THE LIABILITY OF DEBTORS AND GUARANTORS UNDER CONTRACTS DISCHARGED FOR BREACH*

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It is trite law that a contract may be terminated on the basis of a repudiation, a breach of condition, a substantial breach of an intermediate term, or pursuant to a termination clause. What is less often appreciated is that termination, especially in the context of an instalment contract, may well have adverse consequences for recovery from the debtor or its guarantor either in debt or in damages This article examines the potential problems which can arise and suggests methods by which they can be overcome.

LIABILITY OF DEBTORS

1. Introduction — consequences of termination

(a) Background

There is a basic distinction between termination of a contract for breach and rescission of a contract for misrepresentation or mistake. It is suggested in Lord Diplock's speech in *Photo Production Ltd v Securicor Transport Ltd*[1] that to understand the effects of termination we have to grasp a distinction not only between primary and secondary obligations, which is reasonable enough, but also between secondary obligations and "anticipatory" second-

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* This is a revised version of two papers presented for the Committee for Postgraduate Studies in the Faculty of Law, University of Sydney, November 1991 and the Centre for Commercial and Resources Law, Faculties of Law, The University of Western Australia and Murdoch University, July 1992.

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1. [1980] AC 827, 849-850.

ary obligations. Reported in the same year was another decision of the House of Lords, *Hyundai Heavy Industries Co Ltd v Papadopoulos*[2] ("*Hyundai*"), which told us that a shipbuilding contract is really more like a contract for the hire of goods than one for the sale of goods, with the result that the shipbuilder may recover an overdue payment even though there is no evidence that any part of the ship has been built and notwithstanding that the builder has been discharged from the obligation to build the vessel. Credulity is strained still further by the decision in *Shevill v Builders Licensing Board*[3] ("*Shevill*") that when a lease is terminated by the lessor in exercise of an express right for breach by the lessee in not paying rent on time, the lessor's loss of bargain is caused not by the lessee's breach but instead by the lessor's foolishness in terminating the lease merely because the lessee's breach of contract gave rise to a right to do so. Perhaps the final blow to understanding the effect of termination came in *Esanda Finance Corp Ltd v Plessnig*[4] where the High Court held[5] that it is quite proper to have an agreed damages clause, applying on termination and allowing the recovery of loss of bargain damages, for the very kind of breach which in *Shevill* had been regarded as too minor to sustain such a claim. The time has come to get back to first principles.

(b) Termination and rescission

The starting point must be Justice Dixon's famous statement in *McDonald v Dennys Lascelles Ltd* ("*Dennys Lascelles*") explaining the distinction between termination and rescission:

> When a party to a simple contract, upon a breach by the other contracting party of a condition of the contract, elects to treat the contract as no longer binding upon him, the contract is not rescinded as from the beginning. *Both parties are discharged from the further performance of the contract, but rights are not divested or discharged which have already been unconditionally acquired. Rights and obligations which arise from the partial execution of the contract and causes of action which have accrued from its breach alike continue unaffected.* When a contract is rescinded because of matters which affect its formation, as in the case of fraud, the parties are to be rehabilitated and restored, so far as may be, to the position they occupied before the contract was made. But when a contract, which is not void or voidable at law, or liable to be set aside in equity, is dissolved at the election of one party because the other has not observed an essential condition or has committed a breach going to its root, the contract is determined so far as it is executory only and the party in default is liable for damages for its breach.[6]

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2. [1980] 1 WLR 1129.
3. (1982) 149 CLR 620.
4. (1989) 166 CLR 131.
5. Applying dicta in *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170.
6. (1933) 48 CLR 457, 476-477 (emphasis added).

The key words, italicised, express three basic propositions about the consequences involved when the performance of a contract is terminated for breach or repudiation.[7]

(1) Termination discharges both parties from the obligation to perform the contract;

(2) This discharge does not affect rights and obligations which have arisen from partial performance; and

(3) Discharge does not affect causes of action which accrued from the breach which led to termination.

Propositions (1) and (2) have their main relevance to claims in relation to sums fixed by the contract. Proposition (3) applies mainly to claims for damages for breach of contract.

One point of confusion has arisen in relation to Proposition (1). Did Justice Dixon mean that, apart from accrued rights, all obligations which have not been performed come to an end or was he referring only to those which had not, at the time of termination, fallen due for performance? The correct view is that he was referring both to (future and contingent) obligations which had not matured and to those which had fallen due but not been performed. Countless passages could be cited, most to be found in the speeches of Lord Diplock; but the following, from *Moschi v Lep Air Services Ltd* ("*Moschi*") (a key case in the context of claims against guarantors), is representative.

> Generally speaking, the rescission [termination] of the contract puts an end to the primary obligations of the party not in default to perform any of his contractual promises which he has not already performed by the time of the rescission ... The primary obligations of the party in default to perform any of the promises made by him and remaining unperformed likewise come to an end ...[8]

In *F J Bloemen Pty Ltd v Council of the City of Gold Coast City Council*[9] the Privy Council held that a term requiring the payment of interest on unpaid sums payable to a contractor was not enforceable after termination, and did not think it necessary to consider separately sums due prior to termination and sums which would have fallen due had termination not occurred. Thus, the prima facie rule is that unpaid sums are not recoverable once termination has occurred. Nevertheless, the influence of a narrower view on the effects of

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7. They also apply where termination is based on repudiation. See *Johnson v Agnew* [1980] AC 367, 396 where the passage in Dixon J's judgment was adopted by the House of Lords.
8. [1973] AC 331, 350. For discussion see infra n 132. It was quoted with approval by Rogers CJ Comm D in *Womboin Pty Ltd v Savannah Island Trading Pty Ltd* (1990) 19 NSWLR 364, 369.
9. [1973] AC 115.

termination has been considerable and creates uncertainty in a fundamental aspect of the law.

(c) Intention and the consequences of termination

Since we are concerned with contract law, it must be acknowledged, indeed emphasised, that Justice Dixon was stating prima facie rules applicable where the parties have not expressed an intention regarding the consequences of termination. Parties are free to agree to a different set of consequences, subject to statutory restrictions which govern particular kinds of contracts and terms, and also the common law and equitable rules on penalty clauses and relief against forfeiture. Justice Dixon said as much in *Westralian Farmers Ltd v Commonwealth Agricultural Service Engineers Ltd* ("*Westralian Farmers*") when, after referring to his earlier statement in *Dennys Lascelles*, he (and Justice Evatt) said: "No doubt it is open to the parties to provide in advance for such an event [termination] and by a stipulation to the contrary to produce some other effect".[10]

The most common sources for such agreements are terms expressing rights on termination and regulating the consequences of termination.[11] But many termination clauses go no further than the expression of termination rights. Do Justice Dixon's propositions then apply? No less an authority than Sir Frederick Jordan thought so in *Larratt v Bankers and Traders Insurance Co Ltd* ("*Larratt*"), where he held that the consequences which flow from termination by virtue of an express right:

> depend on the intention of the parties, actual or imputed, and, in the absence of some express or implied indication of intention to the contrary, are governed by the ordinary law applicable to the avoidance of contracts for breaches of essential promises.[12]

Justices Dixon and Evatt were clearly of like opinion in *Westralian Farmers*, where they said: "When the parties themselves have provided for the determination of the contract on a given contingency, the consequences flow altogether from their contractual stipulation and are governed by their intention, either actual or imputed".[13] This statement clearly influenced Chief Justice Jordan in *Larratt*. All that he did was to add the presumption that the rules applicable to termination for breach of condition apply where termination takes place in reliance on an express right. But in that addition lies a large

10. (1936) 54 CLR 361, 379.
11. See generally B R Opeskin "Damages for Breach of Contract Terminated Under Express Terms" (1990) 106 LQR 293; J W Carter "Termination Clauses" (1990) 3 JCL 90.
12. (1941) 41 SR (NSW) 215, 225-226.
13. Supra n 10.

part of the current difficulties in the recovery of damages following termination.

2. Instalment payments

(a) General

Instalment payments fall into three main groups:

(1) Promises to make periodic payments for an executed consideration under credit contracts (of sale or loan) where the principal is payable (with interest) by instalments;

(2) Conditional sale contracts under which ownership in the subject matter of the contract is to be transferred on payment of the final instalment of the purchase price (and any other contract in which a lump sum payment is apportioned over time without express reference to the extent of performance); and

(3) Severable contracts which fix amounts to be paid, at specified intervals, for the use of land or goods or for services rendered, according to the progress of work under a construction contract, or for deliveries of goods under instalment sales contracts.

The feature which is common to all these groups of instalment payments is that they are recoverable when they fall due as debts and not as damages for breach of contract. They share a feature common to all liquidated sums, namely, that they have the character of a debt which, as a distinct chose in action, is thought of as possessing proprietary characteristics.[14] This is attractive for a number of reasons, including the availability of summary recovery procedures,[15] the absence of any requirement of proving loss or damage,[16] and the inapplicability of rules dealing with the mitigation of loss,[17] which frequently apply to actions for damages.

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14. Ibid, Dixon and Evatt JJ, 380. See also *Young v Queensland Trustees Ltd* (1956) 99 CLR 560, 567.
15. If liquidated by the contract the sum may be recoverable under summary procedures, even if strictly liability is not in debt: see *Spain v Union Steamship Co of New Zealand Ltd* (1923) 32 CLR 138, 142; *Coast Securities No 9 Pty Ltd v Alabac Pty Ltd* [1984] 2 Qd R 25.
16. Infra n 75-96 (penalty clauses).
17. This may provide an incentive to keep the contract on foot rather than to terminate: see *White and Carter (Councils) Ltd v McGregor* [1962] AC 413 (recovery of instalments under advertising contract); *Maridakis v Kouvaris* (1975) 5 ALR 197 (principles governing mitigation of damages not relevant to claims for rent under lease where lessee abandoned premises); *Keen Mar Corp Pty Ltd v Labrador Park Shopping Centre Pty Ltd* (1988) ATPR 40-853, 49,196 (where lessee repudiates lease and abandons premises lessor may keep the lease on foot and sue for rent as it falls due).

Many of the contracts within group (1) are governed by statute;[18] and we will not find anything of general interest there. The approach of creditors is to sue for debts as they fall due rather than following termination.[19] Where the loan is secured by mortgage, termination, even under common law rules,[20] is affected by principles of relief against forfeiture. But where termination does take place, any payments outstanding can be recovered, though not those due in the future.[21] Mainly our concern is with groups (2) and (3).

In deciding whether a plaintiff possessed an accrued right to receive all or part of the other party's performance, regard should be had to:[22] (1) the terms of the contract; (2) the performance rendered by the party claiming the accrued right; and (3) the relation between the obligation sought to be enforced and the obligations discharged by termination.

Although this analysis is based mainly on the reasoning in *Dennys Lascelles*,[23] it can be applied to all types of instalment payments. In *Dennys Lascelles*, the High Court decided that, in the absence of a forfeiture clause, part-payments within group (2) are not recoverable from a purchaser of land even if due at the time of termination. Since the relationship between the obligation of the purchaser to make payments and that of the vendor to remain ready and willing to transfer ownership is one of dependency, the parties must be taken to have agreed that the money is no longer payable once termination has occurred without the vendor transferring ownership.[24] In the words of Justice Dixon, the vendor's right to an overdue payment was not "unconditionally" acquired.

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18. See (ACT) Credit Act 1985; (NSW) Credit Act 1984; (Qld) Credit Act 1987; (SA) Consumer Credit Act 1972; (Vic) Credit Act 1984; (WA) Credit Act 1984 (regulated credit contracts).
19. Specific performance may be available: *Beswick v Beswick* [1968] AC 58 (sale of coal merchant's business by A to B in return for a promise by B to pay a weekly sum to C).
20. There have been suggestions that contracts with an executed consideration do not come within the general rules on termination and that a promisee must look to an express provision for termination. See *Mackenzie v Rees* (1941) 65 CLR 1, 15 (bill of exchange); *Progressive Mailing House Pty Ltd v Tabali Pty Ltd* (1985) 157 CLR 17, 44-46 (executed lease). The question was left open in *Wigan v Edwards* (1973) 1 ALR 497 (compromise of disputed claim). But the better view is that termination is available: *Moschi* supra n 8 (debt payable by instalments).
21. Infra n 52 (discount of damages). For acceleration of liability under a penalty clause infra n 88.
22. See J W Carter *Breach of Contract* 2nd ed (Sydney: Law Book Co, 1991) para 1235.
23. Supra n 6.
24. "The very idea of payment falls to the ground when both have treated the bargain as at an end; and from that moment the vendor holds the money advanced to the use of the purchaser"; *Palmer v Temple* (1839) 9 Ad & E 508, 520-521, 112 ER 1304, 1309.

Another way of expressing the point, which should not in our view be regarded as a different general principle and which will also apply to all types of payments, is to say that an instalment payment will not be recoverable from a defendant where the defendant would have the right to get it back.[25] The test for whether an instalment payment can be recovered is the restitutionary principle of unjust enrichment.[26] The plaintiff ("payee") would receive a benefit (money) at the defendant's expense in circumstances where it would be unjust for the payee to retain it. The traditional expression of the injustice element is the requirement of a "total failure of consideration". Thus, in *Dennys Lascelles* itself, the vendor could not recover any overdue payments because their enforcement would have involved a total failure of consideration. Where the idea of total failure of consideration is excluded by an express or implied provision for forfeiture, the criterion for injustice is the willingness of the court to grant the payer relief against forfeiture. We need not be concerned with this because there is no case in which this defence has been put forward. But it should be noted that in *Dennys Lascelles*, in a sale of land context, Justice Dixon said:

> Although the parties might by express agreement give the vendor an absolute right at law to retain the instalments in the event of the contract going off, yet in equity such a contract is considered to involve a forfeiture from which the purchaser is entitled to be relieved.[27]

This means that even an express forfeiture provision will not be effective in a sale of land context. It is suggested that this approach may be relied on as a defence to a claim for an instalment payment.

(b) Commercial contracts

Although the principles governing conveyancing transactions are more or less settled, at least in Australia, there is considerable uncertainty in relation to commercial contracts. This is unfortunate because there is no reason for the basic approach to be any different. A good context to investigate the issues is the decision in *Hyundai* where Hyundai ("the builders") entered into a construction contract to "build, launch, equip and complete" a multi-purpose cargo ship for buyers who agreed to pay the price ($US14.3 million) by instalments representing specified percentages of the

25. See *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32, 53 (avoidance of circuity of action).
26. Compare Peter Birks "Restitution after Ineffective Contracts: Issues for the 1990s" (1990) 2 JCL 227.
27. Supra n 6, 477.

total price.[28] Construction of the vessel was to proceed continuously from keel laying until delivery and the contract expressly provided that the price of the vessel included "all costs and expenses for designing and supplying all necessary drawings for the vessel".

Article 10(b) of the construction contract in *Hyundai* stated that any money paid was to be refunded on cancellation except as provided by article 11. Article 11, which conferred a right to "rescind" the contract where an instalment was not paid, provided that, in the case of default, the builder's rights under the contract were to be in addition to any (common law) rights, powers and remedies they might have in consequence of default by the buyer. A valid notice of rescission was duly given in respect of the second instalment, the first having been paid on time. Although there was in fact no claim by the builder in *Hyundai* against the buyers, three of their Lordships (Viscount Dilhorne, Lords Edmund-Davies and Fraser) expressed the view that termination would not have prevented the buyers being held liable to make the payment due prior to termination.[29] On the other hand, Lords Russell and Keith, without considering the issue in detail, expressed doubts on the ability of the builder to sue.

One approach to this case would have been to hold that the terms of the contract, which would have entitled the builder to retain the second instalment had it actually been paid, indicated an intention that payment was to be recoverable from the buyer following termination. After all, the buyer could hardly be in a better position by reason of not having paid the instalment than it would have been had the payment been made.[30] Yet Viscount Dilhorne expressly disclaimed reliance on the clause.[31] Having taken this view, the case depended solely on the application of common law principles.

Their Lordships held that, once the time for payment had arrived, there was an accrued right to receive performance. Viscount Dilhorne held that any other view would have led to the "curious consequence ... that the very ground

28. Supra n 2, the specified percentages being 2.5, 10, 17.5 and 67.5%. See also J W Carter supra n 22, para 1239; J Beatson "Discharge for Breach: The Position of Instalments, Deposits and Other Payments Due Before Completion" (1983) 97 LQR 389.

29. A contract of guarantee was entered into between the builders and Papadopoulos and others ("the guarantors") who agreed to pay "all sums due" by the buyers under the construction contract. This contract stated that the guarantors would, in the event of default by the buyers, make payment on behalf of the buyers. The House of Lords unanimously held that the guarantors were liable even if the buyers were not. See further below; infra n 159.

30. This is the basis on which deposit payments may be recovered following termination, but the authorities are far from unanimous. See J W Carter supra n 22, paras 1251-1255.

31. See supra n 2, 1132.

for cancellation was destroyed by the act of cancellation".[32] Lord Edmund-Davies quoted with approval the following passage from Treitel:

> Rescission ... releases the party in breach for the future from his primary obligations to perform. But he is not released from primary obligations already due at the time of rescission, and he also comes under a secondary liability to pay damages. His liability may thus relate both to breaches committed before rescission and to losses suffered by the victim as a result of the defaulting party's repudiation of future obligations.[33]

We have already seen that the more usual, and it is suggested more accurate, expression of the scope of termination is that it relates to all "unperformed" obligations. What Viscount Dilhorne described as the "curious consequence" is in fact the normal or usual consequence.[34] Thus, where a vendor terminates performance after the date for settlement, we know that the purchaser is not liable to pay the price. We also know that a seller who terminates a sale of goods contract after the date for payment has arrived is not entitled to the price unless property in the goods has passed to the buyer. More generally, we know that merely keeping a contract open and not exercising a right of termination until after a date for payment has passed does not serve to increase the plaintiff's payment rights.[35]

The right to recover the payment was tested in *Hyundai* by asking whether the buyer could have recovered it back on the ground of a total failure of consideration.[36] Had the contract been for the sale of goods, their Lordships conceded that there might have been such a failure of consideration.[37] However, they held that the shipbuilding contract was more in the nature of a contract for services.[38] In an analogy which seems to exist more in the imagination of their Lordships than in the real world, they relied on cases involving contracts of hire and hire-purchase as authority for the proposition that termination does not cause a total failure of consideration. It is easy

32. Ibid, 1134 and 1141.
33. G H Treitel *The Law of Contract* 5th edn (London: Stevens & Sons, 1979) 641 (see now 8th ed 1991, 748).
34. See *Moschi* supra n 8, 345 where Lord Reid said that he could not agree that after an "accepted repudiation the contractual obligations still exist as obligations"; *Womboin Pty Ltd v Savannah Island Trading Pty Ltd* supra n 8, 368.
35. Unless there has also been performance by the plaintiff. See *White and Carter (Councils) Ltd v McGregor* supra n 17 and the commentary thereon by L J Priestley "Conduct after Breach: The Position of the Party Not in Breach" (1991) 3 JCL 218.
36. See supra n 2, 1134-1136, 1142 and 1147-1148.
37. They doubted, but left open, the wider view of Stable J in *Dies v British and International Mining and Finance Corporation Ltd* [1939] 1 KB 724, 743 that a payment may be recovered where there is no total failure of consideration. See supra n 2, 1134, 1142 and 1148.
38. See supra n 2, 1134-1136, 1142 and 1148-1149.

enough to accept an analogy with a building contract;[39] but to treat $US350 000 as due under a contract where nothing had been delivered because in an earlier case a hirer of furniture had been held liable to pay a few pounds for the use of goods under a consumer hire contract seems strange.

Lord Edmund-Davies sought to buttress his analysis[40] by relying on that part of Justice Dixon's statement in *Dennys Lascelles* quoted earlier.[41] Since Justice Dixon referred to rights accruing through "partial execution" of the contract, one would have thought that this necessitated some analysis of the builder's performance. After all, partial execution involves something more than that the time for performance has arrived. There was no clear evidence as to whether the builder had in fact carried out its obligations to start designing and building the vessel. Yet only Lord Fraser referred to the builder's performance. He emphasised that, in the absence of any allegation or proof to the contrary, it had to be assumed that the builder had performed its obligations under the contract.[42] So, presumably, the other judges thought that the buyer's promise to pay did not depend on any performance by the builder.[43]

This analysis comes down to two possibilities:

(1) Either the buyer had bargained for the builder's promise to do the work, that is, promised to pay independently of performance by the builder; or

(2) The consideration for the buyer's payment had not failed totally because it had admitted performance on the builder's part.

If this is correct, there was in fact no need to rely on the supposed analogy with cases on contracts of hire, except to the extent that they illustrate (as do many other authorities) a partial failure of consideration. However, it is still perplexing that the builder was entitled to a payment when the buyer may have received no performance at all, particularly since, whatever work the builder did, it was (it seems) entitled to keep and use it for its own benefit. Contracts for the construction of ships have in fact usually been treated as analogous to contracts of sale. Advance payments have been recovered by purchasers, after termination, on the ground of failure of consideration and

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39. See *Rover International Ltd v Cannon Film Sales Ltd* [1989] 1 WLR 912, 931. Compare *Re Continental C & G Rubber Co Pty Ltd* (1919) 27 CLR 194 (manufacture of machinery).
40. See supra n 2, 1141.
41. Infra n 6.
42. See supra n 2, 1148 and 1150.
43. This may be the explanation for the difficult decision of the High Court in *Re Continental C & G Rubber Co Pty Ltd* supra n 39 (no failure of consideration where contract for manufacture of machinery frustrated before delivery).

even though the builders had almost certainly begun construction.[44]

(c) Implications for drafting

Perhaps *Hyundai* is authority for the view that it is sufficient to draft a contract which makes payments due at particular times. But the mere fact that a contract obliges the payee to incur expenditure before completion of the contract is not of itself sufficient to prevent a total failure of consideration.[45] An express provision for recovery will be subject to principles governing relief against forfeiture. Although this may seem no more than a theoretical possibility in commercial contracts, it should not be discounted entirely.[46]

Greater security is offered by the apportionment of payments to performance. The simple expedient of lining up payments and performance, that is, instalment payments within group (3), seems to be virtually unchallengable. There are many authorities in which instalment payments have been recovered under such "severable" contracts;[47] the only difficulty is in drafting a lump sum contract in a way which makes it severable. But the progress payments due under a building contract provide a good illustration of the proper way to ensure the recovery of instalments under such contracts.

There are two final points. First, the emphasis on the accrual of rights to payment through performance means that even a payment which was not due at the time of termination may be recovered after termination, assuming it had

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44. See *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour Ltd* supra n 25 is the leading case, and nothing turns on the point that the contract was discharged by frustration; *Reid v Macbeth & Gray* [1904] AC 223; and compare *McDougall v Aeromarine of Emsworth Ltd* [1958] 1 WLR 1126 (termination by buyer).
45. See *Terrex Resources NL v Magnet Petroleum Pty Ltd* [1988] 1 WAR 144, 147-148.
46. See *Stockloser v Johnson* [1954] 1 QB 476, 490 (sale of goods by instalments), the authority of which has been left open by the High Court (see *Legione v Hateley* (1983) 152 CLR 406, 443-444) and the House of Lords (see *Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana* [1983] 2 AC 694, 702-703); *O'Dea v Allstates Leasing System (WA) Pty Ltd* (1983) 152 CLR 359, 392; *Esanda Finance Corp Ltd v Plessnig* (1989) 166 CLR 131, 151; and compare *Esanda Finance Corp Ltd v Plessnig* at 147-148 (exercise of contractual power may be "unconscionable" or "oppressive").
47. See *Brooks v Beirnstein* [1909] 1 KB 98 (hire payments due under contract for the hire of goods); *Leslie Shipping Co v Welstead* [1921] 3 KB 420 (withdrawal of the vessel under a time charterparty after the charterer has had the benefit of the services does not prevent recovery of the agreed hire as a liquidated sum); *Chatterton v Maclean* [1951] 1 All ER 761 (hire-purchaser liable for hire due prior to repossession, pursuant to a contractual right, on breach by the hirer); *Financings Ltd v Baldock* [1963] 2 QB 104 (rent due under hire-purchase contract); *Overstone Ltd v Shipway* [1963] 1 WLR 117 (rent due under hire-purchase contract); *Canas Property Co Ltd v KL Television Services Ltd* [1970] 2 QB 433 (recovery of rent under lease due prior to re-entry on termination).

been earned at that time.[48] But the plaintiff must wait until the payment was due before bringing the claim.[49] Second, although the cases usually deal with the position where the plaintiff is the terminating party, the same analysis can be made in favour of a party in breach. Payments which have been earned through performance are recoverable by such a party.[50]

3. Loss of bargain damages

(a) The concept

Loss of bargain damages are damages assessed by reference to the difference between the market value of the contract or its subject matter at the time of breach and the price (or monetary equivalent) expressed in the contract.[51] Where the value of the contract is simply what the defendant agreed to pay, or the defendant's performance involved the payment of money by instalments for an executed consideration, the instalments must be discounted to their present value when assessing the value of the contract.[52] Discharge of the contract, by termination for breach or repudiation, is necessary before such damages can be recovered.[53] But equally it is now clear that the mere fact of termination for breach is not enough to entitle a plaintiff to recover such damages.

The reference in Justice Dixon's statement in *Dennys Lascelles* to causes

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48. See *Westralian Farmers Ltd* supra n 10 (termination without breach); *Bank of Boston Connecticut v European Grain and Shipping Ltd* [1989] AC 1056 (ability of shipowner to recover advance freight under a voyage charterparty).
49. Compare P v D1 and D2 (The "C" & "J") [1984] 2 Lloyd's Rep 601 and *Zea Star Shipping Co SA v Parley Augustsson (Invest) A/S* [1984] 2 Lloyd's Rep 605 (amendment of pleadings not permitted).
50. See *Boston Deep Sea Fishing and Ice Co v Ansell* (1888) 39 Ch D 339, 352, 360 and 366-7; *Mersey Steel and Iron Co Ltd v Naylor Benzon & Co* (1884) 9 App Cas 434; *Ettridge v Vermin Board of the District of Murat Bay* [1928] SASR 124, 128; *Automatic Fire Sprinklers Pty Ltd v Watson* (1946) 72 CLR 435, 461; *Hyundai* supra n 2, 1136; *Bank of Boston Connecticut v European Grain and Shipping Ltd* supra n 48.
51. See J W Carter "The Effect of Discharge of a Contract on the Assessment of Damages for Breach or Repudiation" (1988) 1 JCL 113 and 249.
52. See *Moschi* supra n 8, 358-359. See also J W Carter and D J Harland, *Contract Law in Australia* 2nd ed (Australia: Butterworths, 1991) para 2161 (discounting an award for subsequent events and accrued rights).
53. *Sunbird Plaza Pty Ltd v Maloney* ("*Sunbird Plaza*") (1988) 166 CLR 245 (not following *Ogle v Comboyuro Investments Pty Ltd* (1976) 136 CLR 444, 450); *The Millstream Pty Ltd v Schultz* [1980] 1 NSWLR 547, 554; and compare *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827, 849 ("anticipatory secondary obligation" to make compensation implied in addition to the general secondary obligation).

of action which accrued from the breach preserves any right to claim loss of bargain damages.[54] The question which arises is, what cause of action should be taken as having accrued, by reason of the breach, at the time of termination? One approach would be to say that it is simply a matter of looking at the breach itself. But this is wrong. Where a buyer terminates performance of a sale of goods contract on the ground that the seller tendered the goods late, and the termination is valid because time was essential, the cause of action which the buyer relies upon in claiming damages is for non-delivery, not late delivery.[55] Damages for non-delivery are a form of loss of bargain damages. The sale of goods example is not unique. The principle applies also to a purchaser's damages claim following termination of a sale of land contract for the failure of the vendor to attend settlement where time is of the essence. In both cases, the breach might involve no more than a few days' delay and it might, objectively, be quite minor; but termination perfects the plaintiff's cause of action for loss of bargain damages. Indeed, the general principle is that, where any contract is terminated for breach or repudiation on the part of the promisor, and the promisee relies on the general law rather than an express termination clause, loss of bargain damages are recoverable.[56] But according to *Shevill* this analysis does not apply where termination is based on an express termination clause.[57]

(b) The *Shevill* doctrine

In *Shevill*, the Board ("the lessor") leased land to a lessee for seven years from 7 March 1976. The Shevills were guarantors of the lessee's obligations.[58] Rent was payable by monthly instalments and clause 9(a) of the lease conferred on the lessor a right to re-enter the land in the event of the rent being unpaid for 14 days. The right of re-entry was expressed to be "without prejudice to any action or other remedy" of the lessor. At a time when two months' rent was outstanding the lessor took proceedings for possession and sued the guarantors for damages. The High Court held that only nominal damages could be recovered because there was no repudiation or breach of

54. Supra n 6, 476-477.
55. Damages are governed by (ACT) Sale of Goods Act 1954 s 54; (NSW) Sale of Goods Act 1923 s 53; (NT) Sale of Goods Act 1972 s 53; (Qld) Sale of Goods Act 1896 s 52; (SA) Sale of Goods Act 1895 s 50; (Tas) Sale of Goods Act 1896 s 55; (Vic) Goods Act 1958 s 57; (WA) Sale of Goods Act 1895 s 50.
56. See *Dominion Coal Ltd v Dominion Iron & Steel Co Ltd* [1909] AC 293, 311; *Sunbird Plaza* supra n 53, 260; *Foran v Wight* (1989) 168 CLR 385, 430.
57. Supra n 3.
58. Ibid.

any term entitling termination under common law principles.[59] The loss of the bargain was caused by the lessor's election to terminate rather than the lessee's breach.[60]

Implicit in this decision was the rejection of Chief Justice Jordan's view in *Larratt*[61] that there is a presumption that the rules applicable to termination for breach of condition apply where termination takes place in reliance on an express right. It would have been sufficient to decide *Shevill* by saying that the presumption was rebutted when termination took place under a clause which might operate in circumstances where there was no breach. However, *Larratt* was not discussed, and although the views of Chief Justice Jordan have been referred to in some of the subsequent cases, and been given some support,[62] only if *Shevill* is overruled can they be applied to the recovery of loss of bargain damages.[63]

The general approach of the common law to contractual terms requiring the payment of money is that the failure to pay on time is neither the breach of an essential term[64] nor a repudiation of obligation.[65] The real or practical

59. The trial judge had awarded damages calculated by deducting the rent which would be received by the lessor for the remainder of the lease from the rent reserved for the period remaining at the time of termination. An appeal to the NSW Court of Appeal was dismissed (Samuels JA dissenting).

60. For comparable English cases, almost all dealing with consumer hire and hire-purchase contracts, see *Financings Ltd v Baldock* [1963] 2 QB 104; *United Dominions Trust (Commercial) Ltd v Ennis* [1968] 1 QB 54; *Eshun v Moorgate Mercantile Co Ltd* [1971] 1 WLR 722.

61. Supra n 12.

62. See *Progressive Mailing House Pty Ltd v Tabali Pty Ltd* supra n 20, 55 (dicta); *AMEV-UDC Finance Ltd v Austin* (1986) 162 CLR 170, 205-207 and 216-220 (dissenting judgments).

63. See *AMEV Finance Ltd v Artes Studios Thoroughbreds Pty Ltd* (1989) 15 NSWLR 564, 566 and 585-586.

64. See *Decro-Wall International SA v Practitioners in Marketing Ltd* [1971] 1 WLR 361 at 368 (agency contract); *Shevill* supra n 3, 627 (lease). Contrast time stipulations dealing with deposits which are usually essential. See *Streatfield v Winchcombe Carson Trustee Co (Canberra) Ltd* [1981] 1 NSWLR 519 (deposit payable on "signing" of contract for sale of land); *Brien v Dwyer* (1978) 141 CLR 378 (sale of land); *Portaria Shipping Co v Gulf Pacific Navigation Co Ltd (The Selene G)* [1981] 2 Lloyd's Rep 180, 185 (sale of goods requiring payment within 48 hours); *Millichamp v Jones* [1982] 1 WLR 1422, 1431 (10% deposit payable on exercise of option to purchase land); *Damon Compania Naviera SA v Hapag-Lloyd International SA (The Blankenstein)* [1985] 1 WLR 435 (payment on signing a standard form for the sale of goods); *Tsimidopoulos v Mulson Holdings Pty Ltd* [1989] WAR 359, 369-370 (sale of newspaper business and leasehold, deposit payable by instalments).

65. See *Decro-Wall International SA v Practitioners in Marketing Ltd*, ibid, (not a repudiation for agents to be continually a few days late in honouring bills of exchange payable to their principals); *Eshun v Moorgate Mercantile Co Ltd* supra n 60, 726 (non-payment

impact of *Shevill* is that something more than the exercise of an express right of termination must be found.[66] This includes, outside the context of late payment of money, that the term which is the subject of an express right be a condition under the general law.[67]

(c) Implications for drafting

Putting agreed damages clauses aside,[68] the drafting implications of *Shevill* are obvious. Indeed, it requires no real imagination or particular ingenuity to circumvent the decision. There are at least four obvious possibilities, even in the case of failure to pay money. Loss of bargain damages will be recoverable if the contract: (1) makes time of payment "of the essence"; (2) states that the time stipulation is an essential term;[69] (3) deems every breach of the term to be a serious breach; or (4) deems every breach of the term to be a repudiation of the whole contract.

These possibilities do no more than define the contractual terms. One further possibility may be added which does not in our view amount to an agreed damages clause.[70] Loss of bargain damages will be recoverable if the contract provides for a right of termination and states that any loss occasioned

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of one or two instalments under hire-purchase agreement not a repudiation); *Afovos Shipping Co SA v Pagnan* [1983] 1 WLR 195 (no anticipatory breach of charterparty where failure to pay hire inevitable); *Fenton Insurance Co Ltd v Gothaer Versicherungsbank VVaG* [1991] 1 Lloyd's Rep 172 (delay in payment of balances under insurance treaty not a repudiation).

66. See *W & J Investments Ltd v Bunting* [1984] 1 NSWLR 331 (declaration of inability to pay rent under chattel lease a repudiation); *Progressive Mailing House Pty Ltd v Tabali Pty Ltd* supra n 20 (proof of a repudiation or fundamental breach by lessee of land).

67. This may be the explanation for *Sotiros Shipping Inc v Sameiet Solholt (The Solholt)* [1983] 1 Lloyd's Rep 605 where an express right of termination under a contract for the sale of a ship operated where the vessel was not delivered on time and there may well have been a right of termination under common law principles enshrined in cases like *Bowes v Shand* (1877) 2 App Cas 455 and *Bowes v Chaleyer* (1923) 32 CLR 159. But the English Court of Appeal said that loss of bargain damages were recoverable without reliance on a common law right of termination and Sir John Donaldson MR took the opportunity to add (see [1983] 1 Lloyd's Rep 605, 607) that it is "trite law" that in deciding whether to exercise a contractual right to cancel the plaintiff need have "no regard to the fact that in the absence of cancellation he would suffer no loss".

68. Infra n 75-96.

69. It is probably not safe to rely on a term which makes time of payment a "condition" because that description may well be thought to be ambiguous. See *L Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235 (term in distributorship agreement which made visits to clients a "condition" of the contract interpreted as intermediate in character).

70. Compare M P Furmston "Contract Planning: Liquidated Damages, Deposits and the Foreseeability Rule" (1991) 4 JCL 1.

by the breach, including the loss caused by termination, is to be recoverable. It would, however, be naive to suggest that success is guaranteed by any of these drafting techniques. There is what might be called, for want of a better description, a hidden agenda.

Cases like *Shevill* have a policy backing. It is not easy to find but it is there nonetheless. And the fact that it is there means that there is the danger that a particular drafting technique will be seen as an unfair way of circumventing the policy. Thus, in *Shevill*, Chief Justice Gibbs said it "would have been easy, although inequitable, to provide that in any of the circumstances mentioned in clause 9(a) the lessor would be entitled to damages for loss of the benefits which performance of the covenants of the lease would have conferred on him in the future".[71] What he did not tell us is whether a court can grant relief against the "inequity". Again, in *Amann Aviation Pty Ltd v The Commonwealth*,[72] where the clause enabled the Commonwealth to recover damages sustained "in consequence of ... cancellation of the contract", Justice Burchett said that a "disturbing consequence" would occur if the Commonwealth used the clause to terminate in respect of a minor breach — that consequence being the recovery of loss of bargain damages "caused" by the election to terminate. And in *Lombard North Central Plc v Butterworth*, where a clause in a consumer lease of goods made time of the essence, thereby classifying breaches activating a termination clause as serious breaches for which loss of bargain damages could be recovered, Lord Justice Mustill said that the drafter had "achieved by one means a result which the law of penalties might have prevented" by another.[73] Similarly, Lord Justice Nicholls viewed the result with "considerable dissatisfaction".[74]

It is not easy to explain this hostility to the recovery of loss of bargain damages. However, the fact that the hostility is there means that anyone drafting a contract should attempt to make the total result fair or at least obvious to the other party. It is to be hoped that the courts will wake up to the fact that commercial people are quite used to liability for loss of bargain damages, and that the only difference between termination of a contract in exercise of an express right of termination and termination in reliance on a clause interpreted as a condition under the common law is form not substance.

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71. Supra n 3, 629.
72. (1990) 92 ALR 601, 629 (affirmed on other grounds sub nom *The Commonwealth v Amann Aviation Pty Ltd* (1991) 104 ALR 1).
73. [1987] 1 QB 527, 540.
74. Ibid, 546.

4. Penalty clauses

Perhaps the natural reaction to *Shevill* is to draft an agreed damages clause to specify the damages recoverable. If it is a valid liquidated damages clause it will be enforceable by a claim for a fixed sum.[75] But the story of agreed damages clauses in this context is not a happy one.[76] It is, however, well known, due to the proliferation of authorities[77] in recent years and the abundant literature.[78] So perhaps we can be forgiven for expressing the law in a series of propositions directed to the recovery of instalment payments and loss of bargain damages.

(1) Because a clause does not fall to be classified as a liquidated damages clause or a penalty unless it provides for the payment of an additional liability on breach of a contractual stipulation,[79] a clause which provides for the forfeiture of a sum of money already paid (or required to be paid at the time of termination) is not subject to the distinction.

However, as we have already seen,[80] the clause may be subject to relief against forfeiture, particularly where termination involves the forfeiture of a property interest.[81]

(2) It is likewise still possible, at least theoretically, to secure the payment of instalments by a provision which makes the whole sum payable under the

75. Strictly, a liquidation of damages in the contract does not alter the character of the defendant's liability, it is still for damages rather than debt. See *President of India v Lips Maritime Corp* [1988] AC 395, 425; *Hungerfords v Walker* (1989) 171 CLR 125, 139.
76. It is unfortunate that all the developments have occurred in what is really a very specific context. The usual context of an agreed damages clause is as compensation for delay in performance, where they have been much more successful.
77. The key authorities are *O'Dea v Allstates Leasing System (WA) Pty Ltd* supra n 46; *AMEV-UDC Finance Ltd v Austin* supra n 62; *Esanda Finance Corp Ltd v Plessnig* supra n 46. Reference can also be made to *Bridge v Campbell Discount Co Ltd* [1962] AC 600 which is the origin of the law in relation to chattel leases, and to *Citicorp Australia Ltd v Hendry* (1985) 4 NSWLR 1; *AMEV Finance Ltd v Artes Studios Thoroughbreds Pty Ltd* supra n 63 as applications of the High Court decisions. Compare *P C Developments Pty Ltd v Revell* (1991) 22 NSWLR 615.
78. See G D Muir "Stipulations for the Payment of Agreed Sums" (1985) 10 Syd LR 503; R P Meagher "Penalties in Chattel Leases" in P D Finn (ed) Essays in Equity (Sydney: Law Book Co, 1985) 46; D S K Ong "Chattel Leasing: Indulgences, Liquidated Damages and Penalties" (1986) 60 ALJ 272; Rogers JA "Liquidated Damages and Penalties" in J W Carter (ed) *Rights and Remedies for Breach of Contract* (Sydney: Committee for Postgraduate Studies, Faculty of Law, University of Sydney, 1987) 96; M P Furmston supra n 70.
79. See *Legione v Hateley* (1983) 152 CLR 406, per Mason and Deane JJ, 446; *Esanda Finance Corp Ltd v Plessnig* supra n 46, 153; *CRA Ltd v NZ Goldfields Investments* [1989] VR 873, 875.
80. Supra n 28.
81. See *O'Dea v Allstates Leasing System (WA) Pty Ltd* supra n 46.

> contract immediately due as a (present) debt, which, by reason of the indulgence given by the creditor, is payable either in the future, or in a lesser amount, provided that certain conditions are met with a provision that, on the promisee's failure to make punctual payment, the whole sum is to become payable.[82]

This has to be described as a theoretical possibility. The doubts cast on *Lamson Store Service Co Ltd v Russell Wilkins & Sons Ltd*[83] in *O'Dea v Allstates Leasing System (WA) Pty Ltd*[84] make the technique dangerous[85] unless the nature of the contract is such that a present loan is the substance of the transaction.[86] We all know that most of the cases involve leasing not sale.[87]

(3) A clause which provides for the payment of all outstanding instalments (past and future) is invalid, no matter how serious the breach which led to termination and irrespective of whether the payments are described as instalments or damages.[88]

(4) Where the clause is invalid under proposition (3) or otherwise, the plaintiff is relegated to a claim for common law damages and the penalty clause is to be ignored when calculating the plaintiff's loss.[89]

The penalty clause is a dead letter.[90] It cannot be relied on as expressing any intention with regard to damages under either limb of the rule in *Hadley v Baxendale*.[91] The plaintiff must rely on the general law of damages, including the doctrine of *Shevill*,[92] without the benefit of the next rule.

(5) A clause which provides for the payment of all outstanding instalments (past and future) is valid if the instalments are discounted to their present value *and* if the plaintiff gives credit for the value of any benefits received on termination such as the receipt of goods which were the subject of a lease.[93]

The validity of this rule results from the decision of the High Court to approach agreed damages clauses in a pragmatic rather than a logical way.

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82. Ibid, Gibbs CJ, 367.
83. (1906) 4 CLR 672.
84. Supra n 46, 366-367, 375, 380-383, 386-387 and 403-404.
85. See Rogers JA supra n 78, 100 ("draftsman beyond price").
86. Compare *Acron Pacific Ltd v Offshore Oil NL* (1985) 157 CLR 514 (moratorium deed); *Oresundsvarvet Aktiebolag v Marcos Diamantis Lemos ("The Angelic Star")* [1988] 1 Lloyd's Rep 122 (loan to be immediately payable).
87. There may well be taxation implications not to mention problems with the credit and bills of sale legisation.
88. See *O'Dea v Allstates Leasing System (WA) Pty Ltd* supra n 46; *AMEV-UDC Finance Ltd v Austin* supra n 62.
89. See *AMEV-UDC Finance Ltd v Austin*, ibid *Citicorp; Australia Ltd v Hendry* supra n 77.
90. See *Jobson v Johnson* [1989] 1 WLR 1026, Nicholls LJ, 1039.
91. (1854) 9 Ex 341 at 345; 156 ER 145, 151.
92. Supra n 3, 58-67.
93. See *Esanda Finance Corp Ltd v Plessnig* supra n 46; *AMEV Finance Ltd v Artes Studios Thoroughbreds Pty Ltd* supra n 63; *IAC (Leasing) Ltd v Humphrey* (1972) 126 CLR 131; *AMEV-UDC Finance Ltd v Austin* supra n 62, 197.

The court is permitted to take into account the fact that the clause operates on termination when deciding whether it is valid.[94] Thus, an agreed damages clause may be invoked in the event of a non-repudiatory breach which allows the recovery of more than would be available in a simple action for damages.[95] This is subject to suggestions that the exercise of a contractual power may be "unconscionable" or "oppressive"[96] being realised by a decision that the termination is itself invalid.[97]

LIABILITY OF GUARANTORS

1. Introduction

There are numerous historical allusions to the risks associated with the status of a guarantor. One of the mottoes inscribed by the seven sages in the Temple of Delphi stated simply "Suretyship is the Precursor of Ruin".[98] And as early as 1,000 BC the Hebrews viewed the position of the surety in this way: "If thou be surety for thy friend, if thou hast stricken hands with a stranger thou art snared with the words of thy mouth."[99]

Many creditors, particularly financial institutions, may today take issue with this perception of the dire consequences associated with suretyship. A casual glance at the increasing number of reported decisions will indicate that many guarantees are successfully challenged on the basis of equitable doctrines, especially undue influence and unconscionability. Nowhere is this trend more evident than in New South Wales where the Contracts Review Act 1980 provides another vehicle for challenge.

This paper, however, indicates that there are potential difficulties for the unwary creditor other than those arising from the execution of the guarantee. The creditor may find that the right to recover from the guarantor, either in debt or in damages, has been prejudiced both by a combination of the manner in which the creditor pursues rights against the principal debtor and by a lack

94. In England this seems not to be permitted; see *Capital Finance Co Ltd v Donati* (1977) 121 SJ 270; *Lombard North Central Plc v Butterworth* supra n 73.
95. Generally where it can be seen that a clause is a penalty in respect of one type of breach it is invalid in respect of any breach the damages for which might in fact have been genuinely pre-estimated by the clause: *Pigram v Attorney-General (NSW)* (1975) 132 CLR 216, 221.
96. See *Esanda Finance Corp Ltd v Plessnig* supra n 46, 147-148.
97. Compare *Legione v Hateley* supra n 79 (relief against forfeiture by specific performance or injunction).
98. Proverbs 6:1 and 2.
99. See T Hewitson *Suretyship: Its Origin and History in Outline*, (1927) 18.

of precision in the drafting of the guarantee itself.

At the outset it should be stressed that the usual form of action against the guarantor will be for a money sum, although (as will be seen) in particular circumstances an action in damages will be appropriate and necessary. Some doubt as to the correctness of this usual form of action against the guarantor has arisen from the decision in *Moschi* which suggested that the action against the guarantor should properly be framed only as a claim in damages.[100] The reasoning was that the obligation of the guarantor should be regarded not as an obligation to pay a sum of money to the creditor but to "see to it" that the principal debtor performs the obligation.[101] But in *Sunbird Plaza Pty Ltd v Maloney* ("*Sunbird Plaza*") Chief Justice Mason rejected this view:

> It may be that as a matter of history the view that the guarantor has an obligation "to see to it" that the debtor performs his obligation explains why the guarantor is not entitled to notice of the debtor's default and why the creditor's cause of action arises on that default. But the view certainly does not accord with the nature of the guarantor's obligation as it is understood today. Rarely do guarantors have control of, or a capacity to influence, the principal debtor such that they would willingly assume an obligation to ensure that he performs his primary obligation. The fact that at common law the creditor sued the guarantor in special assumpsit gives some support to the view that the guarantor's cause of action is for damages for breach of contract. However, the modern view that the guarantor promises to answer for the debtor's debt or default has led to the practice of suing the guarantor for the money sum which the debtor has failed to pay, a practice which may well have been adopted on the introduction of the Judicature Acts.[102]

The remainder of this paper will point to problems which arise in maintaining an action against the guarantor either for a money sum or for unliquidated damages and, in particular, the effect in this context of the creditor's action in terminating or, alternatively, affirming the principal contract.

2. The effect of the terms of the guarantee and principal transaction on the guarantor's liability for a money sum

The major difficulty here is that both the terms of the guarantee or the principal agreement may preclude the recovery of the amount owing as a money sum because the event upon which the debt is payable never occurs. The leading illustration is *Sunbird Plaza*. By the terms of the guarantee the

100. See supra n 8, Lord Diplock 348-349; Lord Simon of Glaisdale; *Degman Pty Ltd v Wright* [1983] 2 NSWLR 348, 350-352.

101. Supra n 8, 348.

102. Supra n 53, 255-256. Contra J Harris "Anticaptory Breach - Innocent Party's Right to Terminate" (1988) 1 JCL 177.

respondent guaranteed "the performance of all the terms and conditions of the contract including the payment of all moneys *payable* by the purchaser *under the contract*".[103] A deposit was paid and the balance of the purchase price was to be paid pursuant to the terms of the contract of sale "upon settlement". The contract of sale provided that settlement should take place within 14 days after notice from the vendor to the purchaser that the relevant building unit plan had been registered. Notice in accordance with this clause was given, but the purchaser wrongfully terminated the contract on the day fixed for settlement. The vendor elected to affirm the contract and eventually obtained an order for specific performance against the purchaser. The question arose whether the vendor could obtain payment from the guarantors.

The High Court held that the purchase price could not be recovered from the guarantors as a fixed sum because their liability was dependent on settlement taking place and that had not occurred. This was despite the fact that settlement did not occur because of the purchaser's wrongful action. As Justice Gaudron stated:

> Even if it be correct that the purchaser is not entitled to a conveyance, that does not alter the fact that under the contract the balance of the purchase money is payable "upon settlement", and not upon the date fixed by the contract for settlement.[104]

Both Chief Justice Mason (with whom Justices Deane, Dawson and Toohey agreed) and Justice Gaudron accepted that the purchase price could be recoverable from the guarantor as a debt if the guarantor had undertaken to pay the purchase price on the *day fixed for settlement* if the debtor failed to do so. Chief Justice Mason, however, refused to accept that the guarantee in question could be given that interpretation:

> No doubt a promise by a purchaser to pay the balance of the purchase price "upon settlement" gives less protection to a vendor than a promise to pay on a date fixed for settlement. But this circumstances cannot justify reading the promise to pay "upon settlement" ... otherwise than according to its terms.[105]

These comments indicate that the vendor should exercise great care to ensure that the guarantee states expressly that the guarantor will become liable to pay the purchase price on "the date fixed for settlement by the parties pursuant to the terms of the contract of sale".

The decision in *Sunbird Plaza* is illustrative of the established principle that ambiguous contractual provisions should be construed in favour of the

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103. Supra n 53, 245 (emphasis added).
104. Ibid, 268.
105. Ibid, 258.

guarantor;[106] but it is perhaps difficult for even the most careful draftsperson to appreciate the vast difference between a reference to "settlement", on the one hand, and "date of settlement", on the other hand, without the wisdom of hindsight.

When the guarantee is appropriately drafted so that the guarantor is liable for the purchase price, it is thought that the guarantor would then be entitled to be subrogated to rights in the property to enforce the right of indemnity against the purchaser. Although the guarantor has paid the purchase price to the creditor, the purchaser has not. As a result, vis-à-vis the purchaser, the creditor has an unpaid vendor's lien to which the guarantor is entitled to be subrogated.[107]

If, however, the drafting in *Sunbird Plaza* is adopted, Justice Gaudron appeared to be of the view that the guarantor could never become liable for the purchase price whilst the purchaser refused to settle. The word "settlement", in the context of this contract of sale, required co-operation between the parties. She stated:

> It is not to the point (if it be the case) that as at the date fixed by the contract for settlement, [the vendor] had done everything on its part necessary for settlement to take place, for the contract makes it clear that settlement can only take place with the active participation of the purchaser.[108]

Chief Justice Mason, however, appeared to take a less restrictive view. The facts were that the vendor had promised to amend certain by-laws governing the unit to be sold. In order to be effective such amendments required registration pursuant to the Queensland Building Units and Group Titles Act 1980, but this was not done by the date which the vendor had fixed for settlement. The High Court found that the act of the purchaser in not attending the settlement effectively ensured that the vendor had more time in which to perform its obligation to secure registration of the altered by-laws. There was, therefore, no breach by the vendor of this obligation.

In remitting the matter to the Full Court of the Queensland Supreme Court to frame appropriate orders, Chief Justice Mason stated that there remained several avenues open to the vendor, having now obtained the registration of the relevant by-laws. One (discussed below) related to the claim for bargain

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106. See *Ankar Pty Ltd v National Westminster Finance (Australia) Ltd* (1987) 162 CLR 549, 561.

107. See J O'Donovan and J Phillips *The Modern Contract of Guarantee* (Sydney: Law Book Co, 1985) 502-522, as to the issue of subrogation. As to subrogation of an unpaid vendor's lien see *Orakpo v Manson Investments Ltd* [1978] AC 95.

108. Supra n 53, 268.

damages, but Chief Justice Mason was of the view that an action against the guarantor in debt was still possible. He stated:

> Alternatively, the appellant may decide to take steps which might entitle it to maintain against the respondents an action on the guarantee for the balance of the purchase price as a debt then due and payable. If the appellant were to tender to the purchaser a registrable transfer of the unit, the purchaser might then come under a liability to pay the balance of the purchase price.[109]

Thus, for the purpose of suing the purchaser and consequently the guarantor in debt, Chief Justice Mason appears to contemplate that the action would arise simply upon a tender of the documents in proper form.

The difficulties which arose in *Sunbird Plaza* may be unusual, particularly in the case of a guarantee of a loan, where the guarantor's liability for a money sum will normally arise on default of the principal. But even here the creditor must be careful in two respects. First, the creditor must not bring proceedings where there is no default or before the default has occurred. Thus, in *Eshelby v Federated European Bank Ltd*,[110] the guarantor of payments due under a building contract to the building contractor was not liable on the guarantee when the work was performed defectively with the result that the principal debtor was not himself liable for the payments and, therefore, was not in default. Similarly, the guarantor of a bailee's obligations under a contract of bailment will not be liable where the goods are stolen from the bailee without any negligence on his or her part, since a bailee is not liable in the absence of negligence.[111] The guarantor for the payment of goods to be delivered is not liable when the goods are not delivered within the terms of the principal contract[112] or when the period of credit granted to the principal by the creditor has not expired[113] because in both cases the principal's obligation to pay has not yet arisen. Conditions precedent to the liability of the principal debtor under the principal contract, such as the giving of notice, may also need to be satisfied before the principal liability can properly be regarded as having arisen.[114]

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109. Ibid, 264-265.
110. [1932] 1 KB 423.
111. *Walker v British Guarantee Association* (1852) 21 LJQB 257 As an example of the absence of default by the principal in fidelity guarantee see *Jephson v Howkins* 133 ER 787.
112. *Schureck v McFarlane* (1923) 41 WN (NSW) 3.
113. *Turner Manufacturing Co. Pty Ltd v Senes* [1964] NSWR 692. A writ issued for payments of such goods will be issued prematurely.
114. *Rickaby v Lewis* (1905) 22 TLR 130; *Mayor of Wellington v Roberts and McNaught* (1883) NZLR 2 CA 56.

Secondly, the creditor must comply strictly with any conditions precedent to the guarantor's liability. Substantial compliance will not be sufficient. Thus, in *Tricontinental Corp Ltd v HDFI Ltd*[115] ("*Tricontinental*") a guarantee (in the form of an underpinning agreement) provided that the entitlement to make a demand upon the guarantor for payment arose "upon the occurrence of the following *events*". Those events, in general terms, were the service of written notices of default upon the principal debtor and also stipulated notices upon the guarantor within prescribed time limits. Justices Samuels and Waddell (President Kirby dissenting) held that the relevant terms were conditions precedent to the performance of the guarantors' obligations with the result that strict compliance with those terms was necessary. As Justice Samuels stated:

> It seems to me to follow from *Ankar Pty Ltd v National Westminster Finance* that it is meaningless to speak of the substantial performance of a condition precedent. Either it has been performed, or it has not. If it has, performance enlivens the obligation to which the stipulation is a condition precedent. If it has not, the obligation does not arise. Tricontinental's submission that a tripartite classification of conditions precedent analogous to that used in assessing the status of promissory terms should therefore be rejected. Where an act by one party is a condition precedent to the liability of the other, whether it has occurred or been fulfilled depends upon if the act proffered matches the description of the condition precedent in the contract, and not upon the seriousness of the divergence from that description.[116]

On the facts, the notice provisions were not strictly complied with and the guarantor was accordingly not liable for the outstanding debt. Although historically correct,[117] the consequence is that the guarantor is placed in a more favourable position if it is shown that the relevant term is a condition precedent and the condition is not fulfilled than if the creditor is in breach of a promissory stipulation. In the former situation, something less than strict compliance means that the guarantor is, in effect, automatically discharged, but in the latter case the guarantor may remain liable, depending on whether the stipulation is classified as a warranty, condition, or intermediate term. The determination of whether the term is a condition precedent or a promissory obligation, however, is not always an easy question of construction. In *Tricontinental*, the guarantor's liability was drafted so that it was dependent upon particular events occurring,[118] but other provisions regarding notice may be so phrased as to impose obligations rather than provide for contingen-

115. (1990) 21 NSWLR 689; J W Carter "Conditions and Conditions Precedent" (1991) 4 JCL 90.
116. Ibid, 705.
117. *Ritchie v Atkinson* (1808) 103 ER 787, 791.
118. Supra n 115, see cl 2.2.1(a)(b) in the case.

cies.[119] Indeed, in *Tricontinental* itself, President Kirby treated the term as an intermediate promissory obligation, which required only substantial compliance.[120]

The present law regarding the construction of conditions precedent is unsatisfactory, allowing the guarantor to be discharged for the most trivial departure from the terms of the guarantee. On a proper construction of the instrument, it may be appropriate to conclude that only substantial compliance is the condition required. The courts should then be able to interpret the condition accordingly.[121]

3. Termination by the creditor for the principal's breach

It is clear that if the creditor terminates the principal transaction according to its terms so as to discharge the principal from future liability, the guarantor of the transaction will be similarly relieved from liability. Thus, if a lessor gives the lessee a notice to quit in accordance with the terms of the lease, the lessee and the guarantor of the lessee's obligations will be discharged from future liability for payment of the rent.[122]

It might reasonably be supposed, however, that if the creditor elects to terminate the principal contract for a breach by the principal in circumstances in which the principal continues to remain liable to the creditor in damages, the guarantor will continue to be responsible for such liabilities. This follows from the fact that the reason for the creditor obtaining the guarantee in the first place is to protect himself against the contingency of the principal's breach. However, it has been argued that because the principal contract determines as a result of the creditor's acceptance of the debtor's breach in such circumstances, the consequence is that the obligation of the guarantor will also be extinguished.

Important to an understanding of this argument is the distinction between two forms of guarantee. The distinction was first drawn by Lord Reid in

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119. See in another context, *Bremer Handelsgesellschaft mb v Vanden Avenne-Izegem PVBA* [1978] 2 Lloyd's Rep 109; *Ankar Pty Ltd v National Westminster Finance (Australia) Ltd* supra n 106 in which the relevant clauses were defined in terms of obligations.

120. Supra n 115.

121. Indeed this is an approach which has sometimes found favour in the construction of promissory conditions (eg *Luna Park (NSW) Ltd v Tramways Advertising Pty Ltd* (1938) 61 CLR 286). Whether or not this approach survives the adoption of the intermediate term concept was a matter left open by Samuels JA in *Tricontinental*, ibid.

122. *Giddens v Dodd* (1856) 61 ER 988; *Tayleur v Wildin* (1868) LR 3 Exch 303; *Associated Dairies Ltd v Pierce* (1981) 256 EG 562.

Moschi[123] and subsequently adopted by the High Court in *Sunbird Plaza.*[124] In the latter case, Chief Justice Mason stated:

> There are, however, two common classes of guarantee of the payment of instalments by the principal debtor. The first is an undertaking by the guarantor that if the debtor fails to pay an instalment he will pay. This is a conditional agreement. The guarantor's obligation to pay arises on the debtor's failure to pay. The second is an undertaking by the guarantor that the debtor will carry out his contract. Then a failure by the debtor to perform his contract puts the guarantor in breach of his.[125]

An example of the first type of guarantee referred to by Chief Justice Mason ("Type (1)")[126] would be an undertaking that "in case the debtor is in default of payment we will forthwith make the payment on behalf of the debtor".[127] A guarantee of "the performance of all the terms and conditions of the contract" would be an illustration of the second type ("Type (2)"). Sometimes the two forms of guarantee are combined. Thus, in *NRG Vision Ltd v Churchfield Leasing Ltd*[128] the guarantee was stated to be in respect of "the payment by the customer of all sums due under the agreement[129] ... *and* the due performance of all the customer's obligations thereunder."

If the guarantee is of Type (1), the creditor's cause of action is in debt or for a money sum, the claim being for a liquidated amount.[130] In respect of a guarantee of Type (2), the cause of action will generally be in damages for breach of contract; but, even in this case, an action for a liquidated sum will be appropriate if the amount claimed can be ascertained objectively by calculation or by other positive data.[131] Bearing in mind the distinction between these types of guarantee, an examination is required of the effect of termination of the principal contract by the creditor on both accrued obligations and future obligations of the principal.

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123. Supra n 8, 344-345.
124. Supra n 53.
125. Ibid, 256.
126. A "guarantee of the payment of instalments" will encompass payments of rental pursuant to a lease and a sale of land by instalments.
127. This is the second part of the guarantee in *Hyundai* supra n 2. See also the second part of the clause in *Sunbird Plaza* supra n 53, (the payment of all moneys "payable by the purchaser") and the guarantee in *Keene v Devine* [1986] WAR 217 (a guarantee "to make good any default on the part of [the principal] in the payment of the said loan and interest").
128. See (1988) 4 BCC 56 (emphasis added); *Sunbird Plaza* supra n 53.
129. But it is suggested below that in any event this first part of the clause should embrace a liability for damages.
130. As to the creditor's cause of action generally see below, and *Sunbird Plaza* supra n 53.
131. *Spain v Union Steamship Co of New Zealand Ltd*, supra n 15.

(a) Termination and the effect on subsequent obligations

The leading authority on this issue is *Moschi*.[132] A guarantee was given to secure a debt payable by instalments. The guarantor personally guaranteed the performance by the debtor of its obligations to make the payments. When the debtor defaulted in making the payments, the creditor accepted this breach as putting an end to the contract and sought to recover the outstanding future payments from the guarantor. The guarantor argued that he was discharged from liability on the basis that once the principal agreement had come to an end by the creditor's acceptance of the debtor's breach, the obligation of the debtor to make the future payments also ceased. Although the debtor would be liable in damages to the creditor, the guarantor argued that he had not guaranteed the obligation to pay damages but only the obligation to make the payments.[133]

The House of Lords rejected this argument on the basis that the guarantor by the terms of the guarantee had undertaken that the debtor would carry out the contract. In other words, the guarantee was of Type (2). Thus, the guarantor was liable in damages, the breach of the principal contract by the debtor putting the guarantor in breach of the contract of guarantee.[134] The measure of damages payable by the guarantor would be whatever sum the creditor could have recovered from the principal.[135]

The same reasoning has been applied in Australia. In *Nangus Pty Ltd v Charles Donovan Pty Ltd*,[136] a guarantor of the "due performance ... and observance of all the ... conditions ... in [a] lease" was held liable in damages to the lessor. This was despite the fact that the lease had been determined by the lessor's acceptance of the lessee's repudiation of the lease, which had brought the lease to an end and relieved the lessee from making future rental payments. Similarly, in *Womboin Pty Ltd v Savannah Island Trading Pty Ltd*,[137] the vendor of land recovered damages (being the deficiency on resale) from a guarantor of "the performance of the covenants and conditions by the

132. Supra n 8.

133. The guarantor also argued that the acceptance of the debtor's breach as putting an end to the contract was a material variation of the principal contract which extinguished the guarantor's liability. This argument was also rejected.

134. Supra n 8, Lord Reid, 345; Lord Diplock, 348; Lord Simon of Glaisdale, 356-357; Lord Kilbrandon, 359.

135. Supra n 8, 339. But see below as to the assessment of damages in an action against the guarantor.

136. [1989] VR 184.

137. Supra n 8. See E Peden "Contract of Guarantee - Liability of Guarantor after Termination of Principal Contract" (1991) 4 JCL 264.

purchaser" of the contract of sale. It was irrelevant that upon the vendor's acceptance of the purchaser's breach the contract came to an end and the vendor had no right to claim the contract price from the purchaser as a liquidated sum.

Lord Reid, however, in *Moschi* did indicate that if the guarantee only amounted to an undertaking by the guarantor that he would pay any instalment not paid by the debtor (a Type (1) guarantee), the guarantor would be discharged.

> A person might undertake no more than that if the principal debtor fails to pay any instalment he will pay it. That would be a conditional agreement. There would be no present obligation unless and until the debtor failed to pay. There would then on the debtor's failure arise an obligation to pay. If for any reason the debtor ceased to have any obligation to pay the instalment on the due date then he could not fail to pay it on that date. The condition attached to the undertaking would never be purified and the subsidiary obligation would never arise.[138]

Chief Justice Burt in the Supreme Court of Western Australia in *Keene v Devine*[139] referred to this passage with approval. Thus, according to Lord Reid, if the guarantor's obligation is merely to undertake to pay if the debtor fails to pay a particular instalment, rather than an undertaking that the principal debtor will carry out the contract, the guarantor will be discharged by a determination of the contract before the due date for payment of that instalment, even though the determination arises out of the creditor's acceptance of the principal's breach. This result arises because the terms of the guarantee indicate that the guarantor has only promised to pay an instalment if the debtor fails to pay and that obligation to pay never arises because the contract has been determined. In consequence, an action for a money sum is not available because the payment has not yet accrued. A claim in damages is not possible vis-à-vis the guarantor because the terms of the guarantee contemplate merely a guarantee of the instalment and not a liability in respect of damages.

No doubt this reasoning is in accordance with the general principles of strict construction applicable to guarantees. But given that the central object of the guarantee is to protect the creditor against the contingency of the

138. Supra n 8, 344-345. Note, however, that in *Moschi* itself none of the other Lordships specifically discussed the point of construction made by Lord Reid. Eg, the judgments of Lord Diplock and Lord Simon of Glaisdale appear to contemplate the possibility of an action for damages against the guarantor, even though the guarantee is an undertaking to pay an instalment if the debtor fails to pay it. Compare E Peden "A Classification of Contracts of Guarantee (1991) 13 Syd LR 221.

139. Supra n 127. But on the facts the creditor affirmed rather than terminated the contract so that the issue under consideration here did not arise.

principal's breach, the result is unfortunate. The guarantor escapes all liability in respect of future obligations subsequent to termination because of somewhat technical distinctions in drafting. It is to be hoped that the courts will strive for an interpretation of the guarantee that embraces a liability for damages as well as for the recovery of the instalment as a liquidated sum.[140] For example, a guarantee of "all sums due under the agreement" could be viewed as also imposing an obligation to *ensure* that the debtor pays those sums. Thus, the agreement would be interpreted as a guarantee of both Types (1) and (2), [141] rendering the guarantor liable for damages in the event of a determination of the principal contract and relieving the principal (and, therefore, the guarantor) from liability for the future instalments as liquidated sums.[142]

In any event, the message for the creditor is clear. The guarantee should contain a specific clause guaranteeing "the performance of the terms and conditions of the principal contract" so as to render the guarantor liable in damages in the event of a determination of the principal contract arising from the principal's breach before the date for payment of future instalments pursuant to the principal contract arises.

Even if no such clause is included, and the agreement is simply a guarantee of all sums payable by the principal, the creditor's action against the guarantor for a money sum may be preserved in the following ways.

(i) By the inclusion of a liquidated damages provision in the principal contract.

If the principal contract embodies a liquidated damages clause, this may allow the creditor to recover all outstanding amounts from the guarantor. The liquidated damages provision will state that upon the principal's default the principal will become liable for future payments (subject to suitable rebates, for example, in the case of a lease for the estimated rent obtainable from releasing for the balance of the term, and also a rebate for early repayment). In this case the guarantor's liability for the whole sum will arise on default

140. Note that in *Womboin Pty Ltd v Savannah Island Trading Co Pty Ltd* supra n 8, Rogers CJ Comm D, 370, was of the view that, "as a matter of general principle" a liability in damages should survive termination of the principal contract following the principal's breach. But his Honour's comments are limited to "a guarantor, who guaranteed *the performance* of the other party's obligation" (emphasis added). This was the case on the facts.

141. Supra n 126.

142. In such a case, however, damages might be limited to the amount of the debt on the basis that consequential losses are not within the contemplation of the parties.

by the principal and before the contract is determined by the creditor accepting the principal's repudiation.[143]

The benefit to the creditor of this mechanism is that the cause of action will be for a money sum and no duty to mitigate will arise as would be the case in an action for damages. The danger is that the clause, if improperly drafted, may be struck down as being in the nature of a penalty.[144]

(ii) By an indemnity clause

If the agreement is clearly one of indemnity whereby there is a promise to pay even in circumstances in which the principal never becomes liable for the future instalments, the creditor may also recover those instalments as a money sum.[145] The difficulty here is that the drafting of such a clause is not an easy task. A "principal debtor" clause, whereby the creditor is "given liberty to act as though the guarantor were a principal debtor",[146] will not have this effect. The effect of such a clause may be to preserve the guarantor's liability in circumstances in which he would otherwise be discharged, for example, where the creditor improperly releases a security[147] or grants the principal an extension of time to repay the debt.[148] The clause also obviates the necessity for a demand to be made upon the guarantor before issuing proceedings.[149] But the dominant view is that the incorporation of a "principal debtor" clause does not convert what would otherwise be interpreted as a contract of guarantee into a contract of indemnity.[150]

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143. See *Direct Acceptance Finance Ltd v Cumberland Furnishing Pty Ltd* [1965] NSWLR 1504, 1509.
144. See *Citicorp Australia Ltd v Hendry* supra n 77.
145. See supra n 143.
146. An example taken from *Fletcher Organisation Pty Ltd v Crocus Investments Pty Ltd* [1988] 2 Qd R 517.
147. Ibid.
148. See *Heald v O'Connor* [1971] 1 WLR 497; *Brown Bros Motor Lease Canada Ltd v Ganapathi* (1983) 139 DLR (3d) 227.
149. *Esso Petroleum Co Ltd v Alstonbridge Properties Ltd* [1975] 1 WLR 1474, 1478.
150. See *Citicorp Australia Ltd v Hendry* supra n 77, Clarke J (at first instance), 20; *Heald v O'Connor* supra n 148; *Clipper Maritime Ltd v Shirlstar Container Transport Ltd* ("*The Anemone*") [1987] 1 Lloyd's Rep 546, 555; *Brown Bros Motor Lease Canada Ltd v Ganapathi* supra n 148. Compare *Fletcher Organisation Pty Ltd v Crocus Investments Pty Ltd* supra n 146, 5265-527 and 536 where the effect of a principal debtor clause is equated with a specific variation of the contractual arrangements whereby the guarantor clearly assumes a primary liability. See also K P McGuinness *The Law of Guarantee Treatise on Guarantee, Indemnity and the Standby Letter of Credit* (Toronto: Carswell, 1986) 26 who suggests that the effect of a principal debtor clause is "to render the obligation of the surety absolute and unconditional".

Even if the agreement is drafted as an indemnity, or there is an indemnity clause embodied within the guarantee, this may not achieve the desired objective of rendering the guarantor liable in an action for a money sum for instalments which fall due subsequent to the termination of the contract. Thus, in *Citicorp Australia Ltd v Hendry*, it was held that an indemnity provision did not preserve the obligor's liability when the sums payable pursuant to the principal contract were irrecoverable as being in the nature of a penalty.[151] The clause, which preserved the liability of the indemnifier despite the fact that the moneys "are or may be irrecoverable" from the debtor, was construed as being applicable only if the indemnifier came under an existing liability which was then affected by some "supervening irrecoverability".[152] According to Justice Priestley this was not the case because the effect of holding a clause to be a penalty is that no obligation is ever assumed: "[I]t is the same as if it was not in the agreement at all."[153]

An indemnity clause may have the result of preserving the liability of the indemnifier for the instalments in an action for a money sum when the principal debtor is no longer liable to pay those instalments if it is drafted in terms which provide that the obligor assumes a primary liability and undertakes to pay the moneys secured whether or not any other obligor has assumed an obligation to pay those moneys and whether or not the sums are irrecoverable from any other obligor.[154] The clause should, of course, define the moneys secured and might also specify the various grounds on which the moneys are recoverable. But if the clause is embodied in a document which is otherwise clearly a guarantee, it may be read down to accord with the intent of that instrument (that is, it is in reality a secondary obligation).[155]

Indeed, in respect of ascertaining the relationship between the creditor and the obligor the words of the instrument are not decisive. Thus, in *AGC (Advances) Ltd v West*,[156] Justice Hodgson, by reference to extrinsic evidence

151. Supra n 77.

152. Ibid, 41.

153. Ibid, 39.

154. Note, however, Clark J in *Citicorp Australia Ltd v Hendry* ibid, 21 was of the view that it would be contrary to public policy to allow recovery from an indemnifier when the moneys were irrecoverable from the principal and that to allow recovery from the indemnifier on the basis of a formula which gives rise to an irrecoverable penalty would not reflect the creditor's true loss. The matter was left open by Priestley JA on appeal, ibid, 41.

155. There is recent authority indicating that the words of the instrument are not decisive. See *AGC (Advances) Ltd v West* (1984) 5 NSWLR 590. On appeal, sub nom *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610, the question was not discussed.

156. Ibid.

and the surrounding circumstances, held that the position of the party who was the principal borrower according to the instrument was in reality the guarantor whilst the party designated as the guarantor was in fact the principal borrower.

(b) Termination and the effect on accrued obligations

When the principal contract is terminated because of the principal's breach, payments which were due before the date of termination will be recoverable from the principal (and the guarantor) as a debt. Some difficulty, however, arises when the accrued payments are recoverable by the principal debtor from the creditor despite the principal's breach.

The leading Australian authority on the question of the guarantor's liability in these circumstances is *Dennys Lascelles*, discussed above.[157] The guarantee was given to secure the due payment of an instalment by a purchaser under a contract for the sale of land. Although the purchaser failed to pay the instalment when due, the purchaser purported to terminate the contract for the vendor's breach. This repudiation was accepted by the vendor as discharging the contract. A valid termination by the purchaser would certainly have discharged the guarantor because the purchaser would no longer have been under any liability either for payment of the instalment or in damages.

It was argued, however, that the purchaser had no valid ground for terminating the contract, and that the contract was in fact discharged by the vendor's acceptance of the breach by the purchaser arising from his wrongful attempt to terminate. Justice Dixon accepted this argument.[158] The majority regarded which party was in breach as irrelevant.[159] Their reasoning was that, as this was a contract for the sale of land and there had been a total failure of consideration (the purchaser obtaining no title to the land), the overdue instalment ceased to be payable by the purchaser when the contact was discharged and, indeed, was recoverable by him if he had paid it. It did not matter that the purchaser was in breach and might be subject to an action for damages by the vendor. It followed, according to the High Court, that the guarantors of the instalment must also be discharged.

A different result was reached in *Hyundai* where a guarantee was given for the payment of "sums due or to become due ... under a contract" for the

157. Supra n 6.
158. Ibid, 479. See also Evatt J who dissented.
159. Ibid, Dixon J, 479, Starke J, 469, Rich J 467-468.

construction of a ship, the price payable by instalments. Even on the assumption that the principal was *not* liable for instalments which had accrued, it was held that the guarantor still remained liable for those accrued payments.[160] It is not clear why this should be so since the principle of co-extensiveness applicable to guarantees should lead to the result (as in *Dennys Lascelles*)[161] that if the instalment is not payable by the purchaser it should not be recoverable from the guarantor as a liquidated sum. One explanation of the decision in *Hyundai* is that the guarantor's obligation was construed by the court as being a liability to pay regardless of the principal's position; that is, a primary liability in the nature of an indemnity was assumed. But the terms of the relevant instrument do not indicate that it was other than a guarantee.[162]

In our view, the High Court in *Dennys Lascelles* was clearly correct in concluding that if the purchaser is not liable for the accrued payment (or if it is recoverable by him), it cannot be recovered from the guarantor as a liquidated sum.[163]

Yet there is an outstanding question that was not discussed in that case. Why, on the facts of *Dennys Lascelles*,[164] was the guarantor not liable in damages? The answer at first glance is simple. The vendor did not bring an action for damages, perhaps because the vendor could not show any loss since the value of the land had risen.[165] More fundamentally, however, if Lord Reid's view in *Moschi*[166] is correct then an action for damages against the guarantor may not have been possible at all, even if the vendor had been able to show loss of profit on the sale. The guarantee in *Dennys Lascelles* was a

160. Supra n 2. In fact the House of Lords held that the party ordering the construction was so liable.
161. Supra n 6.
162. The agreement was in these terms: "We hereby jointly and severally irrevocably guarantee the payment in accordance with the terms of the contract of all sums due or to become due by the buyer to you under the contract, and in case the buyer is in default of any such payment we will forthwith make the payment in default on behalf of the buyer" (see supra n 2, 1133).
163. Supra n 6.
164. Ibid.
165. Of course the principal must be in breach of contract before an action can be maintained against the guarantor. Eg *Hewitson v Rickerts* (1884) 63 LJQB 111 can probably be explained on the basis that the creditor, by terminating a sale agreement and seizing the goods, prevented the property passing so that the consideration for the sale agreement wholly failed. Thus, the principal could not have been sued even in damages for the outstanding amounts owing so that the guarantor was also relieved from liability: see the explanation in *Brooks v Beirnstein* [1909] 1 KB 98. But in *Dennys Lascelles* supra n 6 there was clearly a breach by the principal.
166. Supra n 8, 132-135.

guarantee to pay the instalment if the debtor did not pay[167] (Type (1))[168] and not a guarantee of the purchaser's obligation (Type (2)).[169] The result, according to Lord Reid's reasoning in *Moschi*,[170] would be that the guarantee did not embrace a liability to pay damages but only to pay the instalment, which was no longer payable by the purchaser. The guarantor would, therefore, not be liable.

4. Where the creditor elects not to terminate the principal contract

It will be recalled that in *Sunbird Plaza* the creditor could not recover the purchase price from the guarantor as a fixed sum because the event upon which the money was payable ("settlement") had not occurred.[171] *Sunbird Plaza*, however, raises another issue, which is directly related to the decision of the creditor to affirm the contract of sale. In that case the respondents guaranteed "the performance ... of all the terms and conditions of the contract". As has been seen, a guarantee of this type will embrace a liability for damages.[172] Prima facie, therefore, the breach of contract by the purchasers would have put the guarantors in breach of their guarantee. Why, then, could not the vendors successfully have sued the guarantors for damages, being the loss of profit on the contract?

The answer to this lies in the course of litigation pursued by the vendor in respect of the contract of sale, namely, that the vendor chose to affirm the contract rather than terminate it and, indeed, obtained an order of specific performance of that contract. Loss of bargain damages are only recoverable if the contract is brought to an end. This was never done.[173] Furthermore, having obtained an order for specific performance, the contract could not be terminated without vacation of the order, which requires leave of the court. This is because the plaintiff cannot be permitted to act inconsistently by terminating the contract in face of an order of the court requiring him to complete.[174] A present claim for loss of bargain damages was, therefore, misconceived against the purchasers and consequently against the guarantors in the present proceedings. The vendor, however, could now apply to the

167. Ibid. The guarantee was simply a guarantee of "the due payment" of the stipulated sum.
168. See supra n 126.
169. See supra n 127-128.
170. Supra n 8.
171. Supra n 53.
172. See supra n 100.
173. Supra n 53, Mason CJ, 260, Gaudron J, 273.
174. Ibid, 259-261.

court for the order of specific performance to be vacated, terminate the contract of sale, and seek damages.[175] Thus, the result of the creditor's decision to affirm the principal contract was that no action for damages was possible without the taking of further procedural steps, even though the guarantee was appropriately drafted so as to embrace a liability for damages.

Sunbird Plaza is not the only example of this result. In *Keene v Devine*,[176] the creditor affirmed a loan contract payable at a future date, despite a declaration (amounting to a repudiation) by the principal debtor that he was not going to perform. An action for loss of bargain damages was therefore no longer possible. The guarantee obliged the guarantor "to make good any default on the part of the debtor in the payment of the said loan and of all interest ... thereon". Chief Justice Burt held that, since there had been no default in "the payment of the said loan ... and interest ... thereon" at the date of the issue of the writ, no cause of action had arisen. The action was dismissed, leaving the plaintiff to commence proceedings again.

5. Where the principal terminates the principal contract

(a) Termination arising from statutory or contractual right

The principal debtor may validly terminate the principal contract, either on the basis of a provision in that contract permitting termination or pursuant to the provisions of a statute.[177] Thus, in *Insurance Office of Australia Ltd v Burke Pty Ltd*,[178] the purchaser under a contract for the sale of land exercised a statutory right to terminate the contract. The result of this termination was that the purchaser was discharged from liability to pay further instalments of the purchase price. The guarantor of the performance by the purchaser of the payment of moneys which would otherwise have become due and payable under the contract of sale was held to be relieved of liability. Another illustration involving termination of the principal contract exists in the context of hire-purchase transactions. If a hirer exercises a right to terminate the agreement in accordance with its terms and fulfils the other obligations under the agreement, a guarantor of his or her commitments will be discharged.[179]

175. Ibid.
176. Supra n 127.
177. *Insurance Office of Australia Ltd v Burke Pty Ltd* (1935) 35 SR (NSW) 438 (valid termination of a lease according to its terms).
178. Ibid.
179. *Western Credit Ltd v Alberry* [1964] 1 WLR 945.

The effect of termination of the principal contract by the principal in the case of a guarantee will be to relieve the guarantor from any future obligations accruing subsequent to the date of termination. But this will not be the case if the contract is viewed as one of indemnity. In *Direct Acceptance Finance Ltd v Cumberland Furnishing Pty Ltd*,[180] a clause in the relevant agreement permitted the recovery of payments due under a hire-purchase agreement, even in circumstances where the principal's obligation to make these payments had ceased because of an effective termination of the hire-purchase agreement under the provisions of the New South Wales Hire-Purchase Act 1960. It was held that the plaintiffs could recover as this was an independent promise to indemnify the plaintiffs and was, therefore, unaffected by any valid termination of the hire-purchase agreement.[181]

(b) Termination upon the creditor's breach

If the creditor repudiates the principal contract or is in breach of a condition of that contract, and the principal debtor accepts the repudiation or breach as terminating the contract, the guarantor will be discharged.[182] Again, the guarantor will be discharged in respect of obligations subsequent to the date of termination.[183] But in this case the guarantor will be able to take advantage of the claim in damages that the principal has against the creditor, at least if the principal is joined as a party to the proceedings.[184]

A guarantor will not be discharged, however, by a non-repudiatory breach of the principal contract unless it can be shown that the relevant term of the principal contract has become "embodied" in the guarantee and that there has been a departure from that term.[185]

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180. Supra n 143.
181. See also *Goulston Discount Co Ltd v Clark* [1967] 2 QB 493. Compare *Unity Finance Ltd v Woodcock* [1963] 1 WLR 455. The construction of the agreement in the latter case, however, was doubted in *Direct Acceptance Finance Ltd v Cumberland Furnishing Pty Ltd*, ibid.
182. *National Westminster Bank P/C v Riley* [1986] FLR 213, referring to repudiation, but the rule should logically apply to a breach of condition.
183. Exceptionally, where the guarantor will not be discharged because the principal's promise is independent of the creditor's obligations (eg a tenant's obligation to pay rent is independent of the landlord's covenant to repair). See *Chatfield v Elmstone Resthouse Ltd* [1975] 2 NZLR 269, 276.
184. See *Cellulose Products Pty Ltd v Truda* (1970) 92 WN (NSW) 561.
185. *National Westminster Bank P/C v Riley* supra n 182, 223.

6. Conclusion

As has been seen, the rights of the creditor against a debtor or a guarantor can be very much enhanced by a combination of a (i) careful drafting of the contract and (ii) exercising the correct options when pursuing rights against the debtor.

In the context of claims for liquidated sums, greater security is offered by the express apportionment of payments to performance than agreed damages clauses. Whereas agreed damages clauses are subject to the rule against penalties, that rule does not apply to sums representing the agreed price of performance. The decisions indicate that if a claim for damages must be made following termination, difficulties are likely to be encountered unless there is an express definition of obligations or an express provision that any breach amounts to a repudiation.

In the context of guarantees, *Sunbird Plaza*[186] is perhaps the best illustration. The draftperson in that case could perhaps be excused for failing to appreciate the difference between liability being dependent on "settlement" and, alternatively, "on a date fixed for settlement". But the litigator should not, in our view, have proceeded to obtain an order of specific performance and thus preclude the client's right to claim loss of bargain damages.

It is not possible, of course, to anticipate every contingency, but the enforcement of contracts against debtors and guarantors is often made more difficult by the failure of legal advisers to review thoroughly their standard form contracts in the light of recent case law.

186. Supra n 53.