SQUIRE PATTON BOGGS

Arbitration

Damages Claims Not "Under" Agreement

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The New South Wales Court of Appeal has held that a claim for damages for failure to pay amounts under a contract is not an arbitrable claim for a "monetary amount payable and/or owed by either party to the other under this Agreement."

In essence, the court held that a claim for damages is not a claim *under the contract*, but is a claim *under the general law* for breach of the contract. If Lord Diplock's theory of secondary obligations arising on breach of contract is adopted, the claim is under those secondary obligations rather than under the contract.

The decision emphasises the need to draft arbitration clauses with a close eye to the disputes intended to be dealt with by arbitration, whether that is all the disputes relating to the contract or only a subset of those disputes.

The Dispute and the Clause

In *Ingham Enterprises Pty Ltd v Hannigan* [2020] NSWCA 82, Inghams supplied Mr Hannigan with chicks, who grew them into chickens for Inghams for a fee. Inghams terminated the contract and ceased providing chicks for almost two years. Mr Hannigan obtained a declaration from the Supreme Court that the termination was unlawful, maintaining that he had not accepted Ingham's repudiation and the contract remained on foot. He reserved his right to claim damages and later commenced arbitration for those damages under the arbitration clause in the contract, which said, in part:

> If:
>
> 23.6.1 the Dispute **concerns any monetary amount payable and/or owed by either party to the other under this Agreement**, including without limitation matters relating to determination, adjustment or renegotiation of the Fee under Annexure 1 or under clauses 9.4, 10, 11, 12, 13 and 15.3.3; and
>
> 23.6.2 the parties fail to resolve the Dispute in accordance with Clause 23.4 within twenty eight (28) days of the appointment of the mediator
>
> then the parties must (unless otherwise agreed) submit the Dispute to arbitration using an external arbitrator (who must not be the same person as the mediator) agreed by the parties or, in the absence of agreement, appointed by the Institute Chairman. [emphasis added]

Inghams applied to restrain the reference to arbitration, with Slattery J at first instance dismissing that application (*Ingham Enterprises Pty Ltd v Hannigan* [2019] NSWSC 1186). Inghams appealed, with Meahger JA (Gleeson JA agreeing; Bell P dissenting in the result) upholding the appeal.

Unliquidated Damages Not "Under" Contract

Meagher JA held that an action for damages for breach of contract is not a claim "under" a contract and did not fall within the terms of the arbitration clause. His Honour said that one must examine the context in which the word "under" appears to determine its meaning in a particular case. Here, the context directed attention to the source of the underlying payment obligation and identified the agreement as its source.

In dispute here was a claim for unliquidated damages for a breach of Inghams obligation to supply chicks. It was not a claim to or about an amount payable of owed under an express term of the agreement. His Honour held that an obligation to pay damages for breach of contract is not created by nor does it arise under a contract. That remedial obligation arises by operation of law, which is the orthodox and uncontroversial position.

Neither is it correct to say that the assessment of unliquidated damages for breach of contract is "governed or controlled by" the contract simply because the measure of damages at common law takes account of benefits which would have been received as a result of performance. Liquidated damages are treated differently. They arise under the contract as they are recoverable in satisfaction of a right of recovery created by the contract itself and accrue by reason of breach. Unliquidated damages are merely compensation the law provides for a breach of contract.

Dissenting on this point, Bell P said that contractual damages are designed to put a party into the position it would have been in had the contract been performed and that the amount of compensatory damages for breach of the agreement will be "governed or controlled by" the agreement, because it will be by reference to the notional performance of the agreement that the damages will be quantified. His Honour quoted Kiefel CJ, Bell and Keane JJ in *Mann v Paterson Constructions Pty Ltd* [2019] HCA 32 at [12]; (2019) 93 ALJR 1164 saying:

> "The right to damages for loss of bargain that arises in such a case is, in this respect, no less a creature of the contract than the right to recover sums that become due before its termination."

His Honour said that, just because an obligation arises by operation of law as opposed to the parties' express agreement does not mean, however, that the contract may not be the source of that obligation.

Agreed Approach to Construction

Bell P and Meagher JA agreed that a dispute resolution clause, like any other clause of a commercial contract, must be construed by reference to the language used by the parties, the circumstances known to them and the commercial purpose or objects to be secured by the contract. They agreed that the issue in this case was one of construction of the contract, and the dispute resolution clause in particular, applying the objective theory of contract to the text and context. An arbitration clause must not be construed in isolation, but as part of the contract as a whole.

Both agreed that in Australia, unlike other jurisdictions, the process of contractual construction of dispute resolution clauses has not been overlaid by presumptions such as that the parties, as rational businessmen, are likely to have intended any dispute arising out of the relationship into which they have entered or purported to enter to be decided by the same tribunal unless the language makes it clear that certain questions were intended to be excluded from the arbitrator's jurisdiction.

Liberal Interpretation of Arbitration Clauses

The President made more of affording dispute resolution clauses a broad and liberal construction, giving liberal width and flexibility to elastic and general words of the contractual submission to arbitration. However, he did not need to rely on this device to come to his conclusion. Meagher JA did not disagree with this approach, but neither did he mention it in his reasons.

Mixed Litigation and Arbitration Clauses

Bell P mentioned, with apparent approval, an academic's comment that courts will strive to give efficacy to clauses that refer both to courts and to arbitration by, if possible, holding that the clause is a reference to arbitration which the court will supervise if arbitration is commenced, but if it is not, a party may commence litigation. Difficulty rises if the clause appears to make reference to arbitration mandatory, while also providing for the jurisdiction, exclusive or otherwise, of the courts. Incoherence is avoided, then, by interpreting the agreement as though the reference to arbitration were optional rather than mutually mandatory. Reference to arbitration is never fully mandatory – if neither party elects to refer the dispute to arbitration, no third party is going to force them. A court may not order a stay of proceedings and refer a matter to arbitration of its own motion, under either the International Arbitration Act or the Commercial Arbitration Acts of the States.

Comment

This fundamental question as to the source of the obligation to pay damages for breach of contract may be destined for the High Court, which may already to be divided on Lord Diplock's theory of damages as secondary obligations. In *Mann*, Nettle, Gordon and Edelman J *appear* to have questioned the theory while the majority made no comment. In the meantime, it will be better to state as broadly as possible if all disputes arising under, out of or in relation to a contract are intended to be arbitrable, or to specify with precision if some disputes must be litigated.

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