NEWSLETTER

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ENHANCING SUCCESS

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Corporate & Commercial Newsletter

Welcome to our May Corporate & Commercial newsletter

This quarter we have included news on:

- the implied contractual duty to cooperate and *Famestock Pty Ltd v The Body Corporate for No 9 Port Douglas Road Community Title Scheme 24368*
- retention of title supplier versus debt factoring financier – the PPSA priority battle
- the decision of *Malago Pty Ltd v AW Ellis Engineering Pty Ltd*, which considers whether parties are bound by heads of agreement
- an article on the value of lawyers in any transaction.

Please do not hesitate to contact us if you would like more information on any topic, whether covered in this newsletter or not. We hope you find the newsletter informative and useful.

Ian Sinclair
Partner
Phone (direct) **+61 3 9608 2166**
Mobile **+61 412 906 896**
Email **i.sinclair@cornwalls.com.au**

*Click on image to view Ian's profile

The implied contractual duty to cooperate – *Famestock Pty Ltd v The Body Corporate for No 9 Port Douglas Road Community Title Scheme 24368* [2013] QCA 354

This recent decision confirms that courts will readily imply a duty to cooperate into a contract; however, the scope of the duty is determined by the agreement itself and does not extend to a party abandoning its own interests.

Background

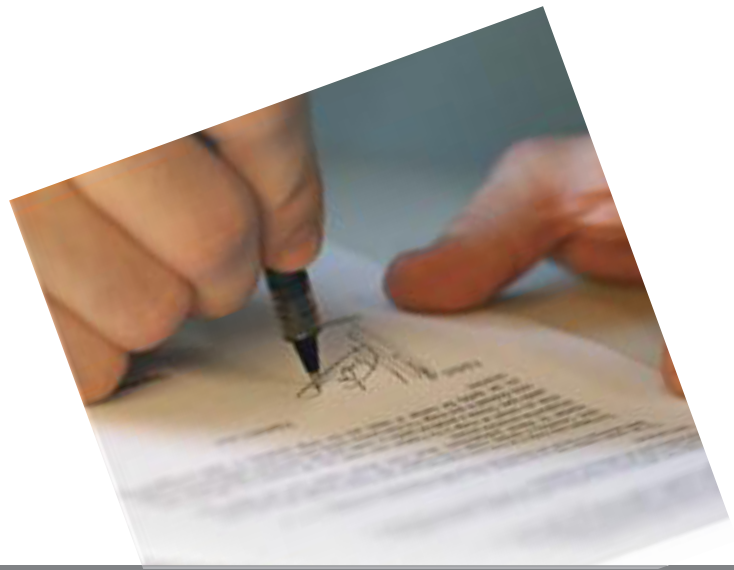
The appellant, Famestock Pty Ltd (**Famestock**), commenced proceedings against the respondent, Body Corporate for No 9 Port Douglas Road Community Title Scheme 24368 (**Body Corporate**), seeking damages for the alleged breach of the respondent's implied contractual duty to cooperate.

Facts

In 1998, Famestock and the Body Corporate entered into a caretaking and letting agreement where Famestock was

the letting agent for the respondent's building complex. Famestock acted as letting agent for the respondent for more than two years without a valid real estate agent licence. In doing so, it breached clauses 8.1.5 and 8.1.6 of the agreement, which entitled the respondent to terminate the contract by notice in writing (per cl 10.1.2). The respondent served eight notices of termination on Famestock; three were related to the failure to obtain the licence.

In order to be granted a new licence, Famestock was required to provide evidence to the Office of Fair Trading (**OFT**) of body corporate approval to conduct the letting business. However, the Body Corporate informed the OFT that the 1998 agreement was possibly invalid due to Famestock's breach of contract. Subsequently, the OFT refused to grant the respondent a licence on the basis that the eligibility requirements, namely body corporate approval, were not met.



Queensland Supreme Court of Appeal decision

At first instance, the trial judge rejected Famestock's argument, finding that the implied duty to cooperate did not require the respondent to assist the appellant in securing a new real estate licence.

On appeal the Queensland Supreme Court affirmed the trial judge's decision. Douglas J (with whom the Chief Justice and Fraser JA concurred) confirmed that the courts will readily imply a term in any contract that the parties shall cooperate to ensure the performance of their bargain. However, the degree of cooperation required is 'determined by the obligations imposed by the contract' (either expressly or impliedly), rather than what is reasonable.

His Honour clarified that the duty does not require a party to abandon its own interests under the contract and refrain from pursuing a remedy available to it (such as the right to terminate upon the other party's failure to comply with their contractual obligations).

A positive obligation on the respondent to assist in the procurement of a licence would contradict the express terms of the agreement. Such an interpretation of the duty would oblige the respondent to assist the appellant to remedy its own two-year ongoing breach. As such, the respondent was under no duty to tell the OFT that the agreement was still on foot.

Douglas J recognised that if an existing licence was coming up for renewal or the appellant did not have a licence at the commencement of the agreement, the duty to cooperate may have required the respondent to do what was 'reasonably necessary' to ensure its existing licensed status did not lapse. However, in this case it was no fault of the Body Corporate that Famestock was operating for more than two years without a licence.

The appellant was not entitled to damages because there was no breach of the implied duty.

Impact

Although a court might readily imply a duty to cooperate into a contract, the scope of the duty is determined by the agreement itself and does not extend to a party abandoning its own interests under the contract.

Contact: **Ian Sinclair**, Cornwall Stodart

Retention of title supplier versus debt factoring financier – the PPSA priority battle

Those in the business of debt factoring will be familiar with the implications of the *Personal Property Securities Act 2009* (**PPSA**) and in particular the role of s 64 of the PPSA.

However, those in the business of supplying commercial goods on retention of title (**ROT**) terms may be less familiar with the repercussions of that provision on their otherwise super priority.

Indeed, s 64 is one of those provisions in the PPSA that you either have to know about for protecting your interest or come to know at your peril when things turn ugly and parties look to priority and extinguishment issues to resolve who gets a bite of the cherry.

This article is aimed at providing a simple 'heads up' to those in the business of supplying goods and at the same time obtaining debt finance by way of, for example, factoring, debtor finance or invoice discounting.

What is section 64?

Section 64 is located in that part of the PPSA dealing with general rules relating to security interests, priority between security interests and specifically priority of purchase money security interests (**PMSIs**).

In summary it provides certain instances where a non PMSI will have priority over a PMSI – in other words, super priority of a PMSI is not assured for the PMSI registered interest.

The key elements are that a **non PMSI** granted for **new value** in an **account** as **original collateral** and perfected by **registration** has priority over a perfected PMSI that is granted by the same grantor in the account as proceeds of **inventory** if either:

- the non PMSI is registered **before** the earlier of the perfection or registration time of the PMSI; or
- the secured party who has the non PMSI gives a **notice** to the secured party who holds the PMSI and the notice is given at least 15 business days before the earlier of the day on which the registration by the non PMSI is made and the day the priority interest attaches to the account.

In other words, if the key elements of s 64 are satisfied and a debtor financier issues a valid notice to a ROT supplier, the debtor financier will have priority over the ROT supplier in certain circumstances.

A practical example:

- goods are supplied under a ROT;
- the goods are on-sold by the customer to a purchaser;
- the customer obtains finance in respect of the unpaid invoice to the purchaser such as by way of factoring, debtor finance or invoice discounting;
- the customer becomes insolvent and at the time of the insolvency, the purchaser has not paid in full for those goods and the ROT supplier is also not yet paid;
- the ROT supplier and the debtor financier both have claims regarding the unpaid debts owing by the purchaser in respect of those goods.

If the debtor financier has issued a valid s 64 notice, it will have priority for the proceeds of payment from the unpaid debts ahead of the ROT supplier, irrespective of whether the ROT supplier has registered a PMSI earlier than the non PMSI registration by the debtor financier.

Will s 64 apply to my business?

Section 64 applies specifically to:

- **Collateral** or 'property' that is classified for registration purposes as 'accounts'. Accounts are monetary obligations arising from disposing of property or granting a right or providing services (eg receivables/ debts/invoices). This does not include bank accounts.
- **Non PMSI interests and PMSI Interests**. ROT terms create a PMSI interest and should be registered as such, whereas debtor finance does not create a PMSI interest in the collateral.
- **Proceeds of inventory**. Inventory is defined as personal property that in the course or furtherance of an enterprise to which an ABN has been allocated is held by the person:
  - for sale or lease; or
  - to be provided under a contract for services; or
  - as raw materials or as work in progress; or
  - to be used or consumed by the person as materials.
- **Proceeds**. Proceeds relate to the proceeds/funds arising from the supply or on-sale of that property.

Practical repercussions for debtor financiers

- Debtor financiers should search the PPSA Register to determine if any other registrations exist over inventory. If a PMSI registration exists over inventory and that inventory will be financed by the debtor financier, then the financier should immediately give a s 64(2) notice to the PMSI holder of its interest in the approved form.
- While the 15 business day period can be extended, it requires leave of the court – which at the very least complicates the process.
- Debtor financiers should diarise to search the register again as soon as the 15 business day period lapses to ensure that no other interests have appeared on the register. Registration should also be immediately made.
- Consider whether the impact of the PPSA priority rules should be altered by entering into a deed of priority with the ROT supplier.

Practical repercussions for ROT suppliers

- The supplier of collateral/property under ROT terms should ensure that it registers its interest as soon as possible to ensure that it does not register after a debtor financier has registered its non PMSI and thereby lose its priority.
- The supplier of collateral under ROT terms should be aware that if it receives a s 64(2) notice, its priority over the inventory will be postponed to the debtor financier in the event that priority becomes an issue.
- If there is a possibility that your ROT covers inventory and non inventory, it is best to do two separate registrations – against inventory and against non inventory – because it could have benefits later in determining the extent of any priority under a s 64(2) notice.
- Check if the notice appears in order or is challengeable for not complying with the PPSA provisions; obtain legal advice if unsure.
- If the notice appears in order, consider it as an opportunity to review your position with the customer to ensure you are otherwise adequately covered for future exposure, or consider negotiating a deed of priority with the debtor financier.

Final cautionary words

Notwithstanding the operation of s 64, be aware that if the proceeds of an item of inventory are deposited into a bank account operated by an ADI (authorised deposit-taking institution), there will be other issues of priority in favour of the bank to consider over and above the issues discussed in this article.

As with much of the PPSA, the devil is in the details when interpreting the operation of the Act. The purpose of this article is to spotlight the operation of s 64 and its possible gremlin role – if in doubt, refer to Cornwall Stodart for further guidance.

Author and contact: **Jacquie Browning**, Cornwall Stodart

Are parties bound by Heads of Agreement?

Malago Pty Ltd v AW Ellis Engineering Pty Ltd [2012] NSWCA 227

In *Malago Pty Ltd v AW Ellis Engineering Pty Ltd*, the court considered the extent to which parties may be legally bound by Heads of Agreement.

The decision is significant because it demonstrates the court's discretion to render parties legally bound by Heads of Agreement entered into after mediation.

Facts

The appellant, 'James Interests', entered into negotiations with the respondent, 'Ellis Interests', for the sale of a super yacht marina business in Sydney.

The parties fell into dispute during negotiations, culminating in mediation. After mediation, the parties entered into a Heads of Agreement for James Interests to purchase Ellis' Interests in the business.

The parties subsequently failed to settle a formal contract clarifying the terms of the Heads of Agreement, and James Interests withdrew from the negotiations.

Ellis Interests commenced proceedings, seeking specific performance of the Heads of Agreement and the sale of the business.

At trial in the New South Wales Supreme Court Equity Division, Sackar J gave orders for specific performance, requiring the parties to enter into a deed with particular clauses to be included. Sackar J considered the parties to have already agreed on these clauses before the negotiations broke down.

The decision was appealed to the NSW Court of Appeal.

Judgment

Their honours Bathurst CJ, Macfarlan JA and Meagher JA allowed the appeal.

The court was satisfied that the parties had objectively intended to be bound by the Heads of Agreement. It also rejected the claim that the Heads of Agreement was void for any uncertainty or incompleteness.

The Supreme Court's order for specific performance was overturned. The Court of Appeal instead found that the parties should not be bound by terms agreed on by the solicitors without instruction from the parties. The Heads of Agreement did not authorise the solicitors to act as 'independent arbiters'.

The court found that the trial judge erred in requiring parties to enter into a deed including a large number of clauses that were either agreed on in post-Heads of Agreement negotiations or were simply reasonable and consistent with the Heads of Agreement.

The court ordered a 'Formal Contract' to be executed, which only incorporated the terms that were negotiated after the Heads of Agreement and that were agreed on by both parties. This was ascertained by submissions made by the parties to the court.

Possible implications

This case reaffirms that a court is willing to enforce commercial agreements and stresses the significance of parties making clear their 'objective intentions' in commercial agreements.

It serves as a reminder that Heads of Agreement may be constructed as formal contracts, giving rise to binding rights and obligations.

When entering into Heads of Agreement, parties should state their legal intentions and include the main terms of the intended arrangement as clearly and promptly as possible.

Contact: **Ian Sinclair**, Cornwall Stodart

Banking lawyers – who needs them?

As the Australian property and financial markets ease themselves out of the global financial crisis, the effects of that crisis continue to be felt across certain areas of legal practice.

This article does not seek to create sympathy for banking or corporate or property lawyers (so hold off the violins!), but rather is aimed at providing a timely reminder as to why lawyers do actually make valuable contributions to business transactions.

In particular, this article reminds us that all lawyers (but for the purposes of this article, banking lawyers) still add value in a significant and important way to all transactions and should not be disregarded.

You need an architect

As funds become short and economic times tough, many tend towards taking short cuts in the hope of saving money. The tendency to do without banking lawyers for commercial and private transactions can be likened to the tendency to do without architects when designing buildings – the perception being that neither is essential and that others can perform the tasks equally well. But how can one create buildings or read and negotiate the terms of a loan facility and securities without expert input?

In a rare attack on the Bank of England, the Mayor of London Boris Johnson told *The Times* that too few people were defending banking's role as a 'vitally important function doing things that are crucial for enterprise in this city'.[1] The role of banks in providing essential capital for enterprises to start up, grow or expand cannot be underestimated.

The relationship between a financier and borrower should be a partnership, built on good foundations and mutual respect.

The landscape is changing

Putting aside particular issues of profits, management and other topical issues more appropriate for political and social debate, the fact remains that at one point or another, most businesses (whether small or large) and most home owners or investors will need funds to enable assets or wealth to be accumulated. Such funds usually source from larger financial institutions, but equally and more frequently than has previously been the case, are sourced from private equity, debt funding organisations and other less mainstream sources of capital.

The landscape is not the same as it once was, and will no doubt

1 Sam Coates, The Times, 'Stop all this austerity talk and speak up for the banks, says Boris' <http://www.thetimes.co.uk/tto/business/industries/banking/article3604235.ece> 19 November 2012

continue to change with globalisation, shifting economies and the internet – which is changing the way business is done.

You need a plan

What value can banking lawyers add to a transaction?

Whether taking out a new facility or refinancing an existing facility with the same lender, banking lawyers perform important roles in negotiating the best terms for their clients, whether acting for lenders or borrowers. Going without a banking lawyer is like building without detailed plans and specifications. Yes, it is possible to get there in the end – but will the result be the best that could have been achieved? Banking lawyers are trained to know what the pitfalls and vulnerabilities are for their clients, and how to negotiate terms that are fair for their clients and robust enough to withstand or deal with unexpected eventualities. Properly negotiated finance documentation enables both parties to achieve their goals in partnership without ongoing uncertainties or misunderstandings.

Despite the perceived imbalance between lenders and borrowers mid/post GFC, room still exists for competitive negotiation between financial institutions and their customers, whether it is a refinance or a new finance. It is a symbiotic relationship – banks need customers and customers need banks – and with that, follows enterprise and growth. Banking lawyers understand the site and can guide you to the best financial position possible, negotiating on your behalf and overcoming any obstacles, ensuring that you reach your destination.

A rough guide

Indicative terms sheet

When negotiating a terms sheet or letter of offer, consider market rates and compare both base interest rates and default interest rates, including the benefits or otherwise of hedging options. Banking lawyers are experienced negotiators in not only rates and pricing, but identifying and negotiating hidden extras such as line fees and ongoing service costs.

Post GFC, it has become standard practice to include provisions dealing with market disruption events and material adverse events that allow banks to pass on increased costs of funding, rather than absorb them. While a borrower may be unable to remove such provisions, it may be possible to negotiate or moderate them. Moreover, a banking lawyer can ensure the financial effects are fully explained so there are no surprises for a borrower in future. From the lender's perspective, a banking lawyer can ensure that the cost of providing funds to a borrower generates a sound financial return for the lender, enabling funds to then be available to lend to other borrowers...and so the cycle continues.

Security

Security taken by banks and other lenders to cover their exposure to debt is an essential part of any banking transaction – particularly now across factoring or debtor financing. Lending institutions will seek to take as much security as possible. This security will generally include freehold (property) mortgages, general security agreements (ie a charge over all assets), director's or personal guarantees (limited or unlimited in amount) and additional security from non borrowers but related parties (known as 'third party' security) and mortgages over leases of premises (including rights of access negotiated with lessors).

Be aware that a financier can seek to recover from any security provider – it does not have to go to the borrower first but can and usually does seek out the easiest and most profitable way of recovering any exposure. Negotiation may alter this position, which is particularly beneficial to those who have provided third party security such as directors. Banking lawyers are generally experienced in this type of negotiation, and know the traps to avoid.

If a borrower has a number of separate projects (particularly in the context of property developments), banking lawyers can also assist in negotiating for each project to be isolated from the others, to avoid 'cross collateralisation of projects via securities'. This can often mean the difference between one project standing alone or causing adverse collateral damage to other projects in the event of a default.

Events of default

Consider closely the events that can trigger a default entitling a lender to call in the loan and enforce its securities. Banking lawyers are familiar with what sorts of events are reasonable and/or commercially standard, and those that are not. Ideally, all events of default should have cure periods (ie, a timeframe for the borrower to try to rectify a default before it leads to the worst case). Be aware that changes in the financial covenants such as loan to value ratios (**LVRs**, being the value of the loan compared to the value of all the security or property in support) can also trigger events of default. At the time of negotiation of the letter of offer loan documentation, a banking lawyer can minimise the

repercussions of a change in the LVR by negotiating for time to either top up the equity (eg additional security or cash deposits) or repay some debt.

Banking lawyers can also review and negotiate clauses dealing with representations, undertakings and warranties so as to ensure that, where possible, such controls are reasonable and do not fetter the business of either the borrower or its third party security providers.

Destination

Lawyers' jokes abound. However, when one of Shakespeare's characters stated: 'The first thing we do, let's kill all the lawyers,' one school of thought argues that Shakespeare was not commenting on the worthless contribution of lawyers to law and order, but referring to corrupt and unethical lawyers, while complimenting attorneys and judges who instil justice in society.

So when you next need to refinance for a business enterprise or property project, consider the value your lawyer can add (and also your architect!). The investment and result will be worthwhile.

Author and contact: **Jacqueline Browning**, Cornwall Stodart

Jacquie Browning has been a banking lawyer for over 25 years, acting for both lenders and borrowers, and also comes from a family of architects.

The new ASX Corporate Governance Principles

On 27 March 2014 the Corporate Governance Council of the ASX released its updated third edition of the Council's *Corporate Governance Principles and Recommendations*, which take effect for a listed entity's first full financial year commencing on or after 1 July 2014. The 8 central principles are maintained with some drafting changes and there are 29 specific supporting recommendations. Changes of particular note include conducting background checks on proposed directors, that the company secretary should be directly accountable to the board (through the chair) on all matters to do with the proper functioning of the board, and the further encouragement of providing information through the company's website.

For more information please contact **Ian Sinclair**.

Team Member Profile

Joel Masterson, Partner and Head of Intellectual Property

Joel is an experienced intellectual property lawyer whose track record includes several years with the IP department of a top-tier national firm, a senior role with a boutique specialist IP firm and an in-house IP commercialisation role with a prestigious medical research institute. Joel also spent 15 months on secondment with the 2009 Victorian Bushfires Royal Commission.

Joel's areas of expertise include managing and enforcing trade marks, copyright, patents, designs and confidential information. Among other things, Joel oversees Cornwall Stodart's clients' trade marks portfolios and plays a key role in the firm's IP dispute resolution and litigation practice.

He is also a registered trade marks attorney.

Joel Masterson
Partner and Head of Intellectual Property
Phone (direct) **+61 3 9608 2264**
Mobile **+61 431 519 383**
Email **j.masterson@cornwalls.com.au**