Construction

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PITFALLS OF SETTLEMENT AGREEMENTS

HOW A WARRANTY KEPT ALIVE LED TO A AUS$7 MILLION CLAIM THREE YEARS LATER

Entering into a settlement agreement is often good news at the end of a challenged project; a settlement should bring finality and certainty to the parties and an end to a troubled relationship.

However, that was not the case for Australian Maritime Systems Ltd (AMS), who received a claim for $7,630,908.59 two years after an agreement was made for "full compensation" under its contract with McConnell Dowell Constructors (Aust) Pty Ltd (McConnell Dowell).[1]

Summary

Understanding what an agreement is meant to encapsulate "as a whole" is not sufficient to protect you against carve-out clauses which may create particular liabilities. Any clause in a settlement agreement that seeks to preserve the existing rights and liabilities of the parties must be carefully considered.

Brief overview

On 11 September 2012, AMS and McConnell Dowell entered into a contract in which AMS agreed to design, supply and install navigation aids at the Cape Lambert Tug Harbour (the Contract). The original contract sum was $2,162,481.50.[2]

Disputes arose in relation to the Contract and the parties executed a Supplemental Agreement[3] to resolve these disputes on 2 September 2013.

In clause 6 of the Supplemental Agreement, amongst other things, McConnell Dowell waived all rights to recover damages or costs under the Contract and it was agreed that AMS would be discharged from all obligations and liabilities to McConnell Dowell. It was agreed that McConnell Dowell would have no claim, in contract or otherwise, "now or in the future… under or arising out of" the Contract."

1 *Australian Maritime Systems Ltd v McConnell Dowell Constructors (Aust) Pty Ltd* [2016] WASC 52 (19 February 2016), at [3].

2 *Ibid*, [17].

3 *Ibid*, Appendix.


However, the Supplemental Agreement also included clause 6(e) which read:

"Notwithstanding the foregoing, all warranties and indemnities given by [AMS] in respect of the Supply and [AMS's] liabilities for the Supply shall remain in force".

Despite that agreement, by letter dated 12 August 2015, McConnell Dowell claimed payment of $7,630,908.59 in respect of a claimed breach of warranty.[4] The matter came before the Western Australia Supreme Court on the application of AMS seeking a declaration that the Supplemental Agreement was a full and final release and that it ought to have no liability to pay the warranty claim.[5]

McConnell Dowell brought a cross application seeking orders that the proceeding be stayed and referred to arbitration under the arbitration agreement in the Contract.[6]

What are the key points?

In the event, the court ordered that the dispute be referred to arbitration on the basis that the arbitration agreement in the Contract was expressly incorporated into the Supplemental Agreement and therefore the substance of AMS's complaint, regardless of whether it was framed as a controversy under the Supplemental Agreement or a dispute under the Contract, must be resolved by arbitration, not judicial intervention.[7] This ought to have been the start and end of the matter before the court. However, in coming to that conclusion the court embarked upon an exercise in constructing the very provision that AMS complained about, namely clause 6(e) of the Supplemental Agreement and, arguably impermissibly given the earlier conclusions about the continuing operation of the arbitration agreement, offered a view on the substance of the underlying dispute. It is that view which, although strictly *obiter*, is a salutary reminder about the importance of being clear when writing settlement agreements.

In most cases, a short agreement setting out the dispute and that terms on which the parties wish to settle the relevant dispute is sufficient.

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The court held that if McConnell Dowell had a valid breach of warranty claim, it would be entitled to bring it under clause 6(e). The court held that the plain meaning of the words of a clause will be adopted as long as:

- They do not contradict the rest of the agreement read as a whole.
- There was no extrinsic evidence that directly contradicted the plain meaning of the clause.[8]

In this case, construing the relevant clause and the Supplemental Agreement was not difficult and the court held that "clause 6(e) clearly indicates that the release of [AMS] from obligations and liabilities is not absolute" and reading the clause as such as not inconsistent with the rest of the Supplemental Agreement which could be construed "harmoniously" as extinguishing any right of claim pursuant to the Contract, while "preserving the operation of warranties and indemnities" otherwise.[9]

HFW Perspective

Settlement agreements are often wrought out of long drawn negotiations and may feel like the conclusion of a hard fought battle. Nonetheless, it is important to carefully consider each of the clauses in the agreement to ensure that it does not compromise the "global" or "holistic" agreement which may have appeared to be the understanding.

If the intention is that the settlement agreement puts to rest all proceedings and claims whatsoever in respect of a particular dispute, ensure that there are no "carve-out" clauses in the agreement that keeps particular liabilities alive.

When negotiating these types of documents it is important that the

4 *Ibid,* [3].
5 *Ibid,* [4].
6 *Ibid,* [5].
7 *Ibid,* [11]; [59]; [71].
8 *Ibid,* [76]; [78].
9 *Ibid,* [75]-[76].



drafting of the particular agreement capture the parties' mutual intentions plainly and unambiguously. Relying on the process of negotiations, correspondence between the parties, the context in which the agreement came about, or presumptions that may come from industry practice which may shape a party's understanding of the agreement will never replace a clearly written document which captures the true agreement.

That said, settlement agreements do not need to be complicated. In most cases, a short agreement setting out the dispute and that terms on which the parties wish to settle the relevant dispute is sufficient. A simple checklist for your next settlement agreement might be as follows:

1. Ensure that there are no clauses which keep liabilities, such as warranties or indemnities, alive.
2. Obtain a mutual releases from any claim or proceeding which may arise in respect of the contract or transaction which gave rise to the dispute.
3. Avoid granting a full release from making future claims if the other party does not provide the same.
4. Finally, be sure that the settlement agreement includes a clause permitting the parties to plead the agreement as a complete defence to any claim in relation to the matters that have been released.

While these matters seem straightforward the fact that the Supplemental Agreement didn't adhere to these simple rules means that the parties are now entrenched in arbitration proceedings three years after the settlement agreement was made in relation to a sum that is nearly four times greater than the original contract sum!

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