NO ORAL MODIFICATION CLAUSES

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INTRODUCTION

(1) Last year, in its decision in *Rock Advertising Limited v MWB Business Exchange Centres Limited* (***Rock Advertising***),[3] the United Kingdom Supreme Court unanimously upheld an appeal from a decision of the United Kingdom Court of Appeal that had denied the effectiveness of a "No Oral Modification" clause (**NOM clause**). As will be discussed below, Lord Sumption, with whom Lady Hale, Lord Wilson and Lord Lloyd-Jones agreed, found that a purported oral variation to a written contract which contained a NOM clause was ineffective where the parties did not comply with the express contractual requirements that any variation be in writing and be signed by the parties (Lord Briggs took a different path to the same result).

(2) The decision in *Rock Advertising* emphatically resolved some ambiguity in earlier decisions of the United Kingdom Court of Appeal,[4] and undoubtedly indicates a shift in the legal position with respect to freedom of contract in the United Kingdom. The decision also heralds a divergence from the position adopted in Australia, namely that a subsequent oral agreement to vary or modify a written contract contains an implied agreement to dispense with the strict requirements of any NOM clause.[5] Given the influence that decisions of the United Kingdom's highest courts have historically had on Australian courts, it is worthwhile to examine how *Rock Advertising* may impact upon the Australian position (if at all).

(3) Recent obiter in *Bundanoon Sandstone Pty Ltd v Cenric Group Pty Ltd; TWT Property Group Pty Limited v Cenric Group Pty Limited* (***Bundanoon***),[6] and *White v Philips Electronics Australia Ltd t/as Philips Healthcare* (***White v Philips***),[7] suggests that the *Rock Advertising* decision may lead the New South Wales Court of Appeal to reconsider the principle of freedom of contract

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[3] [2018] 2 WLR 1603.
[4] See *Rock Advertising* at [9] per Lord Sumption (Lady Hale, Lord Wilson and Lord Lloyd-Jones agreeing) and the cases discussed there.
[5] *Liebe v Molloy* (1906) 4 CLR 347 at 353-355; *Commonwealth of Australia v Crothall Hospital Services (Aust) Ltd* (1981) 36 ALR 567 at 576; *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1 at [217]-[223] (per Finn J); and *Australian Medic-Care Company v Hamilton Pharmaceutical* (2009) 261 ALR 501 at 561-2 [257] (per Finn J).
[6] [2019] NSWCA 87 at [122] (Gleeson JA, with whom Meagher and McCallum JJA agreed).
[7] [2019] NSWCA 115 at [42] (Bell P). While the President did not specifically refer to the decision in *Rock Advertising* his Honour did refer to the comments made in *Bundanoon* in respect of the decision.

in respect of NOM clauses. This article considers whether the decision in *Rock Advertising* should and is likely to be followed in Australia, and whether any special considerations arise in relation to complex building and construction contracts.

THE CURRENT AUSTRALIAN POSITION

(4) The established position of Australian courts is that, notwithstanding any NOM clause, it is open to parties to vary their original agreement either by subsequently entering into an express oral agreement or by a new contract being implied from the conduct of the parties.[8] In other words, a NOM clause is not considered to be binding by Australian courts.

(5) The rationale for the Australian position (as well as the former position in the United Kingdom) has relied heavily on the fundamental common law principle of freedom of contract, which provides that contracting parties have the freedom to strike whatever bargain they choose. In the context of oral variations to written contracts, courts have found this principle to mean that parties are at liberty to strike a new or varied agreement and cannot be limited in that respect by the terms of their earlier written agreement.[9] In other words, the parties should have absolute autonomy (subject of course to statue), if they so agree, to modify or terminate their earlier agreement in whatever form they agree.

(6) The principle of freedom of contract in the context of NOM clauses is, arguably, counter intuitive. This is because if parties properly had freedom of contract to strike whatever bargain they desired, arguably they should also be entitled to agree on the methods by which they can vary or modify their agreement (such as, only by written variation). The very idea of a contract is to bind the future conduct of the parties in their mutual interests. Australian courts have instead adopted a preference for enforcing the latter agreement on the basis that it can be inferred from that latter agreement that the parties intended to vary or modify the formality requirements set out in their earlier agreement.

(7) In order for a variation to be effective, whether oral or in writing, the subsequent agreement must itself satisfy the requirements of a valid contract, including the requirements of certainty and consideration.[10] This means that the subsequent agreement must itself be established to be a contract and a court will need to be satisfied that the parties in fact turned their minds to the question of variation of their earlier contract and reached a *consensus ad idem* as to that variation.[11] Australian authorities do not, however, require the parties to have turned their

[8] *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1 at [217].
[9] *Hawcroft General Trading Co Pty Ltd v Hawcroft* [2017] NSWCA 91.
[10] *Ermogenous v Greek Orthodox Community of SA Inc* (2002) 187 ALR 92 at 99; *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1 at [216].
[11] *OzEcom v Hudson Investment Group* [2007] NSWSC 719 at [173]-[180] (McDougall J).

minds to disregarding the formal requirements for variations set out in their earlier written contract.

(8) In determining whether a consensus as to an oral variation has been reached, the fact that a NOM clause was included in the original contract will be taken into account in interpreting the subsequent conduct of the parties.[12] Australian courts have consistently found that the existence of a NOM clause is a relevant consideration to be taken into account in determining whether the parties reached a concluded agreement to vary their earlier contract. Consequently, the existence of a NOM clause makes it more difficult for a court to infer that the parties did intend to vary their agreement without complying with the formal requirements.[13] However, the test will be whether the subsequent "agreement" constitutes a valid contract of variation.

(9) Finally, in relation to the Australian position, it is relevant to note the position at Equity. That is, if one party induces or encourages the other to assume that a contract has been varied and/or that the formal requirements of their earlier written contract need not be complied with, that party will be estopped from later insisting on compliance with such requirements.[14] Thus, where it would be unconscionable for a NOM clause to be strictly enforced, Equity will step in to protect the innocent party.

ROCK ADVERTISING

(10) The decision in *Rock Advertising* is at odds with the Australian position and signifies a divergence between the Australian and United Kingdom courts.

(11) The *Rock Advertising* decision involved a dispute over an alleged oral variation to a written contract which contained a NOM clause. MWB operated serviced offices in London. Rock Advertising entered into a licence agreement with MWB to occupy office space for a year. The agreement contained a 'no oral modification' clause. Rock Advertising fell into arrears and its director purportedly negotiated an oral agreement with an MWB credit controller to reschedule Rock Advertising's payments. Rock Advertising began to comply with that new agreement by making the rescheduled payments, however, the credit controller took what she understood to be a proposal to her boss for consideration. It was rejected, and MWB demanded the full amount outstanding under the written agreement. MWB was not paid and

[12] *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1; [2003] FCA 50 at [221] (Finn J).
[13] *Mathews Capital Partners v Coal of Queensland Holdings* [2012] NSWSC 462 at [39]-[40].
[14] *Update Constructions Pty Ltd v Rozelle Child Care Centre Ltd* (1990) 20 NSWLR 251.

it proceeded to lock Rock Advertising out of the premises, terminate the licence and sue for the rental arrears.

(12) At first instance, Judge Moloney QC of the Central London County Court found that although the licence agreement had been varied by an oral agreement with the credit controller, who had ostensible authority to vary the agreement, as it was not varied in writing in accordance with the NOM clause it was ineffective. The Court of Appeal overturned the decision,[15] finding that the no oral modification clause was ineffective to limit the parties subsequent bargaining power and that the licence agreement had been varied by the subsequent oral agreement, which also amounted to an agreement to dispense with the NOM clause.

(13) The Supreme Court unanimously allowed the subsequent appeal. Sumption LJ, with whom Hale P, Wilson and Lloyd-Jones LJJ agreed, began by noting that in the United Kingdom at common law there are no formal requirements for the validity of a simple contract. His Honour went on to observe that, in addition to one former exception at common law,[16] the other exceptions to the principle of informality are all statutory (although none applied).[17]

(14) With reference to the oft cited judgment of Cardozo J in the New York Court of Appeals in *Beatty v Guggenheim Exploration Co* (***Guggenheim Exploration***),[18] Sumption LJ recited the common justification for denying effectiveness to a NOM clause, namely: (i) that a variation of an existing contract is itself a contract; (ii) that precisely because the common law imposes no requirements of form on the making of contracts, the parties may agree informally to dispense with an existing clause which imposes requirements of form; and (iii) the parties must be taken to have intended to do this by the mere act of agreeing a variation informally when the principal agreement required writing.[19]

(15) Sumption LJ then sought to turn the argument from autonomy on its head, opining:[20]

> I think that this is a fallacy. Party autonomy operates up to the point when the contract is made, but thereafter only to the extent that the contract allows. Nearly all contracts bind the parties to some course of action, and to that extent restrict their autonomy. The real offence against party autonomy is the suggestion that they cannot bind themselves as to the form of any variation, even if that is what they have agreed. There are many cases in which a particular form of agreement is prescribed by statute: contracts for the sale of land, certain regulated consumer contracts, and so on. There is no principled reason why the parties should not adopt the same principle by agreement.

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[15] [2017] QB 604 (Arden, Kitchin and McCombe LJJ).
[16] A corporation could bind itself only under seal, but what remained of that rule was abolished by the *Corporate Bodies Contracts Act 1960*.
[17] *Rock Advertising* at [7].
[18] (1919) 225 NY 380, 387-388.
[19] *Rock Advertising* at [7].
[20] *Rock Advertising* at [11].

(16) Turning to the practical realities of what parties actually do, Sumption LJ observed that:[21]

> No Oral Modification clauses… are very commonly included in written agreements. This suggests that the common law's flexibility has been found a mixed blessing by businessmen and is not always welcome. There are at least three reasons for including such clauses. The first is that it prevents attempts to undermine written agreements by informal means, a possibility which is open to abuse, for example in raising defences to summary judgment. Secondly, in circumstances where oral discussions can easily give rise to misunderstandings and crossed purposes, it avoids disputes not just about whether a variation was intended but also about its exact terms. Thirdly, a measure of formality in recording variations makes it easier for corporations to police internal rules restricting the authority to agree them.

(17) A final point made in this regard by Sumption LJ is that the law of contract does not normally obstruct such legitimate intentions of businesspeople, except for overriding reasons of public policy, yet there is no mischief in NOM clauses.[22]

(18) Rejecting the argument that an oral variation must include an implied agreement to dispense with the NOM clause, Sumption LJ pithily observed that the natural inference from the parties' failure to observe the formal requirements: "*is not that they intended to dispense with it but that they overlooked it. If, on the other hand, they had it in mind, then they were courting invalidity with their eyes open*."[23]

(19) In the result, Sumption LJ (Hale P, Wilson and Lloyd-Jones LJJ agreeing) considered that the law should and does give effect to a contractual provision requiring specified formalities to be observed for a variation, and their Honours found that the oral variation which Judge Moloney found to have been agreed was invalid for the reason that he gave, namely want of the writing and signatures prescribed.[24] Importantly, Sumption LJ also observed that sufficient safeguards for subsequent oral variations existed in the law of estoppel, noting that for estoppel to apply there would need to be some words or conduct (more than the informal agreement itself) to represent that the variation was valid despite its informality.[25]

(20) For his part, Briggs LJ upheld the appeal on different (and somewhat difficult to understand) grounds. His Honour appears to say that the NOM clause should be given effect, save for where the subsequent oral agreement of the parties expressly also includes the variation of the NOM clause (or such agreement is necessarily implied). It seems odd that parties who would expressly orally vary their NOM clause would not go that minor final step of reducing their agreement to writing. Further, as Briggs LJ acknowledged, his Honour's class of

[21] *Rock Advertising* at [12].
[22] *Rock Advertising* at [12].
[23] *Rock Advertising* at [15].
[24] *Rock Advertising* at [10] & [17].
[25] *Rock Advertising* at [16].

necessary implication is probably co-extensive with cases where Equity would intervene, and orally agreeing to vary a NOM clause sounds incredible.[26]

(21) For completeness, it should be noted that in his discussion of NOM clauses Sumption LJ also sought to draw an analogy with entire agreement clauses.[27] However, it was not necessary for the decision and, with respect, it was less than illustrative for the reasons given by Briggs LJ.[28]

WILL THE PRINCIPLE BE RECONSIDERED IN AUSTRALIA

(22) The *Rock Advertising* decision and the issue of oral variation to written contracts which contain a NOM clause has recently been referred to by the New South Wales Courts in the decisions of *Bundanoon* and *White v Philips*.

(23) In both decisions, it was found that it was unnecessary to resolve the issue determined in *Rock Advertising*. Nevertheless, those cases provide useful guidance in considering what position Australian (and particularly New South Wales) courts may take.

Bundanoon Sandstone Pty Ltd v Cenric Group Pty Ltd

(24) This case involved the alleged oral variation to a written contract for the excavation and harvesting of natural sandstone from a development site in Pyrmont.

(25) Cenric entered into a head contract with TWT, the developer. The contract provided that Cenric would excavate TWT's development site at Pyrmont and harvest the natural sandstone from the site. Cenric engaged a subcontractor, Bundanoon, to perform the excavation and harvesting work. Under the subcontract, Bundanoon was entitled to retain the proceeds of sale of the sandstone, less royalties payable to Cenric. Under the head contract, Cenric was entitled to retain royalties up to a capped amount, with the balance payable to TWT.

(26) Disputes arose between the parties regarding the payment of royalties. On 19 February 2018, TWT, Cenric and Bundanoon attended a meeting in respect of those disputes. In the first instance proceedings before McDougall J, Cenric alleged that at the 19 February meeting the parties agreed to vary the head contract and the subcontract by oral agreement to allow an extension of time and to increase the scope of works. After the meeting, contrary to the alleged oral variation, TWT issued a show cause notice and took the work out of Cenric's hands. Bundanoon then terminated its subcontract with Cenric and was engaged directly by TWT. Cenric commenced proceedings in reliance on the oral variation to the contracts. TWT cross claimed.

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[26] *Rock Advertising* at [31].
[27] *Rock Advertising* at [14].
[28] *Rock Advertising* at [28].

(27) At first instance, McDougall J dismissed TWT's cross claim and ordered judgment for Cenric against Bundanoon in the amount of $3,958,651.08. Bundanoon appealed the decision but abandoned its appeal shortly prior to the hearing. TWT cross-appealled. As part of the cross-appeal, TWT submitted that the primary judge erred in finding that the parties had formed a concluded oral agreement to vary the terms of the head contract and subcontract. TWT's cross-appeal was dismissed.

(28) Relevantly, one of TWT's sub grounds in the appeal asserted that the restriction on variations being made other than in writing, both in the head contract and in the subcontract, was inconsistent with the parties intending their consensus reached at the meeting on 19 February 2018 to be immediately binding. Gleeson JA (with whom Meagher and McCallum JJA agreed) made the following comments (at [122]) in respect of that ground:

> The primary judge held that a no-oral-modification clause cannot prevent the parties to a contract from agreeing orally to vary it, that principle being no more than an affirmation of the basic principles of contractual autonomy. Reference was made to the judgment of Cardozo J in *Beatty v Guggenheim Exploration Company* (1919) 225 NY 380 at 387-388 and intermediate appellate authority in Australia affirming that principle: *Hawcroft General Trading Co Pty Ltd v Hawcroft* [2017] NSWCA 91. See also *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1; [2003] FCA 50 (Finn J). TWT did not directly challenge his Honour's finding or these authorities. Accordingly, it is not necessary to discuss the contrary view of such clauses taken by the Supreme Court of the United Kingdom in *MWB Business Exchange Centres Ltd v Rock Advertising Ltd* [2018] 2 WLR 1603.

(29) Gleeson JA went on to reject TWT's submission that the existence of a concluded agreement, without the need for further writing and formality, was made more unlikely because of the emphasis on the requirement of writing in the provisions of the existing contractual documents, the nature of the contract, and the history of requiring written documents to effect modification and change. In doing so, his Honour considered in detail the contextual factual findings made by McDougall J which supported a conclusion that the parties were content to reach an agreement immediately without the formality of writing.[29] The cross-appeal was ultimately dismissed.

White v Philips Electronics Australia Ltd t/as Philips Healthcare

(30) Gleeson JA's comments in *Bundanoon* have later been referred to in the decision of Bell P in *White v Philips*. That case also involved an alleged oral variation to a written agreement which contained a NOM clause.

(31) The facts of that case were that Philips Electronics (**Philips**) entered into a written agreement with Victorian XRay Group (Balwyn) Pty Ltd (**Victorian XRay**) pursuant to which Philips agreed

[29] *Bundanoon* at [115]-[117] & [123]-[129].

to provide services to Victorian XRay for certain computed tomography (**CT**) equipment. Mr White and Mr Mensink (directors of Victorian XRay) guaranteed Victorian XRay's obligations. The written agreement contained a clause which provided that no alteration or modification of the agreement would be binding unless in writing and signed by Philips's authorised representative and the customer.

(32) Eighteen months after entering into the agreement, and after Victorian XRay had fallen significantly into arrears, Mr White (on behalf of Victorian XRay) attended a meeting with Mr Damen (on behalf of Philips). There was a factual dispute as to what was discussed at that meeting. Mr White alleged that he and Mr Damen had agreed to terminate or substantially vary the contract. Mr Damen said there was no such variation. Olsson DCJ at first instance preferred Mr Damen's evidence in relation to the meeting and held that there was no agreement to terminate or vary the written contract. Her Honour gave judgment in favour of Philips in the amount of $263,994.10. Mr White challenged her Honour's factual findings in respect of the meeting on appeal.

(33) The appeal was ultimately dismissed. As the factual findings were maintained there was no need for the Court to consider the effect of the NOM clause. Nevertheless, Bell P made the following comments in relation to NOM clauses:

> 42 Counsel for Mr White accepted in the course of argument that this ground would not be reached if Mr White's challenge to the findings of fact was not upheld. For the reasons given later in this judgment, the challenge to the central finding of fact fails so that it is not necessary to consider the first appeal ground, nor the issue noted by Gleeson JA in this Court's recent decision in *Bundanoon Sandstone Pty Ltd v Cenric Group Pty Ltd* [2019] NSWCA 87 at [122], namely whether a "no-oral modification" clause will or can preclude parties to a contract agreeing orally to vary it.
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> 43 The point can conveniently be made in this context, however, that "no-oral modification" clauses, even if not necessarily preclusive of oral modifications, provide important context in considering whether the requisite contractual intention to modify or vary a written contract, objectively ascertained, exists. It may also be observed, parenthetically, that one of the virtues of such clauses might be thought to be the avoidance of disputes of the very kind that arose in the present case as to whether there had in fact been a variation of the contract and, if so, what the terms of that variation were. Variations in writing leave no room for dispute as to what was actually agreed, subject to any ambiguity in the agreed form of written words.

(34) While the Court had no need to (and did not) determine whether NOM clauses were effective at precluding parties from reaching an oral agreement to vary a contract, his Honour did confirm that such clauses "provide important context" in determining whether, in reaching the subsequent agreement, it was the contractual intention of the parties to vary their contract orally without the need for writing. This position is consistent with the previous decisions of Australian courts.

Reconsideration?

(35) Both *Bundanoon* and *White v Philips* suggest that the New South Wales Court of Appeal may be interested in discussing the divergence in law produced by the United Kingdom Supreme Court's decision in *Rock Advertising*.

(36) Of course, it is clear from McDougall J's first instance decision in *Bundanoon* (which was not challenged on appeal in this respect) that the Australian authorities currently confirm "*that a no-oral-modification clause cannot prevent the parties to a contract from agreeing orally to vary it*". Those authorities include the High Court in the decision of *Liebe v Molloy*,[30] and decisions of intermediate appellant courts. Thus, as explained by Finn J in *GEC Marconi Systems*, the principles are not "open to serious question" at least at a first instance level.[31] It may be that the doctrine of precedent[32] requires the intervention of the High Court to effect a significant change to the Australian position in line with *Rock Advertising*.

(37) However, it bears noting that *Liebe v Molloy* was a stated case under arbitration legislation that came up through the Western Australian Court of Appeal which involved the question of whether it was open to the umpire to find as a fact an implied contract to pay for additional building work that was requested or acquiesced in (the ineffectiveness of the NOM clause in the construction contract and specifications was assumed). As such, there would likely be scope for argument that *Liebe v Molloy* could be distinguished, in a case with the right facts, and the Court of Appeal could be invited to depart from the other Australian authorities.

(38) In any event, *Liebe v Molloy* was decided over one hundred years ago, and the High Court may just have something new to say about freedom of contract at common law in Australia.

(39) Indeed, Bell P's comments in *White v Philips* trace some of the breadth of the relevant considerations. His Honour's comments highlighting, on the one hand, the important evidentiary value of NOM clauses in considering whether the parties intended their variation or subsequent agreement to be immediately binding without compliance with formal requirements. And on the other hand, Bell P observing that "one of the virtues of such clauses" is the avoidance of disputes like that which arose in that case.[33]

Complex construction contracts

(40) In the context of complex building and construction contracts, usually based on standard forms resulting from exhaustive deliberative processes, the arguments for requiring

[30] (1906) 4 CLR 347 at 353-355.
[31] *GEC Marconi Systems Pty Ltd v BHP Information Technology Pty Ltd* (2003) 128 FCR 1; [2003] FCA 50 at [223] (Finn J).
[32] *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* [2007] HCA 22.
[33] *White v Phillips* at [43] (Bell P).

compliance with NOM clauses could be said to have greater force. Which is to say, in circumstances where familiar contracts, containing very detailed written procedures for proposing and approving variations, are entered into by well advised sophisticated parties, the scope for oral modification surely shrinks (if not vanishes).

(41) In fact, not giving effect to formal requirements undermines a central pillar of detailed building and construction contracts and opens an avenue for abuse. Whereas, giving effect to NOM clauses avoids disputes about whether a variation was intended, and if so, what was actually agreed. Also, efficacy for NOM clauses accords most closely with the formality necessary to achieve changes in such complex contracts, often with numerous internal contributors and hierarchical approval processes. In sum, wherever one lands on the doctrinal debate about autonomy, permitting argument on, and granting relief in reliance upon, oral modification of complex building and construction contracts frustrates the obvious commercial purposes of the parties.

(42) As such, it is submitted that unless and until the present course of authority in Australia is changed, legislative intervention is justified. Examples abound, and in *Rock Advertising* Sumption LJ lists various jurisdictions and areas of law in which legislation or codes have effected a change to the traditional position at common law including the Statute of Frauds, the United States Commercial Code, and the UNIDROIT Principles of International Commercial Contracts 4th Ed (2016).[34] Of course, notwithstanding it could be achieved relatively easily,[35] it is doubtful that we will see such a change any time soon.

CONCLUSION

(43) The decision in *Rock Advertising* indicates a divergence in the legal positions of Australia and the United Kingdom with respect to the oral variation of written contracts that contain NOM clauses. There may be scope for intermediate appellant reconsideration, and obiter in the NSWCA suggests some interest in discussing this change. Meanwhile, legislative intervention while unlikely is arguably warranted – particularly in respect of complex construction contracts.

[34] *Rock Advertising* at [8] & [13].

[35] Avenues include legislative force for NOM clauses included in contracts based on standard from building and construction contracts or a blanket legislative requirement for written modifications to commercial contracts with an initial value above a certain limit. As is the case with the USCC and UNIDROIT principles referred to in paragraph [42], the limited potential harshness of such legislation can be ameliorated by the express preservation of equitable relief in appropriate circumstances.