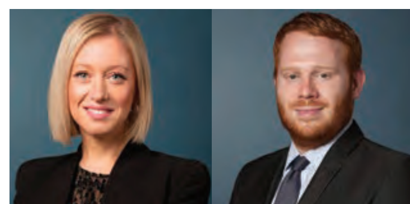
APPROACH TO QUANTUM MERUIT FOLLOWING REPUDIATION OF A CONSTRUCTION CONTRACT: AUSTRALIA VS. THE UNITED KINGDOM

"There has been significant debate as to whether and how the terms of a contract should form the outline or cap for any award in restitution in circumstances where one party had demonstrated its unwillingness to be bound by those terms so as to lead to the agreement's termination."



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Introduction

In this article, we will examine the Australian High Court's decision in *Mann v Paterson Constructions Pty Ltd*[1] (Mann v Paterson) relating to the use of quantum meruit following the repudiation of a construction contract. We will also briefly discuss how that decision compares to the current status of quantum meruit in the United Kingdom.

In its recent decision, the High Court of Australia has provided some clarity to an area of Australian law that has often been described as controversial: the ability to elect to seek a quantum meruit for repudiation of a building contract. Clarity from the High Court comes in two principle ways:

- clarification of the limited circumstances in which a contractor may now pursue a claim of quantum meruit; and
- clarification regarding the quantification of such a claim.

Relevantly, the case was in respect of domestic building works (construction of two townhouses) and was governed by relevant domestic building legislation.[2] The High Court held that the DBC Act applied to the facts at hand and, in particular, to the process which was legislatively required to be applied to variation works. Therefore, variation works were to be assessed in accordance with that legislation and recovery on a quantum meruit basis for the variations was prohibited. There may still be future work for Australian courts to do in order to reconcile the High Court's decision with variation works that are not covered by that or similar legislation.

The decision means that Australian construction contractors must pay close attention to their contracts (both in terms of negotiation and contract administration) as it will now be more difficult for them to avoid onerous contractual mechanisms (such as time bars and caps) by seeking a quantum meruit.

What is Quantum Meruit?

Quantum meruit is a legal doctrine which allows a contractor to claim restitution of a reasonable sum for work and/or services provided. The term quantum meruit translates to 'what one has earned' or, in practical terms, 'what the job is worth'.

A restitutionary claim for quantum meruit can generally arise in the following circumstances:

- there is no contract specifying a sum to be paid;
- there is an express agreement between the parties to pay a 'reasonable sum';
- work is undertaken outside of the contract, at the request of the principal; or
- work is undertaken under a contract which is later found to be void or unenforceable.

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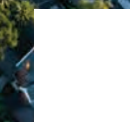
Previous Position in Australia

In Australia, prior to the *Mann v Paterson* decision, a contractor could, following its acceptance of an owner's repudiation of a contract, broadly elect to pursue its remedial rights through either contractual damages or a restitutionary claim for quantum meruit.

In some instances this produced seemingly odd results whereby a contractor could claim for, and receive amounts, on a quantum meruit basis for work performed that were significantly greater than the amounts it would have received had the contract remained on foot and been performed. This was due to the position that there was no 'cap' on the amount that the innocent party could claim for the works completed. This, in turn, raised important considerations for courts and commentators regarding the proper weight that should be given to negotiated and agreed contractual prices in assessing a quantum meruit claim.

In particular, there has been significant debate as to whether and how the terms of a contract should form the outline or cap for any award in restitution in circumstances where one party had demonstrated its unwillingness to be bound by those terms so as to lead to the agreement's termination. In this respect, the Victorian Court of Appeal in *Sopov v Kane Constructions Pty Ltd (No 2)*[3] noted the *"growing chorus of judicial and academic criticism of the availability of Quantum Meruit as an alternative to contract damages where repudiation is accepted"*. It further said that, had it not been constrained by authority, it may have accepted the claimant's argument that the respondent's only remedy was to sue on the contract.



The Facts of the Case

In March 2014, Mr and Mrs Mann (Owners) entered into a major domestic building contract with Paterson Constructions Pty Ltd (Contractor) for the construction of two double storey townhouses.

In April 2015, with one of the two townhouses completed, a dispute arose regarding payment for variations that had been orally instructed by the Owners and implemented by the Contractor. Following the Contractor issuing an invoice for the outstanding variation costs, the Owners repudiated the contract and the Contractor accepted that repudiation, thus terminating the contract.

The Contractor brought a claim against the Owners in the Victorian Civil and Administrative Tribunal (Tribunal), for damages for breach of contract (in the amount of $446,000) or restitution for the work, labour and materials involved (in the amount of $945,000).

The Tribunal found the Contractor was entitled, at the Contractor's election, to restitution on a quantum meruit basis for an amount reflecting the reasonable value of the work performed and the materials used. The Tribunal awarded the Contractor $660,000, which it said was the fair and reasonable value of the work and was substantially more than the Contractor would have been entitled to under the contract.

The Owners appealed to the High Court, after having earlier appeals to the Supreme Court of Victoria and Victorian Court of Appeal substantively dismissed.

The Appeal Grounds

Relevantly, the Owners raised three grounds:

1. That the lower courts had erred in holding that the Contractor was allowed to elect to recover a reasonable value of the works carried out by it on a quantum meruit basis following the termination of the contract based on the Owners' repudiation.
2. Alternatively, if the Contractor was entitled to such a restitutionary remedy, the contract should have operated as a ceiling or cap on the calculation of the quantum meruit.
3. That the lower courts had erred in finding that relevant legislative provisions did not apply, so as to preclude the Contractor from claiming a quantum meruit in relation to variations under a domestic building contract (there was

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no dispute that the domestic building legislation in issue applied, only whether the legislation permitted restitutionary recovery by the Contractor for variations).

The High Court's Decision

The decision comprises three judgements – Kiefel CJ, Bell and Keane JJ; Nettle, Gordon and Edelman JJ; and Gageler J.

In summary, all seven justices agreed that:

1. termination for repudiation does not render a contract void ab initio;[4]
2. upon termination, the parties are excused from further performance of the contract, but accrued rights remain enforceable and the party in default is liable for damages for breach;[5]
3. where a right to payment under a construction contract has accrued, an innocent contractor can recover payment:
    a. as a debt or damages for breach of contract;
    b. but not on a quantum meruit; and
4. where a right to payment has *not yet accrued*, an innocent contractor can recover (at least) damages for breach of contract.

Gageler J identified that the Court essentially had to determine the Contractor's remedial entitlement, following the termination of the contract by acceptance of the Owners' repudiation, in relation to three categories of work performed:

- work in respect of variations to the contractual scope that the Owners had requested;
- work under the contract for which the Contractor had accrued a contractual right to payment prior to termination; and
- work under the contract for which the Contractor had not yet accrued a contractual right to payment at the time of termination.

Gageler J's categorisation provides a convenient structure to consider the practical implications of the High Court's decision.

Accrued Contractual Rights to Payment

The High Court unanimously held that the Contractor's remedy for stages of work completed prior to termination of the contract (i.e. where a right to payment had already accrued) was for the payment of the contractually agreed amounts due for completion of the relevant stages. Accordingly, the Contractor could not elect to pursue a quantum meruit for completed portions of work.

How this reasoning will be applied in more complex contractual contexts is unclear, particularly where progress payments are assessed and paid on a provisional basis (i.e. when it is unclear whether a right to payment of a set amount has properly accrued).

Divisible Obligations and Uncompleted Work

The majority of the Court[6] held that the Contractor was entitled to choose between damages or restitution for work that had not been completed prior to termination (i.e. where a right to payment of a specified amount had not accrued under the contract). However, any such amount calculated on a quantum meruit basis in relation to uncompleted stages of work should generally not exceed the contract price or the relevant portion of it.

In this respect, the majority held at [200]:

> *"Admittedly, there is cause for concern about the potential for disparity between the amounts recoverable by way of restitution for work done under a contract which is terminated for breach and the amounts recoverable by way of damages for breach of contract. That phenomenon – alarmingly widespread in domestic building disputes of the kind in issue, as it appears – implies a need for development of the law in a manner which better accords to the distribution of risks for which provision has been made by contract."*

And, said at [205]:

> *"…where a contract is enforceable, but terminated for repudiation, there are no reasons of practicality and few in principle to eschew the contract price. … There is, therefore, nothing about the termination of the contract as such that is inconsistent with the assessment of restitution by reference to the contract price for acts done prior to termination. The contract price reflects the parties' agreed allocation of risk. Termination of the contract provides no reason to disrespect that allocation."*

Therefore, where a contract does not specify stages of the work and corresponding amounts to be paid upon completion of those stages, a builder may be entitled to claim on a quantum meruit basis for the entirety of the works performed, albeit that the eventual assessment could be constrained by the total contract price. The application of the High Court's reasoning in Mann v Paterson to such circumstances is likely to provide fertile ground for further consideration by Australian courts in the future.

The minority[7] on this relatively narrow point would have allowed the first ground of appeal and limited the Contractor's remedial rights in the present case to damages in contract. This made it unnecessary for the minority to specifically address the issue of whether the contract price acted as a cap on any recovery in restitution.

The reasoning of the Court in Mann v Paterson represents a significant step forward in providing greater certainty and coherence in the costs that may flow from the termination of a contract.

Ultimately, the majority chose not to directly address the controversy surrounding a party's election between damages or restitution by closing off the ability to choose entirely. Rather, the Court's decision limits both the availability and scope of any quantum meruit following termination as a result of repudiation by:

- confining the availability of a quantum meruit to work performed but for which no contractual right to payment had yet accrued prior to termination; and
- making the calculation of any quantum meruit in that regard effectively subject to a cap by reference to the price(s) attached to the work or parts thereof within the terminated contract.

The Court reasoned that this approach represents a more coherent application of remedies following termination of a contract and places due weight on the contract price(s) negotiated between the parties and the contractual allocation of risk that such consideration represents.

Variations – Domestic Building

The Court unanimously held that relevant provisions in Victorian domestic building legislation provided an exhaustive right of recovery for variations subject to the legislation and precluded the Contractor from obtaining restitution for variations on a quantum meruit basis.

The High Court's construction of the Victorian legislation significantly narrows the scope for recovery of variations to contractual works covered by that (and, likely, similar) legislation, where applicable.

However, any application of the majority's broader reasoning to variation work not covered by such legislation will likely need to be considered further in future cases, particularly where similar issues may arise as with progress payments, including whether contractual mechanisms for valuing variations are sufficiently certain and whether entitlement to such payments represents a sufficiently accrued right to preclude a quantum meruit recovery.

Current Quantum Meruit Position in Australia

Following the *Mann v Paterson* decision, the position in Australia on the use of quantum meruit as a restitutionary remedy is limited:

- quantum meruit will not be available if the contractor has an accrued right to payment prior to termination of the contract;
- there appears to be a limited right to quantum meruit if there is no accrued contractual right for payment prior to contract termination; and
- *prima facie* the contract sum will act as a cap to damages.

While the election to pursue a claim in restitution may still be available in limited circumstances, a claim for quantum meruit will likely now be less appealing in the average case, as it is now significantly less likely to permit a party to recover an amount that is materially different from the amount(s) payable under the contract.

The reasoning of the Court in *Mann v Paterson* represents a significant step forward in providing greater certainty and coherence in the costs that may flow from the termination of a contract. However, there is still some way to go before parties can be certain how the case will be applied in relation to more complex construction contracts and projects.

In particular, the question remains how the *prima facie* position of the contract sum acting as a cap will be applied. In respect of a construction contract sum/price, there are many methods which provide for the contractual sum to be adjusted or varied. For example, by variations, increased costs as a result of latent conditions, provisional sums and a change in law. This uncertainty may provide contractors with arguments concerning the amount of the contract sum and how the 'ceiling or cap' should be determined.

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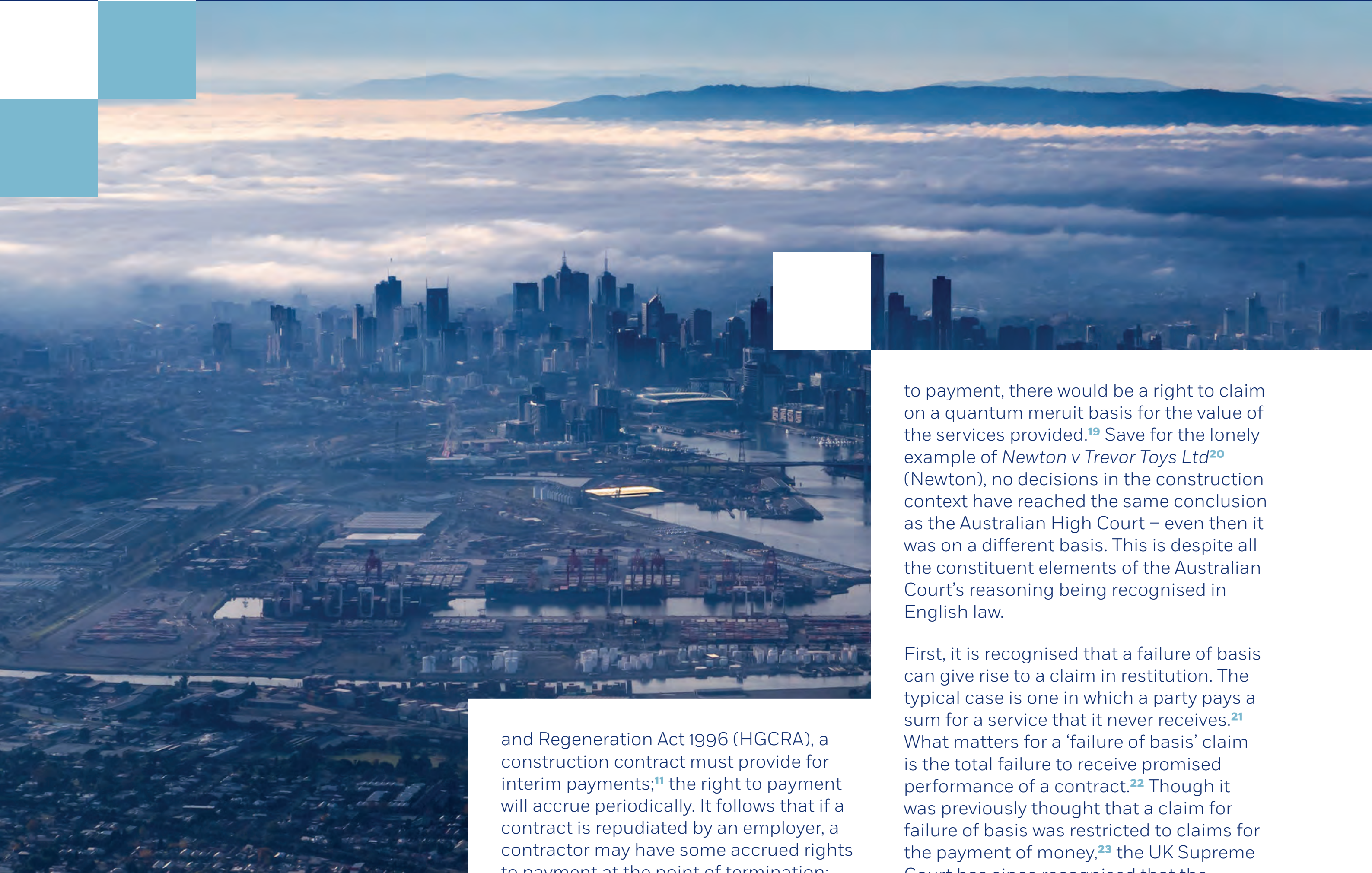

The UK position on Repudiation of Contract, Restitution and Quantum Meruit, and How it Now Differs From Australia

On a review of the leading authorities in the UK[8] and Australia, the majority, in *Mann v Paterson*, noted that:

> *"In view of those developments, it may be that the law of restitution in the United Kingdom and the law of restitution in Australia are no longer quite as far apart as was previously imagined."*[9]

But how does the decision of the High Court fit into a perceived trend of convergence on this issue?

The majority decision on this point in *Mann v Paterson* relied upon threads of legal principle, all of which are recognised in English law, but which were drawn together to reach a conclusion which, on similar facts, has not previously been reached in the UK. Accordingly, the decision provides an interesting point of reflection on both (i) the availability of restitutionary remedies in the context of contractual repudiation, and (ii) restitution on a quantum meruit basis.

A principle central to the decision in *Mann v Paterson* is that a contractor under a construction contract normally has no accrued right to payment, unless that is provided for by the contract.[10] Under the Housing Grants, Construction and Regeneration Act 1996 (HGCRA), a construction contract must provide for interim payments;[11] the right to payment will accrue periodically. It follows that if a contract is repudiated by an employer, a contractor may have some accrued rights to payment at the point of termination; however, it may not have accrued rights to payment under the contract in respect of all the work that it has carried out. How do the UK courts deal with this distinction, which formed the basis of Gageler J's different categories of entitlement?[12]

In respect of Gageler J's first category, the English High Court in *Taylor v Motability Finance Ltd*[13] established that where a party has an accrued right to payment under a contract, which is then repudiated by the paying party, the innocent party cannot elect to claim on a quantum meruit basis.[14] In his Judgment, Cooke J recognised that if the contract, which has been repudiated, set out a basis for remuneration in respect of those accrued rights, there was no space for a restitutionary remedy.[15] Once repudiated, the primary obligations under the contract are replaced by a secondary obligation to pay damages.[16] Despite earlier authorities indicating that there was such a right to election on repudiation,[17] in view of recent High Court decisions confirming no such right in respect of accrued rights to payment, the position in English law, now, seems settled.[18]

Gageler J's second category focused on the availability of restitution for the value of work done where there is no accrued right to payment. The majority decision in *Mann v Paterson* relied upon the principle of failure of basis: where the contractor proceeds in a stage of work under a contract, for which it is prevented from completing and accruing an entitlement to payment, there would be a right to claim on a quantum meruit basis for the value of the services provided.[19] Save for the lonely example of *Newton v Trevor Toys Ltd*[20] (Newton), no decisions in the construction context have reached the same conclusion as the Australian High Court – even then it was on a different basis. This is despite all the constituent elements of the Australian Court's reasoning being recognised in English law.

First, it is recognised that a failure of basis can give rise to a claim in restitution. The typical case is one in which a party pays a sum for a service that it never receives.[21] What matters for a 'failure of basis' claim is the total failure to receive promised performance of a contract.[22] Though it was previously thought that a claim for failure of basis was restricted to claims for the payment of money,[23] the UK Supreme Court has since recognised that the principle can extend to the provision of services, too.[24]

Second, the decision in *Mann v Paterson* relied on an ability to apportion and divide the benefits under a contract: where, say, an employer has performed in respect of stage 1 of the works under a contract, it has not in respect of stage 2. A principle apportioning the benefits of a contract, thus severing the 'basis' for the purposes of a restitutionary claim, has been recognised in the English courts. In *Stocznia Gdanska SA v Latvian Shipping Co*[25] (Stocznia) the House of Lords decided that where a shipbuilder designs and builds a ship under a stage payment contract, the benefit of that contract is divided accordingly.[26] For the purposes of determining failure of basis, Lord Goff stated the test as:

> *"The test is not whether the promisee has received a specific benefit, but rather whether the promisor has performed any part of the contractual duties in respect of which the payment is due"*[27]

Though the decision in *Stocznia* was decided by reference to the terms of the relevant contract, Lord Toulson has since noted that *"Modern authorities show that the courts are prepared, where it reflects commercial reality, to treat consideration as severable."*[28] In view of the frequent use of staged performance and milestones for payment, it is clear that this reasoning would be likely to apply in construction contracts: often the commercial reality of construction contracts is that benefits conferred at different stages or workstreams can be severed.

In summary, the UK courts recognise (i) the right to claim a restitutionary remedy for services rendered for which there has been a corresponding failure of basis, and (ii) the apportionment of basis under a contract.

So long as (1) the contract in question has been repudiated by an employer; and (2) subject to the terms of a contract meaning that a restitutionary award would not undermine the purpose of the contract,[29] is there a principled reason not to follow the example of the Australian High Court in *Mann v Paterson* in respect of rights that have not accrued under a contract?[30]

Contract Price as Cap

One objection, which was also addressed in *Mann v Paterson*, is the disruptive effect of the availability of a restitutionary remedy which, if calculated on a quantum meruit basis, might exceed the sum otherwise due to a contractor under the contract.[31] However, this concern can be allayed by the principle that any benefit awarded in restitution would be made in reference to the contract price.

In *Newton* the Court of Appeal accepted the view that when a contractor accepts an employer's repudiation, in addition to claiming accrued rights, the contractor may be entitled to payments at contractual rates for work done but not covered by the contractual instalments.[32] In that case, the Court of Appeal found that restitution should be made with reference to the contract prices, rather than on a different basis of valuing the worth of the services rendered. This suggests that although the source of the remedy in restitution is independent of the contract, the basis upon which the quantum is calculable is not.[33]

However, the majority decision in the Supreme Court in *Benedetti v Sawiris*[34] (Benedetti) stated the basis of the calculation for a restitutionary claim in unjust enrichment is the objective market value of those services, subject only to the concept of 'subjective devaluation': a reduction in the objective market value to reflect the subjective value of the services to the defendant.[35] Although the contract price is likely to form a basis for the calculation of a restitutionary claim by providing a guide to the objective market value of the work done, the source of the quantum of entitlement is not contractual.

But the Supreme Court in *Benedetti* also underlined that there were limits to such an approach. Importantly, the concept of subjective revaluation was considered and rejected. If that principle were applied, the quantum of a claim in restitution might be referable not to the objective market value, but to a higher figure, as the subjective value contended for by a claimant. In rejecting this, Lord Reed noted that such a conclusion was inimical to the premise of a restitutionary award:

> *"although I accept that a contract price in excess of the ordinary market value might be evidence of the objective value in particular circumstances, I have difficulty, like Lord Clarke and Lord Neuberger, in seeing how the recipient could be required, in the absence of a contract, to pay more than the objective value of the benefit on the basis of unjust enrichment"*[36]

Though there is no express authority that a restitutionary claim is capped by the contract price, it seems likely that the contract price will play a role in determining the value of the work done. Although it is logically possible that a claim on restitutionary grounds could exceed the contract sum, the more likely result, in a competitive construction market, and in view of reigning judicial instinct, is that the restitutionary claim will not exceed the contract price: as Lord Neuberger stated in *Benedetti*:

> *"It would seem wrong, at least in many such cases, for the claimant to be better off as a result of the law coming to his rescue, as it were, by permitting him to invoke unjust enrichment."*[37]

Conclusion

Although the position in the UK is clear in respect of accrued rights under a contract, it is less clear in respect of a contractor's ability to claim in restitution in respect of the value of work done where there is no accrued right under a repudiated contract.

In view of the reasoning of the Australian High Court, which is largely embraced by the UK courts, there seems little principled reason why the courts in this jurisdiction might not also adopt the Australian court's conclusions.

Adopting that approach, in view of the Supreme Court's approach to the quantum of the restitutionary remedy in *Benedetti*, would achieve the same narrowly drawn results as the decision in *Mann v Paterson* – using the contract price as part of the calculation of the restitutionary remedy due. Moreover, it would bring coherence to an unsettled body of UK jurisprudence, while also affirming the trend toward the convergence on the subject of restitutionary remedies, noted in the decision of Nettle, Gordon and Edelman JJ.