Almost 80 years ago, in *Thompson v Palmer* (1933) 49 CLR 507 at 547, Dixon J pointed out that one party to a contract could be required to abide by an assumption because it formed the conventional basis upon which both contracting parties entered into their legal relationship.⁸ This can be so notwithstanding that the estopped party played no part in the adoption of the assumption. Moreover, as Dixon J explained four years later in *Grundt v Great Boulder Pty Gold Mines Ltd* (1937) 59 CLR 641 at 676-677, the relevant assumption can not only be contrary to the facts, but can be *known* by the parties to be contrary to the facts.⁹ Nevertheless, despite this authority, there has been an enduring debate about the extent to which a claim of conventional estoppel can be proved by adducing evidence of pre-contractual negotiations which would otherwise offend the parol evidence rule or

⁶ As Bollen J said in *Mortgage Acceptance Nominees Ltd v Australian Thoroughbred Finance Pty Ltd* (1996) 69 SASR 302at 313: “In his dissenting reasons in *Je Maintiendrai Pty Ltd v Quaglia* (1980) 26 SASR 101, Cox J said, ‘The detriment need not be great but it must be substantial not merely speculative or conjectural’ (at 117). Cox J spoke in a dissenting judgment but that sentence, in my opinion, is undoubtedly correct.”

⁷ Brereton J’s statement of the law has been approved, eg, by NSWCA in *Rydelar Pty Ltd v Euphoric Pty Ltd* (2007) 69 NSWLR 603 at [200]; also referred to with approval in *Rebenta Pty Ltd v Wise* [2009] NSWCA 212 at [65]. In the Victorian Supreme Court, see *Apollo 169 Management Pty Ltd v Pinefields Nominees Pty Ltd* [2010] VSC 40 at [85]-[86] per Emerton J.

⁸ Picked up and applied in *Grundt v Great Boulder Pty Gold Mines Ltd* (1937) 59 CLR 641 at 676.

⁹ See, eg, *Ferrier v Stewart* (1912) 15 CLR 32, referred to by Dixon J in *Grundt* at 677.

contradict an express entire agreement clause.¹⁰ I shall return to this momentarily.

15. The recent decision of the NSW Court of Appeal in *Saleh v Ramanous* [2010] NSWCA 274 provides a different example of how the parties' pre-contractual negotiations can give rise to an estoppel – this time, promissory estoppel – which fundamentally affects the subsequently established contractual relationship between them. This case is an interesting illustration of the breach of a formerly perceived limitation on the operation of promissory estoppel to instances where the conduct giving rise to the estoppel occurred in the context of an *existing* contractual relationship.¹¹ This case also demonstrates that pre-contractual conduct can also give rise to an estoppel fundamentally affecting the operation of the ensuing contract in a way which brings it into direct collision with rules about parol evidence and entire agreement.
16. In *Saleh v Romanous*, the Salehs were developers who owned a property in Dundas. Michael Saleh's brother, Edmond, owned an adjoining property. The Saleh brothers obtained development consent for the erection of eight townhouses on the combined site in July 2003. In May of the following year, Michael Saleh and his wife entered into a contract with the Romanouses to sell

¹⁰ As to expressions of the view against receiving evidence of pre-contractual negotiations to support a conventional estoppel in the fact of an entire agreement clause see, eg, by McLelland J in *Johnson Matthey Ltd v AC Rochester Overseas Corp* (1990) 23 NSWLR 190 at 195 – 196; Miles CJ in *Skywest Aviation Pty Limited v Commonwealth of Australia* (1995) 126 FLR 61 at 102–106; Bryson J in *Australian Co-operative Foods Ltd v Norco Co-operative Ltd* (1999) 46 NSWLR 267 at 279 [51]–[52]; Young CJ in Eq in *CG Mal Pty Limited v Sanyo Office Machines Pty Limited* [2001] NSWSC 445 at [49]–[54] and *Arnot v Hill-Douglas* [2006] NSWSC 429 at [80]–[87]; Palmer J in *Franklins Pty Limited v Metcash Trading Ltd* [2007] NSWSC 242 at [94]–[97]; Einstein J in *Chint Australasia Pty Limited v Cosmoluce Pty Limited* [2008] NSWSC 635 at [134]–[141]. Contrary views were expressed by Rolfe J in *Whittet v State Bank of New South Wales* (1991) 24 NSWLR 146 at 153–154; *semble* by McHugh JA in *State Rail Authority of NSW v Heath Outdoor Pty Limited* (1986) 7 NSWLR 170 at 193; and by Allsop J who carefully reviewed the authorities in *Branir Pty Limited v Owston Nominees (No 2) Pty Limited* (2001) 117 FCR 424 at 543 [444] – 544 [447]. See further the discussion by Tobias JA, with whom Mason P and Campbell JA agreed, in *Rydelar Pty Ltd v Euphoric Pty Ltd* (2007) 69 NSWLR 603 at [204]–[214]; and by Kourakis J in *Palm Gardens Consolidated Pty Ltd v PG Properties Pty Ltd* [2009] SASC 311. There is also a helpful discussion on this topic in Derham, 'Estoppel by Convention – Part 1', (1997) 71 *ALJ* 860 at 867&ff. In my view, just as evidence of pre-contractual negotiations will be received for the purposes of establishing a claim for rectification, it is hard to justify exclusion of evidence of pre-contractual conduct said to give rise to a mutual assumption or conventional basis of dealing affecting the construction or operation of the contract.

¹¹ See, eg, *Legione v Hateley* (1983) 152 CLR 406 at 435 cf *Central London Property Trust Ltd v High Trees House Ltd* [1947] 1 KB 130 at 134-135 per Denning J.

them the property they owned. The purchase price for the property had been negotiated by the parties, and only made sense, upon the assumption that the two adjoining properties would be developed together.

17. Nevertheless, the purchasers' solicitor tried unsuccessfully to have a clause inserted in the contract making it conditional on the vendors obtaining development consent. Such a clause which would really have been redundant since development consent had already been obtained; the Romanouses' real objective was to make sure that the development would go ahead. Before exchange of contracts, Mr Romanous raised this with the vendor, Mr Michael Saleh, who said words to the effect: 'leave my brother Edmond to me. I'll take responsibility for him. If he doesn't want to build, you don't have to buy and you'll get your money back'.
18. No such promise was included in the contract executed by the parties. A substantial deposit was paid by the Roumanouses.
19. Thereafter, the inevitable happened. No joint development proceeded and Mr Saleh's brother declined to sell his property to the Romanouses. Things dragged on fitfully for several years, with the Romanouses ignoring notices to complete from the Salehs and the Salehs declining to return the Romanouses' deposit. Finally, the purchasers purported to rescind the contract and brought proceedings to recover their deposit.
20. The trial judge upheld the purchasers' claim that their inability to negotiate a satisfactory joint venture arrangement activated a promissory estoppel, based on Michael Saleh's pre-contractual promise, which entitled them to rescind the contract. The vendors challenged the trial judge's decision on the basis that the parol evidence rule and an entire agreement clause in the contract excluded any pre-contractual promissory estoppel.
21. These arguments failed in the Court of Appeal, which held that promissory estoppel was amongst the remedies which "trump the legal rules about parol evidence and entire contracts".¹² Despite the fact that the written contract

¹² At [57] per Handley AJA, Giles JA and Sackville AJA agreeing; see also at [68]-[72].

provided that it constituted the parties' entire agreement, the Court upheld the trial judge's finding that Mr Saleh's pre-contractual promise gave rise to a promissory estoppel which precluded the vendors from enforcing the contract of sale. The consequence was that the purchasers were entitled to rescind the contract.¹³ So, even though the Court expressly eschewed any elevation of the pre-contractual promise to one having contractual force,¹⁴ the *practical* effect was that the purchasers were in the same position as if there had been a contractual condition which had failed.

22. So, the purchasers' claim of promissory estoppel in this case circumvented both the parol evidence rule and their express agreement that their written contract was an exhaustive statement of their bargain with the vendors. I adverted earlier to the debate about reception of evidence of pre-contractual negotiations in cases where a conventional estoppel is alleged. Where does the decision in *Saleh* leave this debate?
23. In my view, it vindicates the approach taken by Rolfe J of the New South Wales Supreme Court in the 1991 case of *Whittet v State Bank of New South Wales*.¹⁵ In that case, a husband and wife mortgaged their home as security for a \$100,000 business loan to the husband. The mortgage was expressed to be an "all moneys" security. Nevertheless, evidence was received of an arrangement between the wife's solicitor and the bank prior to the execution of the mortgage that the amount secured was not to exceed the \$100,000 principal of the business loan plus interest and charges. Although the solicitor sought written confirmation of this arrangement from the bank, it was not forthcoming. Subsequently, the husband incurred further liabilities to the bank and, when he defaulted, the bank sought to enforce its security over the house in respect of those additional liabilities. Rolfe J held¹⁶ that evidence of the arrangement limiting the scope of the mortgage was receivable notwithstanding the parol evidence rule and upheld the claim for conventional estoppel. In doing so, he

¹³ Section 55(2A) of the *Conveyancing Act* provided that "[i]n every case where the court refuses to grant specific performance of a contract ... the court may, if it thinks fit, order repayment of any deposit with or without interest thereon"; see also *Harkins v Butcher* (2002) 57 NSWLR 558 at 571-574.

¹⁴ At [73].

¹⁵ (1991) 24 NSWLR 146.

¹⁶ At 153-154.

emphasised that in order to establish a conventional estoppel which overcomes or contradicts the express terms of the parties' subsequent agreement there must – as with a claim for rectification– be clear and convincing proof.

24. Such an approach sits comfortably with the operation of the doctrine of promissory estoppel in its primacy over the parol evidence rule. Indeed, if one subscribes, like Deane J and others, to the thesis that there is but one overarching doctrine of estoppel, it is really inescapable that, notwithstanding the parol evidence rule, evidence of pre-contractual negotiations must be receivable to establish a common assumption forming the conventional basis upon which the parties entered their agreement.
25. Technically, promissory estoppel, which had its origins in equity, differs from common law conventional estoppel in that for promissory estoppel, unlike its common law cousin, the defendant must play a part in inducing the plaintiff to adopt the assumption the subject of the estoppel.¹⁷ Proponents of the theory that there remains a conceptual distinction between the rules of equity and those of the common law in the area of estoppel may put this down to the fact that equity operates on the defendant's conscience and will only come to the plaintiff's aid because it would be unjust or inequitable to allow the defendant, having played a part in getting the plaintiff to make an assumption on which he then relies to his detriment, to resile from that assumption. Those who adhere to a unified theory of estoppel requiring unconscionable conduct on the part of the defendant would, in the context of conventional estoppel, likely find this requirement satisfied, as the Victorian Court of Appeal did in *Equuscorp Pty Ltd v Wilmoth Field Warne*,¹⁸ in the defendant's attempt to resile from an assumption which was shared by the plaintiff and which formed the common basis for the conduct of their relationship.¹⁹
26. By way of parting remarks on this topic, some food for thought: the operation in this contractual context of an estoppel could throw up some interesting or

¹⁷ See *Moratic* at [33], referred to with approval in *Rebenta Pty Ltd v Wise* [2009] NSWCA 212 at [65].

¹⁸ [2007] VSCA 280 at [66]-[74], [76]-[77].

¹⁹ Cf *Ewing International LP v Ausbulk Ltd (No 2)* [2009] SASC 381 at [237] per Layton J.

incongruous results – for instance, if a contract, the construction of which has been affected by a conventional estoppel or promissory estoppel, is assigned. For example, if the purchaser in *Saleh* had assigned the executory contract of sale to another, including a nominee, the new purchaser – to whom no representation about development of the neighbouring property had been made by the vendor - would presumably not have been entitled to rescind. The position would have been quite different if, instead of an estoppel, the vendor's conduct had given rise to an implied term or a variation of the contract. So, while – as in *Moratic* – a single set of factual circumstances may be argued, in the alternative, to give rise to an implied term, variation of contract or an estoppel, the implications of the Court finding the latter rather the former could be profound. In *Moratic*, this was certainly the case because the hotel lessee, which had successfully argued that the lessor was estopped from enforcing the clause entitling it to “additional rent” in the amount of 4% of liquor sales – could not have passed on the benefit of that ruling if it sold the business and transferred the lease to the purchaser if the lessor chose to enforce the terms of the contract.

27. Such factors may give rise to strategic and other considerations for counsel and solicitors when addressing how a client's case might best be framed. But the availability of estoppel might, in a given case, just allow your client to get around the terms of their solemn written bargain.

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