

CONTRACTUAL CONSTRUCTION IN THE CONTEXT OF REGULATED INDUSTRIES: INSIGHTS FROM VICTORIA V TATTS

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Legal Briefings - By **Tania Gray, Mark Smyth**

The High Court of Australia handed down its much-anticipated decision in *Victoria v Tatts Group Limited* [2016] HCA 5.

The decision demonstrates the importance of surrounding context and purpose in construing contractual terms, particularly for regulated industries subject to complex statutory regimes and the attitudes of policy-makers. Where commercial parties contract with government, they may be taken to have understood (and accepted) the risk of policy and legislative change.

IN BRIEF

Yesterday, the High Court of Australia handed down its much-anticipated decision in *Victoria v Tatts Group Limited* [2016] HCA 5.

The dispute arose from a 1995 agreement between Tatts and the State of Victoria governing Tatts' gaming operator's licence. The agreement provided for a substantial terminal payment to be made to Tatts if its gaming operator's licence expired without a new licence being issued to Tatts or a related entity, unless no "new gaming operator's licence" was issued. The High Court found that Tatts was not entitled to the terminal payment once the Victorian gaming duopoly ceased, rejecting the contrary reasoning of the Court of Appeal and at first instance.

The decision demonstrates the importance of surrounding context and purpose in construing contractual terms, particularly for regulated industries subject to complex statutory regimes and the attitudes of policy-makers. Where commercial parties contract with government, they may be taken to have understood (and accepted) the risk of policy and legislative change.

The fact that the High Court and the Court of Appeal took a radically different view of what an honest and reasonable person would understand the contract to mean also illustrates the difficulties and risks that arise where the court is left to discern the parties' objective intention.

BACKGROUND TO THE DISPUTE

The dispute between Tatts and the State of Victoria arose from Victoria's decision to end the gaming machine operators' 20-year duopoly, and Tatts' consequent claim for terminal payments under a 1995 agreement with Victoria.

The 1995 agreement entitled Tatts to a substantial terminal payment if its gaming operator licences, issued under Part 3 of the Gaming Machine Control Act 1991 (Vic) (Gaming Licences), expired without a new Gaming Licence being issued to Tatts or a related entity. No terminal payment was payable if no new Gaming Licence was issued to anyone at all.

In 2008, the Victorian Premier announced a shift in policy around the structure of the gaming industry: Tatts' Gaming Licence would not be renewed upon its expiry. Instead, a new form of licence, known as a "gaming machine entitlement" (**GME**) would come in to existence. This ended the gaming machine duopoly.

Tatts commenced proceedings against the State of Victoria in the Supreme Court, seeking the substantial terminal payment under the 1995 agreement.

The primary judge and Court of Appeal both found in favour of Tatts, awarding Tatts more than \$450 million plus interest.

HIGH COURT'S DECISION

In yesterday's decision, the High Court unanimously overturned the Court of Appeal's decision. The High Court held that the phrase "new gaming operator's licence" was confined to a gaming operator's licence granted under the 1991 Act (as amended or replaced) while the gaming duopoly continued. It rejected the Court of Appeal's reasoning that "new gaming operator's licence" could include substantially similar licences or authorities, such as the GME.

On that basis, Tatts was not entitled to a terminal payment under the 1995 agreement because no "new gaming operator's licence" was ever issued.

CONTEXT AND PURPOSE: WHAT WOULD AN HONEST AND REASONABLE PERSON THINK?

Yesterday's High Court decision underscores the complexity of and risks associated with contractual interpretation.

In reaching their respective decisions, the High Court and Court of Appeal both asked the same question: “What would an honest and reasonable business person in the position of the parties consider the phrase ‘new gaming operator’s licence’ to mean?” However, their respective reviews of the text of the agreement and context and purpose led them to completely different answers. This highlights the difficulties that can arise for commercial parties if differences of interpretation arise – it can be difficult to predict what a court will decide.

Commercial parties should take care in drafting contracts, bearing in mind the risks associated with bargaining for a right which is contingent upon government policy and may be subject to regulatory change. To the extent possible, the parties’ intended outcomes if regulatory change occurs should be expressly dealt with.

CONTEXT AND PURPOSE WHEN CONTRACTING WITH GOVERNMENT OR IN REGULATED INDUSTRY

The High Court found that the 1995 agreement was predicated upon the existence of the duopoly in the operation of gaming machines in Victoria. This was reflected throughout the recitals and the agreement. Reasonable commercial parties would have understood (among other things) that:

1. If the duopoly ceased, even though Tatts would no longer share in the advantages of the duopoly, the business which Tatts had built up and paid for was not being given to another.
2. There was an evident need for the payment to Tatts to be revenue neutral for the State. If the duopoly ceased, there would be no new licence holder willing to pay the market value of Tatts’ licence thereby funding Tatts’ terminal payment.
3. Following the experience of years of the duopoly, the government might make a political judgment that the continuation of the duopoly was not in the public interest, particularly given the socio-economic issues attending gambling.
4. The government should not be understood as being willing to commit the State to a position whereby a decision regarding the public interest might be compromised by “entrenched interests of the duopolists”.

While the Court of Appeal and the primary judge were of the view that Victoria’s position “made ‘commercial nonsense’ of the State’s promise to make the terminal payment as compensation”, the High Court concluded that this was “too broad a view of the commercial interests of Tatts” protected by the agreement, as Tatts’ interests were only protected whilst the duopoly continued: [2016] HCA 5 at [74].

This schism demonstrates the difficulties and risks that arise where the court is left to identify the parties' objective intention, and the desirability for commercial parties contracting with government or in regulated industries considering and clearly articulating the contractual position in the event of regulatory change.

This article was written by Tania Gray, Senior Associate, Sydney and Mark Smyth, Solicitor, Sydney.

MORE INFORMATION

For information regarding possible implications for your business, contact Michael Pryse.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



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