



CONSTRUCTION LAW UPDATE No. 709

Deals on the side

Introduction

The NSW Court of Appeal recently considered an appeal in relation to a verbal deal on the side that was not honoured (*Nassif v Fahd* [2007] NSWCA 269).

The Clarkes wanted to sell their home in the inner suburbs of Sydney. Mr and Mrs Fahd saw the home for sale and wanted to buy it. Their acquaintances, Mr and Mrs Nassif were also interested in purchasing the home. The Fahds ultimately succeeded in negotiating a contract with the Clarkes to purchase the home for \$2,010,000. A six month settlement period was agreed.

The Nassifs miss out on the home

The Nassifs were disappointed to hear that they had missed out on the home and offered the Fahds \$150,000 plus out of pocket expenses if they would rescind their contract with the Clarkes so that a new contract could be made between the Clarkes and the Nassifs.

Mr Fahd and Mr Nassif met with Ms Kenneally, the solicitor acting for the Fahds and explained the deal to her. Ms Kenneally suggested that she draft a written agreement, recording that the \$150,000 was to be paid by the Nassifs. Mr Fahd told her it was a private agreement and that there was no need to reduce it to writing. He said that putting the agreement in writing would defeat its purpose. As Mr Nassif was a man of honour it would cause embarrassment if Mr Fahd doubted him and put the arrangement in writing. Ms Kenneally made file notes but did not prepare a written agreement.

A delay ensued during which one of the Clarkes died. The remaining member of the Clarke family was unwilling to rescind the contract and the Fahds were obliged to settle on the purchase, incurring about \$96,000 in stamp duty which would have been avoided by the planned rescission. Due to the additional cost of the stamp duty, the deal between the Fahds and the Nassifs appeared to have collapsed.

Mr Fahd: the deal is resurrected

However, a few days after the Fahds settled on the purchase of the new home, Mr Fahd and Mr Nassif

met again. According to Mr Fahd they orally agreed to a similar arrangement to the previous one, where the Nassifs would pay \$150,000 on the side to the Fahds, and the Nassifs and the Fahds would enter into a written contract to sell the house to the Nassifs for \$2,010,000.

Mr Nassif: the Fahds needed to sell

Mr Nassif had a different version of events, and said that the Fahds had agreed to sell the house for cash flow reasons and that he had agreed to move quickly because the Fahds no longer wanted the \$150,000 on the side. He said that the Fahds had found out that the house was heritage listed and that they could not build cluster homes on the property resulting in their willingness to offload the property at the purchase price.

In any event, said Mr Nassif, any contract to pay \$150,000 on the side would have been illegal as its purpose was to avoid capital gains tax, or income tax.

The trial judge's finding

The trial judge rejected Mr Nassif's version of the story and accepted that of Mr Fahd. He accepted that the Fahds and the Nassifs were part of a tight knit community who regarded their side agreement as based on honour. He heard a great deal of evidence from various persons and found that the evidence supported Mr Fahd.

The trial judge found that the parties' side agreement was a collateral contract to transfer the property on the basis that the Nassifs would pay the Fahds \$150,000 together with out of pocket expenses.

The collateral contract

For a contract to be binding, there must be consideration (or motivation) for each of the parties to enter into the contract. For the main contract, (the sale of the home), consideration would have been the \$2,010,000 on one side, and the home itself on the other.

As for the collateral contract here, the lower court found that there was an oral agreement to the effect that in consideration of the Nassifs and the Fahds entering into written contracts of sale at prices

totalling \$2,010,000 the Nassifs would pay the Fahds \$150,000 together with out of pocket expenses, including the stamp duty on the original sale.

The result of the decision of the trial judge was that the Nassifs were obliged to stand by the oral agreement and pay to the Fahds \$310,519 plus interest. The Nassifs appealed to the Court of Appeal.

Do oral statements impact on written contracts?

Where parties agree in writing as to their bargain and the terms of the contract are not ambiguous, courts generally will not entertain evidence about what was said at the time of entering into the contract for the purpose of determining the terms of the contract.

In this instance, the issue was made more complex by the claim of a collateral contract. Courts are generally reluctant to accept that a collateral warranty or promise has been made that has a different effect to the written contract terms.

The knock out blow

Surprisingly, in the appeal, counsel for the Nassifs raised for the first time a knock out point of law. The Court of Appeal was critical of the fact that the point had not been raised in front of the judge at first instance.

Since *Hoyt's Pty Ltd v Spencer* in 1919, the High Court of Australia has held that a collateral contract cannot include terms that are inconsistent with the terms of the main contract. In *Hoyts*, Justice Isaacs pointed out that to give effect to an inconsistent collateral contract over the main contract would make it a dominant contract. The principle has been applied in many cases since 1919.

The Court of Appeal applied this principle to the dispute between the Nassifs and the Fahds and found it to be fatal to the side deal. The inconsistency was stark: the main contract effected the sale of the home for \$2,010,000 whereas the collateral contract was to the effect that the sale price was \$2,010,000 plus \$150,000 plus other costs.

Having found this inconsistency, there was no basis for the side deal to be a binding contract and the Nassif's appeal succeeded.

Conclusion

Commercial contracts must be written down in clear language for parties to have certainty as to their agreement. If the parties are in genuine agreement, there is no sensible excuse for reluctance to commit to writing.

Hypothetically speaking, if a party was to avoid committing to writing as a strategy to avoid tax, it is almost certain that the agreement would be illegal and therefore unenforceable anyway.

Alternative bases

Although it is not dealt with in the reported decision, while a party may not succeed under an inconsistent collateral contract in these circumstances, a claim for misleading and deceptive conduct under the *Fair Trading or Trade Practices Acts* might well succeed. Briefly, if a party enters into the main contract because a promise of a side payment is made, the failure to keep the promise may breach the Acts. Provided that a genuine loss has been suffered – that is, provided that the vendor could have sold the property to a third party for the total of the contract amount plus the side deal amount, it would seem likely that the claim as to the side deal would succeed if made under the Acts.

However, there are difficult issues here as to proving what was said and parties who enter into verbal side deals would be advised to exercise great caution. Where there are no written contract terms, the risks cannot be clearly stated.

Contributor: Tom Grace

Tom is a former engineer who ran his own construction company for 20 years before becoming a construction lawyer. He has wide experience in the engineering and construction fields and specialises in the resolution of commercial disputes.

Contact Details

Tom Grace – Partner
Direct: (08) 8110 8004
tom.grace@feg.com.au

October 2007

This publication is not legal advice. It is for general interest. You should not rely on it without obtaining legal advice.

Fenwick Elliott Grace is a law firm that specialises in providing legal services to the construction and engineering industries.

Office: Level 10, Optus Centre
431 King William Street
ADELAIDE SA 5000

Ph: (08) 8110 8000
Fax: (08) 8231 2922
Web: feg.com.au

If you would like to receive our legal publications by email, please contact Amanda Atkins on (08) 8110 8000 or by email to amanda.atkins@feg.com.au.