

Placer (Granny Smith) Pty Ltd v Thiess Contractors Pty Ltd

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The case of *Placer (Granny Smith) Pty Ltd v Thiess Contractors Pty Ltd*² has spent the last few years progressing through the courts of Australia. Grounded on issues of importance to arbitrators such as the obligation of good faith and the assessment and estimation of damages, the final decision in this long and difficult piece of litigation has been handed down.

General facts

Under a 'partnering' contract between Placer (Granny Smith) Pty Ltd ('Placer') and Thiess Contractors Pty Ltd ('Thiess'), Thiess agreed to carry out mining operations for Placer at rates based on genuine estimates of the cost of its operation, plus an agreed profit margin of 5%. The rates for carrying out the various mining operations were to be derived from an 'open book system', and the contract contained a clause requiring the parties to act in good faith in all matters relating to carrying out the works, derivation of rates and interpretation of the contract.

In June 1995, Placer terminated the contract, on the basis that the cost of continuing with Thiess under the existing contract was substantially higher than prices otherwise available on the market. In September 1995, Thiess Contractors commenced action against Placer alleging that, among other things:

1. the termination of the contract was wrongful;
2. Placer breached its contractual obligation to act in good faith; and
3. Placer was therefore estopped from terminating the contract.

Placer counterclaimed, alleging that it had overpaid Thiess because, in breach of the contract and despite its obligation of good faith, Thiess had deliberately inflated its estimates of costs to be incurred in carrying out the contract work. Placer argued that, when bound to act in good faith in deriving rates to be charged, and thus bound to disclose its actual bona fide estimates of costs to carry out the works, Thiess had deliberately inflated them.

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2 (2003) 196 ALR 257.

At trial (Templeman J)

At first instance, the trial judge dismissed the claim by Thiess and gave judgment for Placer for damages in the sum of \$4,853,000. According to Templeman J, this sum represented the difference between the price Thiess was paid and the amount it would have received had it properly disclosed certain costs.

On appeal (Full Court of the Supreme Court of WA)

Thiess appealed to the Full Court of the Supreme Court of Western Australia both against the dismissal of its claim and against the judgment handed down on Placer's counterclaim. While the appeal against dismissal of the claim for wrongful termination of the contract failed, Thiess effectively succeeded in its appeal against the judgment entered on the counterclaim.

The Full Court held that Placer had not proved its damages, and the court therefore set aside the judgment entered on the counterclaim and ordered that Placer receive the nominal sum of \$100.

On appeal (High Court of Australia)

Placer appealed to the High Court of Australia on the question of whether the Full Court was right to conclude that it had failed to prove the damages it had sustained as a result of Thiess' breach of contract. It was not disputed that Thiess had not disclosed its actual bona fide estimates of costs to carry out the works, and had therefore breached the contract.

The appeal was allowed with costs. It was held that the orders of the Full Court, substituting an award of nominal damages for the judgment entered by the trial judge, would be set aside, and Thiess' appeal to the Full Court of the Supreme Court of Western Australia was to be dismissed with costs.

Relevant issues

Two issues of particular importance were dealt with in the various judgments of *Placer (Granny Smith) Pty Ltd v Thiess Contractors Pty Ltd*:

1. good faith; and
2. the estimation of damages.

The treatment of the issues to do with estimation of damages has also, quite importantly perhaps, led to questions of the applicability of this case to the global claims issue.

Good faith

The obligation to act in good faith

Clause 1.1.5 of the contract between Thiess and Placer stated that, *'[t]he successful operation of this contract requires that [Thiess] and [Placer] agree to act in good faith in all matters relating both to carrying out the works, derivation of rates and interpretation of this document'*.

In generally describing the obligation to act in good faith, Templeman J stated that:

'These provisions are typical of many contained in section B which do not define rights and obligations with any precision. Their implementation clearly requires goodwill and co-operation on the part of both parties. "Good faith" must include those matters.

In addition, I think that the obligation of good faith requires the parties to deal honestly with each other. For example, in relation to carrying out the works: if Thiess sought to nominate mining equipment in accordance with cl 2.1.6, it would be required to provide an honest justification to Placer in demonstrating that the proposal resulted in the lowest overall unit costs and achieved the required mining selectivity.

In relation to the derivation of rates, cl C 2.1.3 provides for hourly operating costs of equipment to be formulated which are based on "relevant historical data". Those are Thiess' data. Hence the necessity for the "open book" negotiations. That being so, good faith, I think, would require Thiess to formulate plant rates which were honestly based on the relevant historical data' [sic].

Templeman J further stated that:

'I construe the obligation of good faith as requiring the parties to act honestly with each other and to take reasonable steps to co-operate in relation to matters where the contract does not define rights and obligations or provide any mechanisms for the resolution of disputes. ... In relation to the interpretation of the Contract, the obligation of good faith is more difficult to define. I think it requires the parties to construe or give effect to general provisions in such a way as to promote the contractual objectives which are to be gleaned either from the contract as a whole or from the provision in particular'.

From this case therefore, it can be seen that good faith involves goodwill, cooperation and honesty between the parties.

The good faith obligation and termination of the contract for convenience

The contract between Thiess and Placer was terminated by notice given to Thiess on 17 March 1995. Thiess argued that, as a matter of construction of the contract, Placer was not entitled to terminate. Alternatively, Thiess contended that Placer acted in bad faith, unreasonably, or in breach of a fiduciary duty in terminating the contract.

Templeman J found that, on the true construction of the contract, Placer had an absolute right to terminate for whatever reason it thought fit. That right was not qualified by the good faith obligation. That being so, Placer's exercise of its contractual rights involved no breach of contract. Thiess' claim in this respect was therefore dismissed.

Arbitrators will likely find this issue of particular significance, as it answers the question, perhaps unclear until now, of whether or not a termination for convenience clause can be exercised without the exercise being influenced by a duty to act in good faith.

Templeman J's conclusions on good faith

In summary, Templeman J held that, in respect of good faith:

1. in a contract requiring disclosure of confidential operating costs, a contractual obligation of good faith requires a party to formulate those costs honestly;
2. a clear and unambiguous power of termination, expressed as an absolute and uncontrolled discretion, is not required to be exercised reasonably merely by virtue of the existence of a requirement to act in good faith; and
3. a contractual obligation of good faith does not prevent either party pursuing legitimate commercial interests, even though the pursuit of those interests may result in the re-negotiation or termination of the contract.

Issues of good faith were not dealt with on appeal to either the Full Court of the Supreme Court or the High Court of Australia, so Templeman J's judgment in respect of good faith still applies.

Assessment of damages

At trial

Having concluded that Placer was entitled to terminate the contract, both as a matter of construction and for cause, Templeman J dismissed Thiess' claim for damages. He then considered Placer's counterclaim.

Placer counterclaimed for damages under the contract on a number of bases, including that it was induced to enter into the contract by misrepresentations made by Thiess, and also that Thiess acted in bad faith in not disclosing its true operating costs.

Placer's counterclaim was upheld by Templeman J, who awarded Placer damages of \$4,853,000, which represented the difference between the price Thiess was paid and the amount it would have received had it properly disclosed certain costs.

In its counterclaim, Placer claimed damages for breach of contract represented by:

'the amount overpaid by [Placer] to [Thiess] during the term of the ... contract being the difference between the amount charged by [Thiess] to [Placer] and the amount [Thiess] would have received if [Thiess'] bona fide estimated costs of completing the works at the time of entering into the contract has been used to calculate the rates adjusted at the dates set for quarterly reviews of the base rates plus a profit of 5% calculated as in para 96(a)'.

Templeman J described the manner in which Placer contended the damages were to be arrived at as follows:

1. determine revenue from progress claims (ie, the total amount paid to Thiess, which includes costs plus profit);

2. determine Thiess' profit, by using the percentage profit disclosed by the profit forecast;
3. deduct profit from revenue, so as to derive costs;
4. apply a 5% margin to costs to derive allowable profit; and
5. deduct allowable profit from actual profit to determine damages.

However, Templeman J held that the project forecasts were not reliable, and therefore that damages could not properly be assessed as Placer had contended. He argued therefore that Thiess' true profit could not be calculated by using the percentage profit disclosed by the project forecast. It was therefore not possible to deduct profit from revenue so as to derive costs.

Because of this, Templeman J went on to assess damages differently (in a way not argued by either party to the case), stating that:

'I think the appropriate course is to calculate, on a global basis, the difference between the revenue actually derived by Thiess and Thiess' costs plus a margin of 5%.'

Templeman J approached the actual calculation of damages as follows:

1. Thiess' costs in carrying out the contract were established;
2. the balance between cost overruns and overruns in the internal plant department was determined. The small net overrun was added to the cost (as that net balance resulted in a reduction of profit);
3. the contractual profit of 5% was then calculated on the cost determined after taking into account the overrun (the figure so arrived at being equivalent to the amount to be paid to a contractor under a cost-plus contract);
4. productivity increases were determined and added to the costs plus the overrun plus the contractual 5% profit; and
5. the figure arrived at in terms of the calculation in paragraph 4 above was then deducted from total revenue. The balance was then assumed to be the profit derived by Thiess from the inflated plant rates utilised in breach of the contract.

This calculation assumed that the only sources of profit earned by Thiess were the 5% fixed by the contract, cost underruns and productivity gains.

Before the Full Court

On appeal to the Full Court of the Supreme Court of Western Australia, Thiess' appeal was upheld. The Full Court held that:

1. where costs under a contract are to be determined according to a complex accounting process, that determination cannot be made after the event by the court without appropriate and persuasive evidence in relation to the workings of that process; and
2. an assessment of damages will be set aside where it is determined according to a formula different from the formula on which the parties based their evidence, cross examination and conduct of the case generally.

The Full Court held that, contrary to Thiess' contention, it was obliged to provide Placer with a genuine estimate of its costs under the contract, and that, as a consequence of Thiess' breaches of contract, Placer paid a higher rate of remuneration than had otherwise been agreed. However, the Full Court found that the method adopted by the trial judge for calculation of damages was flawed and was not a method that had been pleaded or propounded by either party to the litigation. The Full Court also held that the method of calculation advanced by Placer at trial not only had failed, but was bound to fail, to provide an accurate measure of what had been lost.

The Full Court concluded that the trial judge's method of calculation of damages was erroneous, and that there was insufficient evidence to enable a calculation on proper principles to be made. There was '*a critical lacuna in [Placer's] damages formula*', and because Placer had not proved its damages, it was entitled only to nominal damages.

In the High Court

On appeal to the High Court, however, the judgment of the Full Court in relation to the assessment of damages was overturned. This was because:

1. Thiess had effectively admitted that the difference between Thiess' internal plant department rates and the amount it charged Placer on the basis of those rates was \$2,713,940. This admission had not been drawn to the notice of the Full Court, and on that basis alone, the majority (Gleeson CJ, McHugh J and Kirby J) held that Placer was entitled to substantial, not merely nominal, damages; and
2. the majority agreed with the reasoning of Hayne J that, when due allowance is made for the fact that the calculation of damages was necessarily based on information that was primarily in the knowledge of Thiess, and involved matters of estimation as well as calculation, the assessment made by the trial judge was not shown to be in error.

Hayne J

Hayne J found that Placer sought to prove its damages by attempting to work backwards from what it had paid to the amount it had overpaid. He reasoned that:

1. it was not suggested that there was only one way in which the amount of Placer's damages could be established. It may have been that, as the Full Court suggested, another method which replicated the calculation of remuneration using proper rates would have been better than the method that was adopted. However, the method adopted by the trial judge was not, as the Full Court held, fatally flawed;
2. the method used by the trial judge sought to compare the profit in fact with the profit that should have been earned. The profit that should have been earned was 5% of estimated costs. The calculation that was made took actual not estimated costs into account. Once it was accepted, as the trial judge found, that estimated costs closely approximated actual costs, the profit that should have been earned could be calculated with considerable and sufficient precision;

3. if there were any error in the calculation of damages by the trial judge, it would flow from the fact that estimated costs may have differed from actual costs. But, as the trial judge said, *'the internal plant rates were accurate predictions of the operating costs'*;
4. once Placer demonstrated that Thiess' estimated costs closely approximated its actual costs, it was for Thiess to show why some further adjustment of the figures was necessary. Thiess raised only two matters – cost overruns and productivity gains, and the trial judge had already made adjustments for these considerations in accordance with evidence adduced by Placer;
5. it was not enough for Thiess to answer the evidence of Placer by saying that there might have been some other unidentified reason for its profit being as large as it was, or by pointing to the possibility of adopting some other method of assessing Placer's damages. Yet in essence it was these two propositions that underpinned the Full Court's conclusion that Placer had not proved the amount it had lost as a result of Thiess' breach; and
6. the proof tendered by Placer, and accepted by the trial judge, supported the conclusion that the trial judge reached that Placer had paid \$4.853 million more than it would have paid if Thiess had not breached its contract.

Callinan J

Callinan J also discussed the assessment of damages in his judgment, and made some general comments which arbitrators will no doubt find useful. Relevantly, he stated that:

1. because Thiess was deceitful in respect of the very subject matter of the claim, no court should be too critical of imperfections in the proof of a claim by the party who has been deceived, and repeatedly so in respect of its subject matter;
2. Thiess, as the party which actually did the work and was in the business of doing that work, was obviously far better placed to prove the actual relevant amounts and respective entitlements, indeed the true net financial position in respect of the performance of the contract. This was especially so in this case, in which a finding was made that Placer relied on Thiess' asserted but false costings of the work which were peculiarly in the knowledge and possession of Thiess;
3. despite what the Full Court said as to the orthodox and appropriate method of calculating damages, very often one method of calculation of damages may not necessarily prove the exclusive means of doing so. The rules in relation to the assessment of damages are not inflexible;
4. in assessing damages a court does the best it can. A judge relies on predictions and probabilities. Precision will rarely be possible in respect to future costs and profits, particularly where deceit by one party obscures the true position. Added to that here was the fact that the performance of the contract and the overcharging had been going on for a fairly long period in respect of a multiplicity of activities and items of equipment (some of which were substituted for other items of equipment); and

5. realistically, in this case, what the parties tried to do was to prove their respective net advantages and disadvantages by reason of alleged breaches of contract on either side. Thiess was in a much better position to do this than Placer. Thiess could have been in no doubt that the outcome of the trial would depend upon what it could convince the trial judge was its entitlement to, among other things, legitimate productivity gains. In this regard it was for it to put its best foot forward. Thiess should not be now heard to complain that, having failed to do so, the trial judge erred in doing the best he could in assessing damages in circumstances of some uncertainty and difficulty. This was a case in which precision was not possible without the co-operative participation of Thiess, and even then estimation of damages rather than calculation was inevitable.

Callinan J concluded by stating that he was not prepared to say that such a method of calculation of damages as the trial judge used would not have produced a reasonable measure of the damages (being what Placer would have been entitled to had Thiess honestly performed its obligations under the contract). Thiess' breaches of the contract consisted not only of overcharging but also of systematically misrepresenting the true position.

Callinan J further stated that the contractual obligation to act in good faith '*in all matters*' should not be regarded as discharged on the commencement of proceedings or suspended during them. This statement may prove to be of great significance, to arbitrators as well as lawyers, as it seems to require parties whose contract contains a good faith provision to act in good faith even during a subsequent dispute between them.

Application of this case in the context of global claims

Placer (Granny Smith) Pty Ltd v Thiess Contractors Pty Ltd may also prove to be an important case in the context of global claims. Comments made by Hayne J and Callinan J in the judgment lend support to the notion that, when all else fails, it is possible for a party to estimate or predict the damages which it has suffered (rather than providing precise evidence of what has been lost).

For example, Hayne J stated that, '*It may be that, in at least some cases, it is necessary or desirable to distinguish between a case where a plaintiff cannot adduce precise evidence of what has been lost and a case where, although apparently able to do so, the plaintiff has not adduced such evidence. In the former kind of case it may be that estimation, if not guesswork, may be necessary in assessing the damages to be allowed*'. Further, Callinan J stated that, '*what the trial judge did here was reasonable. The approach that his Honour adopted was not unfair to the respondent: the calculation, on a global basis, of the difference between the actual revenue derived by the respondent, and the respondent's costs plus a margin of 5%*'.

In recent years, there has seemed to be some softening in the approach of the courts in dealing with global claims. The question must be asked – is this case another example of such softening. While it is too early to answer this question for sure, it will be interesting to see how owners and contractors react to the conclusions of this case, particularly given that it is a judgment of the High Court of Australia. Chances are arbitrators will be seeing more and

more cases of global claims being pleaded on the basis that the High Court of Australia has now stated that it is permissible to estimate the amount of damages reached rather than factually proving this up. How much leeway this case gives those who wish to make global claims, however, and how much this case will actually change the approach of arbitrators when it comes to dealing with the assessment of damages, remains to be seen.

Conclusion

Arbitrators will likely find this case to be of much significance. The judgment of the trial judge in respect of good faith is another step towards the development of the (oftentimes still unclear) concept, and an illustration of its application. The treatment of the assessment of damages by all three courts illustrates the current attitude towards the assessment of damages and the principles to apply. Comments made by Hayne J and Callinan J in the judgment of the High Court may well have a wider applicability to the question of whether or not global claims can be made when the exact amount of damages is unclear or unable to be ascertained.

And lastly, but not least, arbitrators should turn their minds to just how significant the 'off hand' comment by Callinan J that the obligation to act in good faith continues during the resolution of the actual dispute between the parties (whether arbitration, mediation or litigation?) actually is. Just what effect will this have on the day to day proceedings of an arbitration?

