SUPREME COURT OF VICTORIA

COURT OF APPEAL

S APCI 2016 0041

MASTERS HOME IMPROVEMENT PTY LTD (FORMERLY SHELLBELT PTY LTD) (ABN 21 066 891 307) — First Applicant

and

WOOLWORTHS LIMITED (ABN 000 014 675) — Second Applicant

v

NORTH EAST SOLUTION PTY LTD ACN 129 466 851 — Respondent

JUDGES:	SANTAMARIA, FERGUSON and KAYE JJA
WHERE HELD:	MELBOURNE
DATE OF HEARING:	13, 14, 21, 22 September 2016
DATE OF JUDGMENT:	27 April 2017
MEDIUM NEUTRAL CITATION:	[2017] VSCA 88
JUDGMENT APPEALED FROM:	*North East Solution Pty Ltd v Masters Home Improvement Pty Ltd and Woolworths Limited* (Supreme Court of Victoria, 28 January 2016)

CONTRACTS – Construction and interpretation of contracts – Whether Agreement for Lease incorporated Letter of Offer – Principles regarding when term will be implied or inferred well settled – *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales* (1982) 149 CLR 337, *Grocon Constructors (Victoria) Pty Ltd v APN DF2 Project 2 Pty Ltd* [2015] VSCA 190, *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410.

CONTRACTS – Breach – Whether applicant had breached obligation to act reasonably and in good faith in resolving differences regarding cost of constructing store – No sufficient basis for findings of breach.

EVIDENCE – Inferences – Drawing adverse inferences in a civil case – Whether inferences drawn were open on the facts – Breach of the rule in *Browne v Dunn* – Failure by a party to put allegation to witness directly relevant to assessing whether inference is open – No sufficient basis for inferences and findings made – *Briginshaw v Briginshaw* (1938) 60 CLR 336, *Browne v Dunn* (1893) 6 R 67.

DAMAGES – Quantification of loss and damage – Damages for loss of opportunity – Court must ask whether there was a commercial opportunity of some value and whether opportunity would have been pursued – Court looks to what amount should be awarded having regard to prospects of success if opportunity pursued – Judge applied discount of 25 per cent – 25 per cent discount did not reflect high risk that not all options would be exercised – Risk warranted applying discount between 50 and 75 per cent.

EVIDENCE – Expert evidence – Whether Court bound to accept evidence of experts – Court should not take on role of expert – Court's role is to evaluate expert evidence critically – Not Court's role to bring third set of opinions to arena or piece together own evaluation – Where conflicting evidence Court may accept part of evidence and reject other parts – Court may make adjustments to conclusion of expert in some circumstances – Court may disregard non cogent expert evidence.

APPEARANCES:	Counsel	Solicitors
For the Applicants	Mr N Young QC with Mr P D Crutchfield QC and Dr O Bigos	Minter Ellison
For the Respondent	Mr P Bick QC with Mr B Gibson	Tisher Liner FC Law

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SANTAMARIA JA
FERGUSON JA
KAYE JA:

Introduction

1 The respondent ('NES') is a corporate entity within the 'Maxi Foods Group' ('Maxi'), which at all material times was controlled by Mr Brendan Blake. The first applicant ('Masters') was a subsidiary of the second applicant ('Woolworths'). It was the corporate vehicle by which Woolworths conducted the business of operating a chain of home improvement stores.

2 This proceeding and the application for leave to appeal relate to a site located on the McIvor Highway, Strathdale, Bendigo (the 'Strathdale site'), which NES agreed to acquire for the purpose of constructing a store that would be leased to Masters, with that company's obligations to be guaranteed by Woolworths. In February 2010, the parties entered into an Agreement for Lease ('AFL') in respect of the Strathdale site. In the proceeding, NES claimed damages against Woolworths and Masters for breach of that agreement. The judge upheld NES' claim. He found that Woolworths and Masters breached their obligation under the AFL to act reasonably and in good faith to attempt to resolve any differences they had with NES about the cost of the construction of the store on the Strathdale site and the amount and manner in which Masters was to contribute to that cost. The judge awarded damages against Woolworths and Masters in the sum of $10,875,000 together with interest.[1] Woolworths and Masters seek leave to appeal against that decision.

3 After a long and complex trial, the judge expeditiously provided reasons which are very detailed. The judge made a critical finding that during the course of the negotiations about how much it would cost to construct the store and how much Masters would contribute to that cost, the amount that NES was seeking was less

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1 *North East Solutions Pty Ltd v Masters Home Improvement Australia Pty Ltd & Anor* [2016] VSC 1 ('Reasons').

than the estimate that Woolworths had been given by its quantity surveyor. That finding was primarily based on a spreadsheet provided by the quantity surveyor. However, based on the evidence, that spreadsheet was still a work in progress. The figures contained in it were not final. They were still subject to a number of queries that the quantity surveyor had. Consequently, we consider that there was not a sufficient basis for the judge to make the pivotal finding that he did. That finding influenced the judge's conclusions as to the inferences he should draw and it underpinned many of his other findings.

4 For the reasons which follow, we would grant leave to appeal and allow the appeal.

Background and facts

5 In the years leading up to 2009, Woolworths developed a strategy of expanding its business by opening a chain of hardware stores to be conducted by its subsidiary Masters. In order to compete with existing hardware stores, Woolworths sought to expand the business rapidly, by identifying suitable sites and entering into agreements to build stores on those sites as quickly as possible. As a consequence, Woolworths adopted the approach of agreeing to contribute the difference between the cost of building a Bunnings store (Masters' major competitor) on a particular site, and the cost of building a Masters store on that site. The cost of construction of the Masters stores was generally more expensive than that of constructing a Bunnings store, because Woolworths' strategy involved the construction of stores that were more attractive than Masters' competitors. The roll out of Masters stores was known as 'Project Oxygen'.

6 In May or June 2009, members of Woolworths' board inspected the Strathdale site. As a consequence, on 2 June 2009, Woolworths and Mr Blake, on behalf of Maxi, executed a document referred to as the 'Letter of Offer' ('LOO'), by which Maxi agreed to acquire the Strathdale site and to construct a store on it, to be leased by the Woolworths Group. In accordance with the LOO, NES acquired an option to

purchase that site.

7 The LOO was a binding agreement that recorded the intention of the parties, subject to certain conditions being met, to construct and lease a Masters store at the Strathdale site, and to enter into a formal agreement for lease based on Woolworths' standard documentation. The LOO was expressed to be subject to the Woolworths board's approval. It provided for a lease term of 12 years, with six five year options. The LOO also provided for an annual rent of $1,264,200 plus goods and services tax ('GST'), with annual rent reviews.

8 Clause 13 of the LOO provided as follows:

> A design brief will be issued in due course which will contain Woolworths' current standard Specification. The Landlord is to provide a turn-key premises in accordance with the obligations contained in the Specification. Should the design brief differ in cost to other major trade supply/restricted retail premises (full height pre-cast brief), the difference in cost is to be made by payment as a lump sum. Rider Hunt quantity surveyors are to verify the cost difference.

9 It was common ground that the phrase 'other major trade supply/restricted retail premises' was understood to be a reference to a Bunnings store.

10 On 4 August 2009, Woolworths' Property Committee (the Property Committee) approved entry into the LOO, and, among other things, approved a contribution to the development costs of a Masters store on the Strathdale site of up to $1.7 million. That figure was not communicated to Mr Blake or to NES, and in the proceeding it was referred to as 'the undisclosed budget'. The Property Committee also decided to pursue only one Masters store in Bendigo for the time being. The Strathdale site was considered at the time to be the best site to serve the area, and its feasibility had been rated 'best' among the sites considered by Woolworths, which included the Hume & Iser site in Bendigo, to which reference will shortly be made.

11 On 25 August 2009, Woolworths made a take-over bid to acquire the hardware group of companies operated by Danks Holdings Limited ('Danks'). The business conducted by Danks principally had a trade (rather than retail) focus.

Before Woolworths made that bid, Danks had identified the existing hardware store on the Hume & Iser site in Bendigo as a key acquisition target for its business.

12 In late November 2009, Woolworths formed the view that the Greater Bendigo Council ('the council') was not supportive of the development of the Strathdale site as a Masters store. On 23 November 2009, Mr Timothy Stuart Macmillan, the Group Property Operations Manager – South, Woolworths, attended a meeting of the council. At that meeting several council representatives raised concerns about the proposal to construct a Masters store at the Strathdale site, expressing the view that they would support development on another site that was more distant from residential developments. On the following day, the council communicated those views in a letter to Mr John Panozzo of the Department of Innovation Industry and Regional Development, who had been assisting Woolworths with planning amendments for its key Masters stores, including in Bendigo.

13 Nevertheless, Woolworths proceeded with the development of its plans relating to the Strathdale site. By mid-December 2009, a generic Masters design brief ('Design Kit Rev B'[2]) was available. Rider Levitt Bucknall ('Rider Hunt'), a quantity surveyor engaged by Woolworths, estimated that constructing a 13,465m² Design Kit Rev B Masters store (on a prepared site) would cost $12,104,254 (or $899 per m²), which was $1,176,562 more than the cost of constructing a 14,072m² store built to the specifications of a Bunnings May 2008 Brief Rev 2. At about the same time, a second quantity surveyor retained by Woolworths (Slattery) gave Woolworths an estimate of a construction cost of $11,950,000 for a 13,500m² Masters store, which equated to $885 per m².

14 In January 2010, Design Rev Kit B was provided to Mr Blake. He engaged Vaughan Constructions Pty Ltd ('Vaughans'), a builder, to provide a quotation to construct a Masters store on the site. On 1 March 2010, Vaughans provided a

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2 For more information about how these designs came to be, see [115]-[117].

quotation of $12,348,061 (which equates to $1,130 per m²) ('the Vaughans estimate').

15 In the meantime, on 3 February 2010, Rider Hunt provided to Woolworths an estimate of the cost of constructing a larger 13,676m² Masters store on the site in the sum of $12,000,000 (or $877 per m²).

16 In February 2010, Mr Blake asked Woolworths to provide interim funding for a separate shopping centre development in Bendigo, referred to as the Kennington Village Development. That development was to be constructed by NES and leased to Woolworths. Although Woolworths agreed to provide the funding, the development did not proceed, as Kennington Village Pty Ltd was unable to obtain the necessary planning approvals. As a result, NES defaulted on paying out or re-financing Woolworths' loan, and Woolworths exercised its option to purchase the site. The failure of the Kennington Village proposal was relevant at the trial because NES contended that, as a result of it, Woolworths' representatives formed the view that NES had funding difficulties.

The agreement for lease dated 24 February 2010

17 On 24 February 2010, NES and Woolworths and Masters entered into the AFL for the Strathdale site. Clause 3 of the AFL provided that NES must at its cost construct the store in accordance with the plans and specifications referred to in the agreement. Those works were referred to as the 'Landlord's Works'. Clause 9 of the AFL provided for NES to grant to Masters, and for Masters to accept, a lease of the store in the form annexed to the AFL, with an initial 12 year period, and five options of six years each, exercisable at the discretion of Masters. Woolworths guaranteed Masters' obligations under the AFL, and was to act as guarantor under the lease.

18 Clause 1.1 of the lease defined 'Landlord's Works Costs' as follows:

> Landlord's Works Costs means the estimated costs that will be incurred by the landlord in constructing the landlord's works based on construction on a level and benched site and excluding costs for works external to the Premises. To avoid doubt it does not include any other costs such as design costs, consultants' fees and any fees, costs or charges incurred in connection with obtaining the Development Approval.

19 The key provision of the AFL, which was at the centre of the dispute in the case, was clause 2, which provided as follows:

> **2.1 Briefing Kit**
>
> The Tenant must, as soon as practicable after the date of this Agreement, and in any case on or before 15 January 2010, develop and give to the Landlord the Briefing Kit and the Site Plan.
>
> **2.2 Costs Estimate**
>
> (a) As soon as reasonably practicable after receipt by the Landlord of the Briefing Kit the Landlord, acting reasonably and in good faith, must:
>
> (i) determine the Landlord's Works Costs and advise the Tenant in writing of the Landlord's Works Costs;
>
> (ii) provide, on an open book basis, its costing of the Landlord's Works Costs; and
>
> (iii) advise the Tenant whether it requires the Tenant to contribute towards the Landlord's Works Costs and the amount of that contribution (if any).
>
> (b) The Landlord and the Tenant, acting reasonably and in good faith, must attempt to resolve any differences they may have in relation to:
>
> (i) the Landlord's determination of the Landlord's Works Costs; and
>
> (ii) the amount that the Tenant must contribute towards the Landlord's Works Costs (if any) and the manner in which this contribution will be made.
>
> (c) If, by the later of:
>
> (i) 20 April 2010; and
>
> (ii) the date which is 6 weeks after the date of receipt by the Tenant of notice of the Landlord's Works Costs, or such later date to which the parties agree, the Landlord and the Tenant cannot agree on:
>
> (iii) the Landlord's Works Costs; or
>
> (iv) the amount that the Tenant must contribute towards the Landlord's Works Costs (if any) and the terms and conditions on which this contribution will be made, the Landlord or the Tenant may:
>
> (v) terminate this Agreement by giving notice in writing to

the other; and

(vi) procure the withdrawal of the application for Development Approval.

(d) Termination of this Agreement pursuant to clause 2.2(c)(v) does not prejudice any claim which either party to this Agreement may have arising from the non-compliance by the other party of any of its obligations under this Agreement.

(e) Subject to each party's rights under clause 2.2(d), if this Agreement is terminated pursuant to clause 2.2(c), each party will bear their own legal and other costs and expenses in connection with this Agreement arising before termination.

20 The principal dispute, on the issue of liability, concerned whether Woolworths and Masters had breached the obligation, in clause 2.2(b) of the AFL, to act reasonably and in good faith in attempting to resolve any differences that they had with NES in relation to the Landlord's Work Costs ('LWC'), the contribution of Masters to those costs, and the manner in which that contribution was to be made. We will later set out the detailed history of exchanges between the parties, and between Vaughans and Rider Hunt, in relation to those matters, when we consider the individual grounds of appeal which relate to the findings by the judge that Masters and Woolworths had breached that obligation. At present, it is sufficient to summarise the facts, relating to that aspect of the case, in brief compass.

21 Before doing that, we mention that while the obligation to act reasonably and in good faith under clause 2.2(b) was one imposed on Masters as tenant, the parties did not distinguish between Masters and Woolworths. Both at trial and on the appeal, no distinction was made between them. We will proceed on this basis and will predominantly refer to Woolworths alone while recognising that, contractually, the obligation was that of Masters.

Negotiations in relation to Landlord's Works Costs and clause 2.2(b) Amount

22 On 3 March 2010, NES provided to Woolworths (via Mr Macmillan) its formal estimate of the LWC under clause 2.2(a) of the AFL. By that estimate, NES determined the LWC to be $12,348,061 plus GST (or $1,130 per m²), being the amount of the Vaughans estimate in respect of a 10,923m² store. NES advised that the construction estimate for an alternative trade supply development of the site (that is a Bunnings store) was $8,375,640 plus GST. Accordingly, NES advised that the contribution that Woolworths was required to make to the LWC was $3,972,421 plus GST.

23 On the same date (3 March 2010), Vaughans provided to Masters a quotation for a proposed Masters store at Hawthorn which equated to $1,047.74 per m².

24 On 9 March 2010, Mr Blake instructed Vaughans to provide Woolworths with the Vaughans costings. Mr Blake, who was the principal negotiator for NES, and Mr Macmillan, who was the primary negotiator for Woolworths, each gave evidence that the detailed assessment of the amount of the LWC, and of the difference between the costs of development of a Masters store and of a Bunnings store on the Strathdale site, was a technical exercise beyond their respective levels of expertise.

25 As a consequence, Mr McDonald, of Rider Hunt, engaged in discussions with Vaughans concerning the LWC and the clause 2.2(b) amount. Mr Macmillan gave evidence that he understood that Vaughans was acting for NES, and he did not invite Mr Blake, or any other representative of NES, to participate or attend in the open book costing meetings.

26 The first of a number of meetings between Rider Hunt and Vaughans took place on 12 March 2010. Following that meeting, Mr Grigg of Vaughans sent an email to Mr McDonald of Rider Hunt, containing further information, which enabled Rider Hunt to identify items that Vaughans had included in estimating the LWC, and which Mr McDonald considered should not have been included in that

calculation. There then followed a number of exchanges of emails between Mr McDonald and Mr Grigg, to which reference will be made later. On 16 March 2010, Vaughans advised Mr Blake that certain costs should be excluded from its previous estimate of the LWC, which resulted in a revised LWC estimate of $11,516,809 plus GST (or $1,051.36 per m²).

27 Further communications took place between Rider Hunt and Vaughans, and between representatives of NES and Woolworths. On 18 March 2010, Vaughans sent a spreadsheet to Mr McDonald, which (it seems) estimated the difference in cost between a Bunnings store and a Masters store on the Strathdale site at $3,454,674.74. The spreadsheet was amended by Rider Hunt. The significance of the spreadsheet, and the amendments to it by Rider Hunt, assumed substantial importance in the trial, and will be discussed in some detail when we consider grounds 5.4(e) and (f) of the proposed grounds of appeal.

28 On 26 March 2010, the solicitors for NES wrote a letter to the solicitors for Woolworths advising that NES' adjusted determination of the LWC, for the purposes of clause 2.2(a)(ii) of the AFL, was $12,348,061 plus GST. The solicitors advised that NES required a reduced contribution under clause 2.2(b) of the AFL of $3,772,421 (less the costs of any earthworks and power connection costs to the land).

29 On 29 March 2010, Rider Hunt emailed to Mr Macmillan a copy of the amended spreadsheet (to which we have referred), which set out the details of Vaughans' cost comparison between a Masters store and a Bunnings store. In the original spreadsheet, Vaughans (but not Rider Hunt) identified the difference between the cost of constructing a Bunnings store and developing a 10,923 m² Masters store on the Strathdale site, in the sum of $3,247,194.55.

30 In his evidence, Mr Macmillan said that he did not accept that that figure was final, or represented the outcome of the open book process. Mr McDonald gave evidence that he had divided the Vaughans estimate into what he regarded as base building costs (which he understood were to be the subject of any contribution by

Woolworths) and site specific fit out and authorities' costs (which he understood were to be treated separately). The base building cost totalled $2,573,493.26, but included more than $2,000,000 of costs that Mr McDonald highlighted on the amended spreadsheet in blue, and which were still under discussion with Vaughans. Mr McDonald described the spreadsheet as a 'work in progress' document.

31 On 31 March 2010, Mr Macmillan telephoned Mr Blake, and told Mr Blake that the Vaughans estimate was not acceptable to Woolworths.

32 On 6 April 2010, the solicitors for NES wrote a letter to the solicitors for Woolworths noting that the earthworks and power connection costs, referred to in their letter of 26 March, were to be deleted from the LWC, thereby reducing Woolworths' contribution to the LWC to the sum of $2,941,169. In that letter, the solicitors for NES stated that their client required that the payment of that sum was to be made by a lump sum *at the commencement of* construction of the works.

33 The solicitors for Woolworths responded by a letter dated 9 April 2010, to the solicitors for NES, stating that the amount that NES required Woolworths to contribute to the LWC was not acceptable. The solicitors also stated that the payment terms proposed by NES were unacceptable, and, instead, proposed that 95 per cent of the tenant's contribution be paid 10 business days after the commencement date of the lease, with five per cent payable after the expiration of the defects liability period. In their correspondence of 6 and 9 April, the solicitors for NES and the solicitors for Woolworths respectively reserved their clients' right to terminate the AFL under clause 2.2.

34 On 8 April 2010, Vaughans provided to Rider Hunt a 'consolidation' of its original estimate, confirming the deduction of certain items from its estimate of the LWC. Following that, further meetings took place between Rider Hunt and Vaughans on 12 and 15 April.

35 In his reasons for judgment, the judge made two findings relating to the

assessment by Vaughans and Rider Hunt of the LWC, and the tenant's contribution to it, which were of significance in the resolution of the issues at trial, and which assumed substantial importance on appeal.

36 First, the judge found that on 29 and 31 March 2010, Rider Hunt had provided Woolworths with an estimate of the clause 2.2(b) amount in the sum of $3,247,195, so that by 1 April 2010, the Rider Hunt estimate of the clause 2.2(b) amount stood at $3,247,195.[3]

37 Secondly, the judge further found that, following a review conducted by Rider Hunt between 12 and 18 April 2010, Rider Hunt arrived at an estimate of the LWC of $11,516,809, which was the amount of the revised Vaughans estimate that had been communicated to Rider Hunt on 16 March 2010.[4]

22 April 2010 meeting and termination of AFL

38 Mr Macmillan attempted to arrange a meeting between the parties and their respective solicitors before 20 April 2010, which was the date fixed by clause 2.2(c) as the date by which the parties must agree on the LWC and the tenant's contribution to those costs. Ultimately, a meeting was fixed to be held on 22 April 2010. On the morning of the meeting, and shortly before it began, Mr Macmillan received an email from Mr McDonald, attaching a document that he was not able to read on his mobile phone, and which set out the point to which Rider Hunt and Vaughans had progressed in relation to the determination of the clause 2.2(b) amount. The document identified a comparison amount of $1,513,413. In his evidence, Mr McDonald stated that he was still carrying out his assessment of that amount at that time. Mr Macmillan spoke to Mr McDonald on the telephone shortly before the 22 April meeting, and his evidence was that he understood that the process undertaken by Rider Hunt and Vaughans was not complete.

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3 Reasons [94], [174], [183].

4 Reasons [212], [265].

39 At the 22 April 2010 meeting, the parties did not reach agreement on the clause 2.2(b) amount, or the manner in which the tenant's contribution to that amount was to be paid. The judge made findings in relation to what took place at the meeting, which will be discussed later in these reasons. At the conclusion of the meeting, it was common ground that the parties could not reach agreement on those aspects as required by clause 2.2 of the AFL. Mr Blake made an offer to sell, to Woolworths, the option held by NES to purchase the Strathdale site. The parties agreed that if, by 4 May 2010, Woolworths decided not to purchase the option, the AFL would terminate. Subsequently, on 6 May 2010, the parties terminated the AFL pursuant to clause 2.2(c). Consequently, NES did not exercise the option it held to acquire the Strathdale site.

The proceeding

40 NES commenced the proceeding by writ in May 2012. It alleged that Woolworths and Masters had breached clause 2.2 of the AFL. In particular, NES contended that there was no genuine disagreement between the parties in relation to the calculation of the LWC, and the tenant's contribution to those costs, or, if there was such a disagreement, Woolworths had not acted reasonably or in good faith to resolve it. NES alleged that Woolworths terminated the AFL for ulterior reasons. Those reasons were: (a) the calculated construction costs, and Woolworths' required contribution to those costs, exceeded Woolworths' undisclosed budget (of $1.7 million); (b) Woolworths had determined to acquire the alternative Hume & Iser site in Bendigo, instead of proceeding with the development of the Strathdale site; (c) Woolworths perceived that the opposition of the council and residents was an obstacle to developing the Strathdale site; and (d) Woolworths perceived that NES had funding difficulties.

Reasons for judgment

41 As we noted at the outset, in detailed reasons which were delivered after a lengthy and complex trial, the judge upheld the claims made by NES, to which we have referred.

42 The judge commenced by accepting the submission by NES that paragraph 13 of the LOO was an important part of the factual matrix that is relevant to a construction of the effect of clause 2.2(b) of the AFL.[5] Accordingly, the judge accepted the contention of NES that Woolworths was required to pay the contribution to the LWC by a lump sum payment, as specified in paragraph 13 of the LOO.[6]

43 The judge then turned to the question whether Woolworths had complied with their obligation to act reasonably and in good faith, under clause 2.2(b) of the AFL, to resolve any differences they may have in relation to NES' determination of the LWC, the amount of the tenant's contribution to those costs, and the manner in which the contribution was to be made.

44 As already mentioned, as a central part of that aspect of the case, the judge found that, on 29 and 31 March 2010, Rider Hunt had provided to Woolworths an 'estimate' of the clause 2.2(b) amount in the sum of $3,247,195.[7] The judge noted that that amount was greater than the amount which NES had, at that stage, sought from Woolworths by way of the tenant's contribution to the LWC. Further, as mentioned, the judge found that, by reason of a review conducted by Rider Hunt between 12 and 18 April 2010, Rider Hunt and Vaughans had arrived at an estimate of the LWC at $11,516,809, which equated to a contribution by Woolworths to the LWC of $2,941,169.[8]

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5 Reasons [81]–[82].

6 Reasons [154(c)].

7 Reasons [94], [151], [154(a)], [174].

8 Reasons [265].

45 Based on those findings, the judge concluded that, as at 1 April 2010, and also as at 18 April 2010, there was no genuine disagreement between the parties as to the calculation of the LWC.[9] The judge accordingly held that Woolworths did not negotiate reasonably and in good faith in relation to the quantification of the LWC, and the tenant's contribution to those costs, because (a) the quantification of those costs exceeded Woolworths' undisclosed budget, and also (b) Woolworths had determined to pursue the Hume & Iser site instead of the Strathdale site. Further, the judge found that Woolworths was motivated by their perception of the financial position of NES and of opposition from council or residents to the proposed development of the Strathdale site. The judge held that Woolworths had acted unreasonably and not in good faith by taking those extraneous matters into account when negotiating, or purporting to negotiate, the LWC and the tenant's contribution to it.

46 The judge quantified NES' loss and damage on the basis of a loss of opportunity by NES to develop the Strathdale site and lease it. The judge held that if Woolworths had acted reasonably and in good faith in performing their obligations under clause 2.2 of the AFL, it would have reached agreement with NES relating to the LWC and the tenant's contribution to that sum, so that the lease and the development of the site would have proceeded. The judge found that the appropriate method by which to evaluate the loss of opportunity by NES was to combine the loss of rental surplus from the Strathdale site (the income that would have been derived by NES if the lease had run to its full 42 year possible term, including the exercise by the tenant of the six five year options), with the net equity of the site at the conclusion of the lease. The judge quantified the loss and damage sustained by NES in the sum of $14.5 million. He then applied a '*Sellars*' discount[10] of 25 per cent, resulting in an award of damages of $10,875,000.

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9 Reasons [85], [122], [175]–[178].

10 *Sellars v Adelaide Petroleum NL* (1994) 179 CLR 332 ('*Sellars*').

The application for leave to appeal

47 Woolworths and Masters seek leave to appeal against the orders of the judge.

48 The application and proposed appeal concern the following key issues as to both liability and quantum:

(a) the judge's holding that aspects of paragraph 13 of the LOO were incorporated into clause 2.2 of the AFL by incorporation, inference and/or implication; (Proposed Ground of Appeal 5.1)

(b) the proper construction of clause 2.2 of the AFL, including whether the 'good faith' obligation imposed on the parties required Woolworths to take the prescriptive steps identified at Reasons [244]; (Ground 5.3)

(c) the judge's findings (including in respect of the 'undisclosed budget', the Rider Hunt's 'estimates', the open book process, the role of Vaughans and Woolworths' motivations), and failure to make other findings, which led to the conclusion that Woolworths and Masters breached their obligations under clauses 2.2(b) and (c) of the AFL; (Grounds 5.2, 5.4, 5.5)

(d) the assessment of the value of any loss of opportunity, including the methodology for assessment adopted by the judge in light of the expert evidence led by the parties on the appropriate methodology to be applied in the circumstances; (Grounds 5.6, 5.7)

(e) even if the methodology adopted by the judge is appropriate, the proper application of and inputs into that methodology; (Grounds 5.8, 5.9)

(f) the appropriate discount to be applied to reflect risks of the opportunity not materialising; (Grounds 5.10, 5.11)

(g) the basis on which interest should be awarded on damages. (Ground 5.12).

CONSTRUCTION OF CLAUSE 2.2 (Ground 5.1)

49 The issue in respect of ground 5.1 centres on whether the judge wrongly imported terms from the LOO into the AFL. On the hearing of the appeal, the principal issue reduced to a narrow point directed to whether the tenant's contribution to the LWC was to be made by a lump sum.

(a) The judge's reasons about construction of clause 2.2

50 The judge noted that, at the time the LOO was signed, Woolworths did not have a settled design brief for the construction of Masters stores. One consequence was that the difference in construction costs between a Bunnings and Masters store was not known.[11] As mentioned above, clause 13 of the LOO provided:

> A design brief will be issued in due course which will contain Woolworths' current standard Specification. The Landlord is to provide a turn-key premises in accordance with the obligations contained in the Specification. Should the design brief differ in cost to other major trade supply/restricted retail premises (full height pre-cast brief), the difference in cost is to be made by payment as a lump sum. Rider Hunt quantity surveyors, are to verify the cost difference.

51 Clause 24 of the LOO which was headed 'Binding Agreement' provided:

> Although it is intended that a formal agreement for lease will be executed based on Woolworths standard documentation, including the commercial terms in this letter, it is intended that acceptance by you of the terms and conditions in this letter will create a binding agreement between you and Woolworths.

52 The judge held that, in so far as the provisions of the LOO had not been abrogated or varied by clear provisions of the AFL, they continued to apply. He said:

> Quite clearly, the commercial parties to the Letter of Offer intended its terms to have meaning and to be binding. It follows that the commercial context and the factual matrix in which the Agreement for Lease was entered into by corporate entities associated with and contemplated, at least in general terms, by the parties to the Letter of Offer must be accommodated and given effect

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11 Reasons [27].

to by implication or incorporation into the terms of the Agreement for Lease.[12]

53 It will be recalled that clause 2.2(b) of the AFL provided:

> The Landlord and the Tenant, acting reasonably and in good faith, must attempt to resolve any differences they may have in relation to:
>
> (i) the Landlord's determination of the Landlord's Works Costs; and
>
> (ii) the amount that the Tenant must contribute towards the Landlord's Works Costs (if any) and the manner in which this contribution will be made.

54 The judge held that the provisions of clause 2.2 of the AFL were sufficiently certain to be enforceable when read in their factual matrix, particularly when read in conjunction with clause 13 of the LOO.[13] The judge stated that the LOO provided for payment of the difference in cost as a lump sum 'but without specifying the time of payment.'[14] When he came to construe clause 2.2(b) of the AFL, he described Woolworths as having already made a commitment to pay the difference in cost.[15] The judge also found that, under the AFL, the tenant was obliged to make the payment by way of a lump sum, such a term having been incorporated by inference or implication from clause 13 of the LOO.[16]

55 The judge concluded:

> Woolworths was not free to terminate the Agreement for Lease to pursue the acquisition of an alternative site, having agreed to lease the Masters store from NES at a price that was based on the price to construct the store to Bunnings' specifications and having agreed to pay the difference between that cost and the actual cost to construct a Masters specification in a lump sum, once known. In my opinion, it is clear that Woolworths knew very well, both for the reasons discussed in the preceding reasons and from advice it sought from its solicitors…, that it was not free to terminate the Agreement for Lease under cl 2.2(c) unless it had first acted reasonably and in good faith to resolve any differences it may have had in relation to the estimate by NES of the Landlord's Works Costs or the Tenant's contribution to those costs and no agreement could be reached.

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12 Reasons [46]. See also Reasons [79], [81].

13 Reasons [55]. See also Reasons [82], [243].

14 Reasons [27].

15 Reasons [82], [83], [242].

16 Reasons [39], [46], [154(c)], [242].

> On its proper construction, having regard to the terms of the Agreement for Lease and the factual circumstances in which it was entered into, cl 2.2 of the Agreement for Lease is not an agreement merely to negotiate. It is an agreement to act reasonably and in good faith in an attempt to resolve differences in relation to the estimate by NES of the Landlord's Works Costs. Clause 2.2 was a mechanism by which the parties agreed to act reasonably and in good faith, that is, with the joint object of resolving any differences that may be identified, to determine the actual cost to construct a store to Masters' specifications so that Woolworths could meet the difference between that cost and the cost on which the lease amount had been based. It is not a clause that permitted Woolworths to terminate the Agreement for Lease if that cost exceeded some undisclosed budget on the part of Woolworths, or if issues arose with respect to the development or if it decided to pursue other alternative options.[17]

(b) Legal principles - contract construction and terms

56 A commercial contract is construed objectively by asking what a reasonable businessperson would have understood its terms to mean at the time that the contract was entered into.[18] This requires consideration of the text, context (the entire text of the contract as well as any contract, document or statutory provision referred to in the text of the contract) and commercial purpose.[19]

57 At least where the contractual language is ambiguous or susceptible of more than one meaning, evidence of events, circumstances and things external to the contract is relevant to the construction of that language.[20] In *Codelfa Construction Pty Ltd v State Rail Authority of New South Wales*[21] Mason J (with whom Stephen and Wilson JJ agreed) said:

> [T]hat evidence of surrounding circumstances is admissible to assist in the interpretation of the contract if the language is ambiguous or susceptible of more than one meaning. But it is not admissible to contradict the language of the contract when it has a plain meaning. Generally speaking facts existing when the contract was made will not be receivable as part of the surrounding

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17 Reasons [243].

18 *Electricity Generation Corporation v Woodside Energy Ltd* (2014) 251 CLR 640 ('*Woodside*') 656–657 [35].

19 *Mount Bruce Mining Pty Ltd v Wright Prospecting Pty Ltd* (2015) 256 CLR 104 ('*Mount Bruce Mining*').

20 *Mount Bruce Mining* (2015) 256 CLR 104, 117 [50] (French CJ, Nettle and Gordon JJ).

21 (1982) 149 CLR 337 ('*Codelfa*').

> circumstances as an aid to construction, unless they were known to both parties, although, as we have seen, if the facts are notorious knowledge of them will be presumed.
>
> It is here that a difficulty arises with respect to the evidence of prior negotiations. Obviously the prior negotiations will tend to establish objective background facts which were known to both parties and the subject matter of the contract. To the extent to which they have this tendency they are admissible. But in so far as they consist of statements and actions of the parties which are reflective of their actual intentions and expectations they are not receivable. The point is that such statements and actions reveal the terms of the contract which the parties intended or hoped to make. They are superseded by, and merged in, the contract itself. The object of the parol evidence rule is to exclude them, the prior oral agreement of the parties being inadmissible in aid of construction, though admissible in an action for rectification.[22]

58 The principles as to when a term will be implied into a contract are well settled. Where there is no express term, a term will be implied if five conditions are satisfied. They are:

(a) the term must be reasonable and equitable;

(b) the term must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it;

(c) the term must be so obvious that 'it goes without saying';

(d) the term must be capable of clear expression; and

(e) the term must not contradict any express term of the contract.[23]

59 The distinction between implied and inferred terms is not always easy to identify. Inferred terms are those which 'can properly be inferred from all the circumstances as having been included in the contract as a matter of actual intention of the parties.'[24] On the other hand, the implication of terms is directed to what the parties would have agreed upon had they turned their minds to it at the time they entered into the contract. Some of the authorities speak of a two stage process for the

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22 Ibid 352.

23 *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266, 282–3 ('*BP Refinery*'). The test was adopted by Mason J in *Codelfa* (1982) 149 CLR 337, 347. See also *Grocon Constructors (Victoria) Pty Ltd v APN DF2 Project 2 Pty Ltd* [2015] VSCA 190 [139]–[146] ('*Grocon*').

24 *Hawkins v Clayton* (1988) 164 CLR 539, 570 (Deane J).

identification of the terms of the contract and observe that the two stages may overlap – first, inference of terms based on actual intention and secondly, implication of terms based on presumed intention.[25]

60 In *Byrne v Australian Airlines Ltd*,[26] McHugh and Gummow JJ considered that, where a contract was not in writing and was oral or partly oral, or it appeared that the parties had not reduced their agreement to a complete written form, courts should exercise caution and avoid an automatic or rigid application of the conditions set out above for implying terms.[27] They observed:

> In such situations, the first task is to consider the evidence and find the relevant express terms. Some terms may be inferred from the evidence of a course of dealing between the parties. It may be apparent that the parties have not spelled out all the terms of their contract, but have left some or most of them to be inferred or implied.[28]

61 As observed in *Grocon*, the case law dealing with when terms will be inferred concerns contracts where not all the terms are in writing and will have limited application to detailed written contracts between experienced and sophisticated commercial parties.[29]

62 Terms may also be incorporated by reference into a contract. So, for example, a contract of sale may refer to the sale being on the vendor's standard terms and conditions, those terms being contained in a separate document. Similarly, a contract may refer to the incorporation of terms from a separate contract between the parties.

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25 Ibid 570; *Byrne v Australian Airlines Ltd* (1995) 185 CLR 410, 422 (Brennan CJ, Dawson and Toohey JJ); *Breen v Williams* (1996) 186 CLR 71, 90–91 (Dawson and Toohey JJ).

26 (1995) 185 CLR 410 ('*Byrne*').

27 *Byrne* (1995) 185 CLR 410, 442.

28 Ibid.

29 *Grocon* [2015] VSCA 190 [191].

(c) Ground 5.1 – the proper construction of clause 2.2

63 The ground of appeal relating to the construction of clause 2.2 of the AFL is:

> 5.1 The learned judge erred in holding that clause 2.2 of the AFL included, by incorporation, inference and/or implication, terms to the effect that:
>
> (a) Masters and Woolworths had agreed that Masters would meet the difference (as verified by Rider Hunt) between the cost to construct a Masters store and the cost to construct a store to Bunnings specifications ('clause 2.2(b) amount'); and
>
> (b) the clause 2.2(b) amount would be paid to NES by a lump sum.

(d) Submissions about construction

64 The submissions of Woolworths on the proper construction of clause 2.2 fall into two broad categories. First, Woolworths contended that the judge wrongly conflated the AFL and the earlier LOO and treated them as cumulative. In its submission, there is no basis for implication or incorporation of any provisions from the LOO into the AFL. Secondly, whilst the LOO was a 'surrounding circumstance' that could be taken into account in construing ambiguous terms in the AFL, terms in the LOO which were inconsistent with the AFL could not be incorporated or implied into the AFL. For example, the LOO provided the context when construing what 'differences' the parties were to attempt to resolve under clause 2.2(b) of the AFL. The context of the LOO showed that the 'differences' were the differences between the cost of a base building retail hardware store for Bunnings compared to the base costs for the Masters building at Strathdale. Woolworths submitted that although the word 'differences' required interpretation by reference to the factual matrix it did not provide any licence or authority to incorporate other provisions in the LOO, nor to suggest that in other respects the AFL ceased to be wholly in writing. Apart from the ambiguity associated with what the parties meant by 'differences,' Woolworths contended that the AFL otherwise made complete and perfect sense.

65 Woolworths submitted that the starting point is the AFL which was a formal, detailed, negotiated agreement between sophisticated commercial parties with the

assistance of lawyers. It contained an entire agreement clause in the lease attached to it. Woolworths submitted that the lease and AFL were to be read together as embodying one single entire agreement. In any event, Woolworths submitted (relying on the reasoning in *Grocon*) that looking at the terms of the AFL it is clear on its face that the parties intended it to be a comprehensive statement of their agreement from the time it was executed. In addition, the AFL was between different parties to those that were signatories to the LOO. There was no reference to the LOO in the AFL.

66 Woolworths submitted that clause 2.2(b) of the AFL established a vastly different process to that in the LOO. According to Woolworths, under clause 2.2(b) each of the parties, acting reasonably and in good faith, was to attempt to resolve three matters:

(a) the landlord's determination of the amount of the LWC;

(b) the amount of the contribution towards the LWC; and

(c) the manner (meaning all aspects of the terms and conditions) in which the contribution is to be made.

67 Woolworths submitted that this process was at odds with clause 13 of the LOO, such that clause 13 cannot stand with, and was overtaken or replaced by, clause 2.2. It contended that the process under clause 13 is one whereby a third party, Rider Hunt, verifies the objective cost difference and effectively binds both parties to pay (Woolworths) and receive (Maxi) that amount as a lump sum. Clause 2.2 made no reference to a Rider Hunt verification process.

68 Woolworths submitted that the judge wrongly incorporated the proposition that Woolworths was committed to pay an unascertained amount (notwithstanding the attempt to resolve process established by clause 2.2(b)) and that that amount must be paid as a lump sum. Woolworths identified the error as emanating from the judge having used as his starting point the LOO rather than the AFL. This, so Woolworths contended, led the judge into error by first, using the LOO when the

relevant provision of the AFL was not ambiguous (contrary to the permitted use of surrounding circumstances described in *Codelfa*),[30] secondly, implying terms taken from the LOO into the AFL when the pre-requisites for implication specified in *BP Refinery*[31] had not been established, and thirdly, incorporating terms from the LOO when there was no express or implied agreement of the parties to do so.

69 According to Woolworths, clause 2.2 of the AFL did not impose any obligation on Woolworths to pay an unspecified amount. Woolworths accepted that under the LOO, it had agreed to pay an unascertained amount, but contended that any such obligation had been superseded by the AFL obligation by each party to attempt (reasonably and in good faith) to agree an amount. If they did not agree, then either party had the right to terminate.

70 Nor, according to Woolworths, did clause 2.2 of the AFL specify any time when the payment was to be made. Rather, the timing of the contribution was one of the matters to be resolved as a component of the manner in which the contribution was to be made. Woolworths submitted that the judge had initially acknowledged that timing had to be resolved[32] but had omitted to consider this issue when determining that there had been a breach of the clause 2.2(b) obligations. Woolworths' submission went not only to the timing of the payment, but also as to whether clause 2.2 required payment by a lump sum. In that connection, counsel focused on clause 2.2(b)(ii) which required the parties to resolve their differences as to the 'manner' in which the tenant's contribution was to be made. So Woolworths' argument ran, there was always one of the three available grounds to terminate under clause 2.2(b) available because the manner and timing of payment was never resolved.

71 Senior counsel for NES took the Court to the references in the LOO to Maxi

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30 (1982) 149 CLR 337.

31 (1977) 180 CLR 266.

32 See [50] above.

and to Woolworths. He observed that NES was a member of Maxi, Woolworths became a guarantor under the AFL and Masters became the tenant. Consequently, NES contended, the changes to the parties in the AFL were not material, particularly given that the LOO contemplated the AFL.[33] It pointed to clause 24 of the LOO and to clause 22 which provided that Woolworths would prepare the AFL and lease documentation and would pay stamp duty and registration fees.

72 NES submitted that the AFL did not work on its own and it was necessary to look to the LOO. For example, although there was no provision in the AFL as to what the 'differences' that had to be resolved were, the parties were agreed that it was the difference in cost between construction of a Bunnings and Masters store. That was a commercial term which came from clause 13 of the LOO. NES submitted that a second commercial term that came from clause 13 was that the difference in cost would be paid by the tenant to the landlord. It characterised the reference to Rider Hunt's role in clause 13 of the LOO as a 'perceived' but 'minor difficulty.' NES submitted that Rider Hunt (as a quantity surveyor) would verify construction costs on some basis or other but that did not mean that there were no other differences that could be subject to the parties attempts to resolve acting reasonably and in good faith. Counsel gave as an example the specification and layout of the store; Rider Hunt would have no role to play in that regard. Understood in this way, the reference to the role of Rider Hunt in clause 13 of the LOO did not make that clause contradictory to the express terms of the AFL (that is, clause 2.2).

73 Senior counsel for NES contended that the phrase 'manner of payment', in clause 2.2(b)(ii), referred to the question whether payment should be made by cash or cheque. Thus he submitted that that clause did not supersede the requirement in clause 13 of the LOO that payment be made by lump sum.

74 NES contended that by clause 24 of the LOO, the parties expressly agreed to

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33 See [19] above.

incorporate these commercial terms from the LOO into the AFL. So it submits, there were commercial terms omitted from the AFL but present in the LOO and where they were not inconsistent with the AFL they should be incorporated, implied or inferred. Alternatively, NES contended that clause 2.2 was ambiguous such that when the Court was construing that clause, it was entitled to go to the matrix of background facts which included the LOO.

75 NES submitted that the entire agreement clause did not assist Woolworths. It was provided for in the form of lease attached to the AFL but no lease was entered into by the parties. Consequently, it had no role to play.

76 NES submitted that the manner of payment (that is by lump sum) was not a live issue so far as termination was concerned because the parties never resolved their differences as to the amount that the tenant must contribute.

(d) Analysis – proper construction of clause 2.2

77 In our view, properly construed, the AFL did not impose an obligation on the tenant to pay the difference in cost of construction between a Bunnings and Masters store based on a figure verified by Rider Hunt. But the judge did not find that it did. He did not construe the AFL as having imported from the LOO the Rider Hunt verification process.

78 The AFL did impose an obligation to pay, but only once the process for the resolution of differences was complete. Not only the amount but also the manner of the payment fell to be determined through that process. The manner of payment includes not only such things as the mechanics for payment (for example, by bank cheque, electronic funds transfer or some other method) but also timing and whether it would be paid by instalments or as a lump sum. In our view, it is artificial to construe the word 'manner' in clause 2.2(b)(ii), to refer only to the mechanics of payment (such as by cash or cheque) in the commercial context of the case in which the tenant is a large national enterprise. Whether the tenant paid by cash, cheque or

other means could have very little (if any) impact upon the commercial drivers likely to be motivating the parties. As long as the money was received, it is inherently unlikely that the mechanics of payment would make any significant difference, particularly given the identity of the tenant and its guarantor. By contrast, the timing of the payment may be all important from a commercial perspective. For example, if the contribution was to be paid in a lump sum before construction began, this may well have affected the amount, timing and other aspects of additional finance needed for completion of the project. Payment by instalments of the tenant's contribution may have had a different commercial impact. For these reasons, it is most unlikely that commercial parties in the circumstances of this contract would intend that the 'manner' of payment concerned only the mechanics for payment.

79 Contrary to the conclusion of the judge, we do not consider that, on its proper construction, the AFL imposed an obligation on the tenant to pay its contribution by way of a lump sum.

80 As Woolworths submitted, the starting point for the interpretation of the AFL is the AFL itself. Clause 2.2 (b)(ii) is ambiguous to some extent, because it is not clear from the text what differences between the parties, as to the tenant's contribution to the LWC, are to be the subject of the parties' reasonable and good faith attempts to resolve them. To address that ambiguity, it is permissible to consider the surrounding circumstances, which include the LOO.

81 There is, though, no other ambiguity relevant to the issues on this appeal which would lead to regard being had to the LOO such that the conclusion was reached, that as a matter of construction, an obligation was imposed on the tenant under the AFL to pay by way of lump sum. Rather, as the AFL made clear, any difference as to the manner and timing of payment was to be resolved by the parties acting reasonably and in good faith.

82 Nor was an obligation to pay by way of lump sum incorporated into the AFL by virtue of clause 24 of the LOO. Whilst that clause stated that it was *intended* that a

formal agreement for lease would be executed including the commercial terms in the LOO, when the AFL was entered into at a later time, it did not incorporate by reference any of the terms from the LOO. That is understandable given the relatively informal nature of the LOO in contrast to the detailed AFL. Leaving to one side for present purposes the fact that the two agreements were between different entities, it is clear that things had moved on by the time the AFL was entered into and that the process sketched out in the LOO for determining the amount to be paid by the tenant had been superseded by a reasonable and good faith negotiation process.

83 Nor was a term as to payment by lump sum to be inferred. On its face, the AFL was a formal agreement entered into by sophisticated commercial entities with the benefit of advice from lawyers and the preparation of the document by them. It is most unlikely that the parties intended that their agreement would include such an important term yet they did not record it in the written terms of the AFL. Indeed, the fact that the 'manner' of the payment was to be subject to the reasonable and good faith process militates against such a term being inferred.

84 Finally, the criteria for implying such a term are not satisfied. First, it is not necessary to imply such a term to give business efficacy to the AFL. The parties set out a process for how the amount of the contribution was to be arrived and the manner in which it was to be paid. There is nothing to suggest that the AFL would not satisfy its purpose or could not work commercially if there was no provision for how the payment was to be made given that a method was laid down for resolving that issue. Such a term is not so obvious that 'it goes without saying.' Finally, such a term would contradict that process.

85 In conclusion, ground 5.1(b) is made out.

DID WOOLWORTHS BREACH ITS OBLIGATION TO ACT REASONABLY AND IN GOOD FAITH? (Grounds 5.2, 5.3, 5.4, 5.5)

86 Having held that the agreement between the parties included the term that

they were to act reasonably and in good faith to determine (a) the LWC (b) the tenant's contribution and (c) the timing and manner of that contribution, the judge accepted the contention of NES that Woolworths had breached that term. In particular, he found that (a) on 29 March 2010 or 31 March 2010, Rider Hunt had provided to Woolworths an 'estimate' of the clause 2.2(b) amount in the sum of $3,247,195 million;[34] (b) by reason of a review conducted by Rider Hunt between 12 April 2010 and 18 April 2010, Rider Hunt had arrived at an estimate for LWC at $11,516,809, which equated to a clause 2.2(b) amount of $2,941,169;[35] (c) the Rider Hunt 'estimate' was the reason Mr Macmillan sought to exclude NES from the negotiations and the reason Woolworths did not negotiate with NES.[36] The judge also found that the purpose of the open book process was to verify the clause 2.2(b) amount and that that process had been completed at the latest by 15 April 2010.[37]

87 In particular, the judge found that, as at 1 April 2010, there was no 'genuine disagreement' between the parties.[38] At the hearing of the appeal, Woolworths maintained that this finding was 'pivotal or central'; it was 'absolutely fundamental'.

88 Moreover, the judge found that, in order to avoid reaching an agreement, Woolworths prevaricated, doing no more than telling NES that its assessments of the LWC and the tenant's contribution were 'too high' without indicating what those differences were or how their cost should be estimated. The judge found that there were several reasons behind Woolworths' prevarication. First, it had a capex budget for the construction which it had not disclosed to NES.[39] Secondly, it had identified

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34 Reasons [94], [151], [154], [174], [209], [245]. This finding is the subject of ground 5.4(e) of the proposed grounds of appeal.

35 Reasons [265]. This finding is the subject of ground 5.4(f) of the proposed grounds of appeal.

36 Reasons [122], [183], [187], [215]. This finding is the subject of ground 5.4(g) of proposed grounds of appeal.

37 Reasons [119], [123], [154], [157], [174], [177]–[178]. This finding is the subject of ground 5.4(h) of the proposed grounds of appeal.

38 Reasons [85].

39 The judge referred to the existence of the budget and of its non-disclosure several times throughout his reasons. See Reasons, [7], [21], [83], [84], [86], [87], [94], [122], [125], [151],

another site in Bendigo and had resolved to abandon its interest in the Strathdale site in order to pursue the development of the alternative site. Thirdly, it held unjustified (and, so far as the LOO/AFL was concerned, irrelevant) concerns about (a) the ability of NES to proceed with and complete the construction and (b) the attitude of the local municipality to the development.

89 On the hearing of the appeal, Woolworths contended that the judge had made several errors in reaching his conclusion. First, it said that the judge had misconstrued the nature of the communications between Woolworths and its quantity surveyor, Rider Hunt; the quantity surveyor had not settled on a figure for the LWC by late March. Secondly, it said that, in finding that Woolworths had no justification for rejecting the amount for the LWC determined by NES when that figure was less than the amount determined by Woolworths' own quantity surveyor, the judge had failed to recognise that NES figure had not been communicated to Woolworths by 1 April so the comparison found by the judge could not have occurred by 1 April. Thirdly, it said that, in finding that the open book review had been completed by 1 April, the judge had overlooked other findings that he himself had made that the review had continued well into April. In addition, Woolworths contended that there was no basis for the conclusion by the judge that Woolworths prevaricated, and did not enter into genuine negotiations with NES, concerning the LWC, and the tenant's contribution to those costs. Woolworths further submitted that there was no basis for the judge's conclusions relating to the reasons that, he found, motivated that prevarication by Woolworths.

90 For its part, NES contended that all the judge's findings were justified.[40] In

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[154], [159], [163], [169], [178], [182], [183], [187], [188], [204], [212], [213], [215], [226], [228], [238], [241] and [243].

40 NES summarised those findings as follows: Woolworths did not wish openly and willingly to engage in the clause 2.2 process; Reasons [182]. Woolworths sought to exclude NES from the clause 2.2 process until such time as the construction costs could be reduced to a level that was within Woolworths' approved but undisclosed budget; Reasons [183], [187], [204]. Woolworths refused to respond to repeated requests for information as to progress of the open book process by NES; Reasons [184]. Woolworths did not attempt to identify or negotiate differences as to the LWC at the 22 April 2010 meeting; Reasons [189]–[190]. Any

oral submissions, NES pointed out that Mr Macmillan had himself given evidence of what would have been reasonable for Woolworths to do and that it had not done this. Secondly, NES drew a distinction between the persons involved in the open book review process. The differences could only be dealt with by the principals: Mr Blake for NES and either Mr Killesteyn or Mr Macmillan for Woolworths: Vaughans and Rider Hunt were not decision makers. The only role for Vaughans was to expose the basis for its cost estimate on a line by line basis so that Rider Hunt could understand it. Next, NES contended that, under clause 2.2 of the AFL, NES was obliged to do three things: (1) determine the LWC and advise the tenant in writing of the LWC (2) provide, on an open book basis, its costing of the LWC and (3) advise the tenant whether it required the tenant to contribute towards the LWC and the amount of that contribution (if any). By 1 April 2010, all these things had been done. By 1 April, the LWC contribution had been assessed at $3,247,194.55. On 6 April 2010, the figure was reduced below $3 million 'by virtue of removal of some earthworks which were to be at [NES'] cost'. NES contended that, after that, Rider Hunt ceased to assess costs on the line by line basis set out in the spreadsheet that it had amended, but moved to a method of cost assessment which was described as being 'at a macro level', that is cost to construct per square metre and that process was not completed. However, the request for payment of the LWC was made for $3.247 million and it was then reduced by the removal of earthworks costs to the

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differences that Woolworths may have had in relation to the LWC were never identified by it or articulated to NES thereby preventing negotiation to resolve any such differences; Reasons [191]. It would have been reasonable and appropriate for Woolworths to advise NES of the differences identified in the 22 April 2010 Rider Hunt report as to the LWC and for attempts to be made by Woolworths to negotiate those differences and that did not occur; Reasons [193]. As was conceded by Mr Macmillan, on behalf of Woolworths, it was for Woolworths to negotiate with Mr Blake to attempt to resolve the differences as to the contribution to the LWC; Reasons [206]. Woolworths were not willing to provide NES with any detailed or transparent information in support of the bare assertion that NES estimate of the LWC was too high or unacceptable that would enable NES to negotiate in any meaningful way to resolve any differences; Reasons [208]. Woolworths, did not attempt to negotiate or actually negotiate the LWC at the 22 April 2010 meeting; Reasons [209]. Woolworths, with some other object in mind and not being faithful to the contractual obligation in clause 2.2, breached the obligation to act reasonably and in good faith; Reasons [216]. The lack of agreement in respect of the contribution to the LWC was Woolworths' own creation as a basis for terminating the AFL, and this occurred for a variety of reasons that had nothing to do with any inability to resolve differences in relation to the contribution to the LWC; Reasons [246].

figure of $2.9 million.

91 In its oral submissions in reply, Woolworths said that, at trial, NES had submitted that Woolworths had 'embarked on a deceptive course of feigned negotiation' of the LWC. The judge had accepted the submissions of NES that Woolworths had engaged in a 'course of deception' and, in particular, he had held that (a) there was no genuine disagreement at the end of March 2010 and (b) by the middle of that month, the Property Committee had decided to abandon its interest in the Strathdale site. Woolworths said that NES was now contending that those findings could be discounted and that the judgment could be supported on other findings about a 'lack of engagement'. However, Woolworths submitted that, in making his findings, the judge constantly relied upon his findings that Woolworths had engaged in a fraudulent course of deception. Accordingly, his other findings needed to be examined sceptically in the light of his errors about such fundamental matters, rather than generously in the way in which findings of fact of a judge might ordinarily be approached. The contemporaneous written record, which the judge had accepted was the most reliable evidence, did not justify the broad inferences he drew because of his findings that Woolworths had been deceiving NES.

(a) Overview — breach grounds of appeal

92 The grounds of appeal, relating to the issue of breach, are contained in grounds 5.4 and 5.5. They are as follows:

> 5.4 The learned judge erred in making a number of findings and failing to make other findings – leading to the erroneous conclusion that Masters and Woolworths had breached their obligations under clause 2.2(b) and (c), namely:
>
> *'Undisclosed budget'*
>
> (a) the erroneous finding that Woolworths and Masters should have disclosed the $1.7 million 'budget' to NES (Reasons, [163]);
>
> (b) the erroneous finding that the revised NES offer of 6 April 2010 of $2,941,169 was not accepted because it exceeded the 'undisclosed budget' (Reasons, [122], [151], [175], [266]);

(c) the erroneous finding that the real reason that Woolworths and Masters terminated the AFL was their inability to bring the Clause 2.2(b) amount within their 'undisclosed budget' (Reasons, [87], [122], [178], [183], [187], [212], [213], [215], [216]);

(d) the failure to find (including in Reasons, [213]) that NES was precluded from relying on allegations of breach in relation to the 'budget' in circumstances where the allegations were not included in NES's opening, or put to Mr Macmillan (the relevant Woolworths witness) in cross examination;

Rider Hunt's 'estimate'

(e) the erroneous findings that on 29 March 2010 and 31 March 2010 Rider Hunt provided to Woolworths an 'estimate' of the Clause 2.2(b) Amount in the sum of $3,247,195 million (Reasons, [94], [151], [154], [174], [209], [245]);

(f) the erroneous finding that by reason of a review conducted by Rider Hunt between 12 April 2010 and 18 April 2010, Rider Hunt arrived at a LWC 'estimate' of $11,516,809, which equated to a Clause 2.2(b) Amount of $2,941,169 (Reasons, [265]);

(g) the further erroneous findings that the Rider Hunt 'estimate' was both the reason why Mr Macmillan sought to exclude NES from the negotiations and the reason why Woolworths did not negotiate with NES (Reasons, [122], [183], [187], [215]);

Open Book process

(h) the erroneous findings that the purpose of the open book process was to verify the Clause 2.2(b) Amount and that the open book process had been completed at the latest by 15 April 2010 (Reasons, [119], [123], [154(a), (b)], [157], [174], [177], [178]);

Interaction with Vaughans

(i) the failure to find that Woolworths, who had retained Rider Hunt in relation to assessment of the costs, had reasonably believed that [Vaughans] was the counterpart that NES had retained, and that those two representatives were engaged in a process and dialogue to ascertain which costs were properly characterised as part of the LWC;

Masters'/Woolworths' expectations

(j) the erroneous finding that the $1 million figure put forward by Woolworths and Masters could not have been a genuine attempt to resolve the parties' differences in relation to the Clause 2.2(b) Amount (Reasons, [209], [245]);

22 April meeting

(k) the erroneous finding that the parties never engaged in relation to the issue of the Clause 2.2(b) Amount at the meeting held on 22 April 2010 (Reasons, [162], [189]);

(l) the erroneous finding that the failure by Woolworths and Masters to provide to NES the Rider Hunt report (which Woolworths and Masters had received immediately prior to the 22 April meeting) was indicative of an absence of good faith on the part of Woolworths and Masters (Reasons, [163]);

Mutuality of obligations

(m) the failure to find that, in determining whether the obligations of good faith and reasonableness (which the learned judge accepted were mutual: Reasons, [69], [70]) were satisfied, the conduct of Woolworths was to be informed by the conduct of NES;

Masters'/Woolworths' motivations

(n) the erroneous finding that because the Letter of Offer had referred to payment by lump sum, Woolworths' attempt to vary this payment term was an attempt to bring about a difference between the parties that it could rely on as a basis for termination of the AFL (Reasons, [154]);

(o) the erroneous finding that the real motivation for Woolworths' lack of agreement with respect to the LWC and the Clause 2.2(b) Amount was that its Property Committee wished to pursue the alternative Hume & Iser site instead (Reasons, [108], [222], [223], [225], [236], [240]);

(p) the related erroneous findings that the strategy of pursuing the acquisition of the Hume & Iser site was inconsistent with the Property Committee decision that Woolworths would pursue only one store in Bendigo (Reasons, [100], [222]);

(q) the related erroneous inference, based on the absence of evidence adduced by Woolworths from Mr O'Brien or any attendee at the 9 March 2010 meeting, that a decision had been made by Woolworths to pursue the Hume & Iser site by at least 16 March 2010;

(r) the erroneous finding that Woolworths acted in bad faith in terminating the AFL by inter alia acting on matters which were not contemplated by the AFL (Reasons, [87], [183], [246]);

Other findings

(s) the erroneous finding that Woolworths was unwilling to engage with NES in any meaningful way to seek to resolve any differences with respect to the Clause 2.2(b) Amount (Reasons, [208], [211]).

Matters ancillary to clause 2.2

5.5 The learned judge erred in finding that Woolworths and Masters were not entitled to take into account, in deciding following the meeting on 22 April 2010 to terminate the AFL, issues relating to NES' ability to fund the development (Reasons, [235], [237], [238]) or council opposition to the development (Reasons, [229]).

93 It is convenient to deal with those grounds in a different order to that in which they appear in the proposed grounds of appeal. In particular, it is convenient to deal first with grounds 5.4(e) and (f), that address the finding by the judge that as at 1 April 2010, there was no 'genuine disagreement' between the parties relating to the LWC and the tenant's contribution to those costs. Before doing so, it is necessary first to set out some legal principles that apply to these grounds of appeal.

(b) Legal principles — appeal on factual findings

94 Each of the proposed grounds of appeal contained in paragraph 5.4 of the application for leave to appeal, in effect allege error by the judge in reaching a factual conclusion, or factual conclusions, on the basis of which the judge found in favour of NES on the issue of liability. The principles that apply to such a proposed ground of appeal have been traversed in a number of recent decisions of the High Court, and of this Court, and for present purposes, they can be stated reasonably concisely.

95 If leave were given in respect of any of the proposed grounds just mentioned, the consequent appeal before the Court would be by way of re-hearing. In such a case, the Court is required to examine the record and to give the judgment which in its opinion ought to have been given at first instance.[41] If the Court, upon such a review, concludes that there has been a material error of fact by the primary judge, it must give effect to that conclusion.[42]

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41 *Warren v Coombes* (1979) 142 CLR 531, 537 (Gibbs ACJ, Jacobs and Murphy JJ); *Allesch v Maunz* (2000) 203 CLR 172, 181; *Robinson Helicopter Company Inc v McDermott* (2016) 331 ALR 550, 558 [43].

42 *Fox v Percy* (2003) 214 CLR 118, 126-127 [25], 131-132 [41]; *Devries v Australian National Railways Commission* (1993) 177 CLR 472, 481 (Deane and Dawson JJ).

96 In conducting such a review, the Court must make full allowance for the advantages that are available to the judge, that are not shared by this Court, particularly in evaluating the credibility and reliability of witnesses, and of gaining an appreciation of the evidence, and the effect of it, while that evidence is being given.[43] In *Fox v Percy*,[44] Gleeson CJ, Gummow and Kirby JJ said:

> On the one hand, the appellate court is obliged to 'give the judgment which in its opinion ought to have been given in the first instance'. On the other hand, it must, of necessity, observe the 'natural limitations' that exist in the case of any appellate court proceeding wholly or substantially on the record. These limitations include the disadvantage that the appellate court has when compared with the trial judge in respect of the evaluation of the witnesses' credibility and of the 'feeling' of a case which an appellate court, reading the transcript, cannot always fully share. Furthermore, the appellate court does not typically get taken to, or read, all of the evidence taken at the trial. Commonly, the trial judge therefore has advantages that derive from the obligation at trial to receive and consider the entirety of the evidence and the opportunity, normally over a longer interval, to reflect upon that evidence and to draw conclusions from it, viewed as a whole.[45]

97 It is for those reasons that a judge's conclusion, which is based either wholly or substantially on the credibility or reliability of a witness or witnesses of one party, may only be set aside where it is demonstrated to be incorrect, in that it is contrary to incontrovertible facts or uncontested evidence, or if it is either 'glaringly improbable' or 'contrary to compelling inferences'.[46]

98 On the other hand, in general, an appellate court is in as good a position as the judge to decide on the proper inferences to be drawn from facts which are undisputed, or which, having been disputed, are established on the findings of the judge. In deciding the proper inference that is to be drawn, the appellate court should give respect and weight to the conclusion of the judge, but, once having

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43 *Louth v Diprose* (1992) 175 CLR 621, 626 (Mason CJ), 633 (Deane J), 639–40 (Dawson, Gaudron and McHugh JJ).

44 (2003) 214 CLR 118.

45 Ibid, 125–6 [23] (Gleeson CJ, Gummow and Kirby JJ) (citations omitted); see also *CSR Limited & Anor v Della Maddalena* (2006) 224 CLR 1, 7 [16] (Kirby J).

46 *Fox v Percy* (2003) 241 CLR 118, 128 [28]–[29]; *Devries v Australian Postal Commission* (1993) 177 CLR 472, 479.

reached its own conclusion, it must give effect to it.[47] In that respect, however, it must be borne in mind that, commonly, the relationship between a finding of a particular primary fact or facts, and the drawing of an inference or inferences, is not entirely separate and discrete. As this Court stated in *Box Hill Institute of TAFE v Johnson*:[48]

> while an inference is a conclusion based on established facts, nevertheless the interplay between the finding of a particular fact or facts, and the drawing of a conclusion, is not entirely discrete. The drawing of an inference, or reaching of a conclusion, is necessarily affected by precisely how and for what reasons a judge may have accepted, or rejected, a particular piece of evidence which is important to the drawing of that inference or conclusion. Secondly, in a civil proceeding, a judge may only draw an inference or reach a conclusion in favour of a party on whom the onus of proof lies, if that inference or conclusion is the more probable inference or conclusion available on the facts of which the judge is satisfied. The question whether an inference is more probable than another may be affected by the judge's view of particular facts relied on in support of any competing inference, or of facts relied on to contradict the inference ultimately formed by the judge.[49]

(c) Legal principles — act reasonably and in good faith

99 The content of the contractual duty to act reasonably and in good faith was not in issue in the appeal. The judge set out the relevant law in respect of the duty, in comprehensive terms, in the Reasons.[50] Woolworths submitted that although the judge accurately set out the relevant legal principles, on a number of occasions the judge misapplied the principles by bifurcating the expression 'reasonably and in good faith.' In essence, Woolworths' submissions reduced to criticisms of many of the judge's findings of fact and his conclusions based on those findings that Woolworths had not acted reasonably and in good faith. Those matters are dealt with in detail below. Before turning to them, it is sufficient for present purposes to

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47 *Warren v Coombes* (1979) 142 CLR 531, 551; *Fox v Percy* (2003) 241 CLR 118, 126–7 [25]; *Marriner & Ors v Australian Super Developments Pty Ltd* [2016] VSCA 141, [141].

48 [2015] VSCA 245.

49 Ibid [37] (citations omitted); see also *CSR Limited & Anor v Amaca Pty Ltd & Anor* [2016] VSCA 320 [135].

50 Reasons [56]–[74].

note that the contractual duty to act reasonably and in good faith encompasses the basic obligations (a) to act honestly and with fidelity to the bargain; (b) not to undermine the bargain or the substance of the contractual benefit bargained for; and (c) to act reasonably and with fair dealing having regard to the interests of the parties (which will, commonly, at times be in conflict), and to the provisions and objectives of the contract, objectively ascertained.[51] The obligation does not require that a party subordinate its legitimate interests to those of the other party.[52] The content of the obligation is informed by the contractual, commercial and factual context.[53]

(d) Legal principles — drawing of inferences

100 The conclusions of the judge, which are the subject of grounds 5.4 and 5.5, largely consist of inferences drawn by the judge based on primary facts that were established by the evidence.

101 The principles, relating to the drawing of inferences in civil cases, are well established. First, any inference must be based on facts established by admissible evidence. Secondly, the process of reasoning must constitute a valid inference, as distinct from speculation or guesswork. Thirdly, and importantly, where the inference is drawn in favour of the party which bears the burden of proof in the case, the conclusion must be 'the more probable inference' from those facts. In other

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51 *Paciocco v Australia and New Zealand Banking Group Ltd* (2015) 236 FCR 199, 273 [288] ('*Paciocco*'); Reasons [60]. See also *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228 [28] (Buchanan JA with whom Warren CJ and Osborn AJA agreed); *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service* [2010] NSWCA 268 [12]; *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 263–68; *Hughes Bros Pty Ltd v Trustees of the Roman Catholic Church for the Archdiocese of Sydney* (1993) 31 NSWLR 618; *United Group Rail Services Ltd v Rail Corporation New South Wales* (2009) 74 NSWLR 618, 634–40 [56]–[77] (Allsop P with whom Ipp JA and MacFarlan JA agreed); *Coal Cliff Collieries Pty Ltd v Sijehama Pty Ltd* (1991) 24 NSWLR 1, 22–7 (Kirby P, with whom Waddell AJA agreed. Handley JA agreed the appeal should be allowed, but said that a duty to negotiate in good faith was illusory).

52 *Paciocco* (2015) 236 FCR 199, 273 [289]; *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service* [2010] NSWCA 268 [13], [17], [147].

53 *Paciocco* (2015) 236 FCR 199, 273 [209]; *Macquarie International Health Clinic Pty Ltd v Sydney South West Area Health Service* [2010] NSWCA 268 [137].

words, the inference drawn by the judge must be reasonably considered to have a greater degree of likelihood than any competing inference.[54] Fourthly, in determining whether an inference is to be drawn as a matter of probability, the tribunal of fact is not required to consider each primary fact, established by the evidence, in isolation. Rather, the Court considers the totality of those facts together, giving effect to their united and combined force.[55]

102 In its recent decision in *Marriner & Ors v Australian Super Developments Pty Ltd*,[56] this Court summarised the relevant principles as follows:

> A party seeking to establish that an inference ought to be drawn must demonstrate that that inference is the more probable one which arises from the established facts. The inference must be based on evidence rather than speculation.
>
> In *Holloway v McFeeters*, in the context of a claim for damages for a death caused by a vehicle collision, Williams, Webb and Taylor JJ explained the process the court will undertake when drawing inferences in the following often cited passage:
>
> > Inferences from actual facts that are proved are just as much part of the evidence as those facts themselves. In a civil cause 'you need only circumstances raising a more probable inference in favour of what is alleged ... [W]here direct proof is not available it is enough if the circumstances appearing in evidence give rise to a reasonable and definite inference; they must do more than give rise to conflicting inferences of equal degree of probability so that the choice between them is mere matter of conjecture... All that is necessary is that according to the course of common experience the more probable inference from the circumstances that sufficiently appear by evidence or admission, left unexplained, should be that the injury arose from the defendant's negligence. By more probable is meant no more than that upon a balance of probabilities such an inference might reasonably be considered to have some greater degree of likelihood'.
>
> The questions of whether an inference is open as a matter of

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54 *Luxton v Vines* (1952) 85 CLR 352, 358 (Dixon, Fullagar and Kitto JJ); *Holloway v McFeeters* (1956) 94 CLR 470, 480–81 (Williams, Webb and Taylor JJ); *Naxakis v Western General Hospital & Anor* (1998) 197 CLR 269, 284–5 [45] (McHugh J); *Transport Industries Insurance Co Limited v Longmuir* [1997] 1 VR 125, 129-130 (Winneke P), 141 (Tadgell JA); *Chapman v Cole* [2006] VSCA 70 [14] (Callaway JA); 15 VR 150, 154.

55 *Plomp v R* (1963) 110 CLR 234, 242 (Dixon CJ); *Chamberlain v R* (No 2) (1984) 153 CLR 521, 535–536 (Gibbs CJ, Mason J); *Shepherd v R* (1990) 170 CLR 573; *R v Bayden-Clay* (2016) 334 ALR 234 [4], 248–249 [70]–[71].

56 [2016] VSCA 141.

> probability and whether that inference is the more probable one are to be determined by considering the combined weight of all the relevant established facts rather than by considering each fact sequentially and in isolation from the other facts.
>
> Whether one inference is more probable than another may be affected by the judge's view of the facts relied upon to support or contradict the competing inferences and why any evidence which is important to any of those inferences should be accepted or rejected.
>
> A judge's finding as to the most reasonable and probable explanation for a state of affairs, if it is a correct finding, remains correct notwithstanding that other possible explanations for the known facts cannot be excluded.[57]

(e) Ground 5.4(e) — the Rider Hunt 'Estimate' of the Clause 2.2(b) Amount

103 Ground 5.4(e) is directed to the finding by the judge, that on 29 and 31 March 2010, Rider Hunt provided to Woolworths an estimate of the clause 2.2(b) amount in the sum of $3,247,195.[58]

104 At trial, NES had contended that the open book review process commenced on 12 March 2010 with a meeting between Vaughans, Woolworths and Rider Hunt and that the open book review process ended on 1 April 2010 when Rider Hunt reported back to Woolworths. NES says that, at the conclusion of the open book review process, Rider Hunt estimated that the LWC that would be payable was $3,247,195.[59]

105 The judge concluded that Rider Hunt was advancing as its own estimate the total figure of $3,247,195. In reaching that conclusion, he relied particularly upon the email sent on 29 March 2010 by Mr McDonald of Rider Hunt to Mr Bob Killesteyn and Mr Macmillan of Woolworths, to which Mr McDonald attached what is described below as the 'amended spreadsheet'. The judge added that the Rider Hunt figure was 'materially greater than the revised contribution amount that NES had

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57 Ibid [73]–[77] (Tate ACJ, Kyrou and Ferguson JJA) (citations omitted).

58 Reasons [94], [151], [154], [174], [209], [245].

59 Reasons [121].

sought from Woolworths of $2,941,169'.[60]

106 The judge expressed his findings as follows:

> On 31 March 2010, Mr Blake received a telephone call from Mr Macmillan. In this conversation Mr Macmillan again said that the Vaughan Constructions estimate was not acceptable, yet again failed to provide any explanation as to why. Mr Macmillan did not identify any specific issue with the Vaughan Constructions estimate and offered no alternative. Mr Blake offered to obtain quotes from other builders if Woolworths could identify any who would be prepared to quote for the work. No such names were ever provided by Woolworths to Mr Blake. In the circumstances, the only explanation for Mr Macmillan stating that the Vaughan Constructions estimate was 'not acceptable' on 31 March 2010, particularly where the revised NES estimate of 26 March 2010 was materially less than the 29 March 2010 estimate from Woolworths' own quantity surveyor, [Rider Hunt], is that the Landlord's Works Costs still exceeded Woolworths' approved but undisclosed budget.[61]

107 Several propositions are included in this passage. First, on 26 March 2010, NES had provided to Woolworths its revised estimate. Secondly, the judge found that that spreadsheet which he called 'the Vaughans estimate' (of the contribution that was to be made by Woolworths) corresponded to the 'NES estimate'. Thirdly, he found that, on 29 March 2010, Rider Hunt, which was Woolworths' own quantity surveyor, had provided an estimate to Woolworths. Fourthly, he found that NES estimate (of 26 March) was 'materially less' than the Rider Hunt estimate. The conclusion, unstated, is that, as its own quantity surveyor had estimated its contribution as much higher than that estimated by NES, Woolworths had no justification in not accepting the lower estimate provided by NES.

108 It will be noticed that the judge was here comparing the 'revised NES estimate' with the Rider Hunt estimate of 29 March 2010. It is clear that he took it as a matter of bad faith on the part of Woolworths that it did not accept that NES

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60 Ibid.

61 Reasons [122]. On the hearing of the appeal, Woolworths described this finding as the 'central finding' in the judgment below, one that 'permeates' the judgment. The finding is also apparent in Reasons [85], [86]. See also [174]: 'Moreover, by the end of the line by line part of the open book review process, Rider Hunt estimated the Landlord's Works Costs at $3,247,195'. Subsequently, the judge fixes 15 April 2010 as the date beyond which there was no genuine disagreement between the parties; Reasons [175]–[178].

estimate given that it was less than that of Rider Hunt. The comparison formed a vital part of the judge's reasons. The refusal of Woolworths to accept NES' estimate, given that it was lower than that provided by Woolworths own quantity surveyor, demonstrated that Woolworths was proceeding in bad faith.

109 However, three matters should be noted. First, in their letter of 26 March 2010, the solicitors for NES had identified a figure which was provisional: it was described as:

> (less the cost of any earth works and power connection costs to the land which our client will be happy to estimate on your client's request).

110 Secondly, no further figure had been supplied to Woolworths as at the end of March. As will appear below (and as was accepted by NES on the appeal), the revised NES estimate was not provided to Woolworths until 6 April 2010, and, even then, the estimate provided was not a final estimate. The comparison that the judge found to be pivotal was not one that could have been made at the end of March 2010.

111 Thirdly, the judge's finding that Woolworths own quantity surveyor had provided an estimate by the end of March 2010 in the 'amended spreadsheet' cannot be sustained.[62]

The chronology

112 The events leading up to this proceeding are set out above at [5]-[40]. It is now necessary to examine some of these events in closer detail. Both of the parties urged this Court to examine closely the record of contemporary communications. As indicated above, the judge said that, given the passing of time, they represent the best evidence of what the parties were saying and doing in 2009-2010. We agree. The course we propose to adopt is to set out those communications and the evidence of the witnesses that were collateral to those communications in strict chronological

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62 On the hearing of the appeal, the parties gave a great deal of attention to the content of the 'amended spreadsheet', and its meaning.

order. In some ways, it will make this part of our reasons laborious; but, we see no alternative. The contention that the judge misunderstood the evidence that was before the Court is at the heart of this appeal.

113 In his reasons, the judge summarised the attempts by the parties to determine the cost of the construction of a Masters store on the Strathdale site as well as the cost of building a Bunnings store on the same site.[63]

114 In July 2009, Mr Macmillan reported to Richard Champion who was Woolworths' National Property Manager. Mr Champion reported to Grant O'Brien, Woolworths' General Manager for Business Development. Mr Macmillan worked with Bob Killesteyn, the National Construction Manager for Masters. In July 2009, Mr Macmillan appointed Rider Hunt to undertake a costs review of what was called 'Design Kit Rev A' so that Masters would have a general price comparison for the likely cost to construct a Masters store in each state compared against tenders received from builders for the construction of specific Masters stores.

115 On 31 August 2009, Mr Macmillan received an email from Ewan McDonald, a director of Rider Hunt, which attached an estimate of costs to construct a generic Masters store based on the scope of works in the Design Kit Rev A. Rider Hunt estimated the costs for constructing a generic Masters store of 13,362m² to be $15.4 million. It also estimated the difference in cost to build a Bunnings store to be approximately $3,266,000. At a meeting held shortly thereafter, the Rider Hunt estimate was rejected as too expensive.[64]

116 In September 2009, before a revised Design Kit had been prepared, Mr Blake approached Mr Steve Troon of H Troon Pty Ltd ('Troons'), a Ballarat based national building and construction firm, with a view to their constructing the Masters store

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63 During the hearing of the appeal, Woolworths handed to the Court a document entitled '*NES v Masters & Woolworths – Chronology of Key Events*'. NES handed to the Court a document entitled '*Respondent's Chain of Events leading up to the 22 April 2010 Meeting*'.

64 Reasons [89].

on the Strathdale site (at the time, Troons were working with Mr Blake on the construction of a Bunnings store in Ballarat). Mr Blake provided Troons with a brief for the cost of constructing a Masters store on the Strathdale site. In the brief to Troons, it was stated that the rate to construct a 10,535m² 'Woolworths' warehouse was $780 per m² plus GST, excluding head works, external boundary works and full height precast concrete panels. Troons provided an estimate of $8,467,300 plus GST as the price including the full height precast concrete panels. The additional cost of the full height precast concrete panels was expressed as a range, which produced a rate of between $804 per m² and $808.50 per m². These prices represented Troons' estimate of the cost of building a 10,535m² 'Bunnings' warehouse. Woolworths' revised brief was not available at this time.

117 By December 2009, Woolworths had developed a new design brief which became known as Design Kit Rev B.

118 On 10 December 2009, Woolworths received an estimate from another quantity surveyor, Slattery, which estimated the cost of building the generic Masters store, based on Design Kit Rev B, at $11,950,000 (or $885 per m²).

119 On 18 December 2009, Rider Hunt provided to Woolworths their first design brief comparison based on Design Kit Rev B. Rider Hunt estimated the cost of a generic Masters store with a total enclosed area of 13,465m² at $12,104,354 (or $899 per m²). Rider Hunt estimated the cost difference with a comparable Bunnings store to be $1,176,562.[65] The judge found that it was on the basis of this estimate that the cost difference for the Strathdale store would be 'roughly $1 million'.[66]

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65 Reasons [91].

66 Reasons [91], fn 184. The exact cost difference was estimated by Rider Hunt to be $1,176,562; Reasons [91]. That evidence had been given by Mr Macmillan who gave evidence that, on the strength of the estimate provided by Slattery and Rider Hunt on Design Kit Brief Rev B, his expectation of the tenant's contribution was '$1million'. About this estimate, the judge said (at [91], fn 184): 'This estimate was for a 13,465 square metre store, which is larger than the 10,923 m² store at the Strathdale site. It was on this basis that Woolworths' expectations were that the Strathdale store would cost roughly $1 million'.

120 On 13 January 2010, Woolworths provided Mr Blake with access to Design Kit Rev B.[67]

121 On 28 January 2010, Mr Blake contacted Vaughans and asked them for a quote for the construction of a Masters store on the Strathdale site.

122 On 3 February 2010, Rider Hunt provided Woolworths with a further estimate for the cost of a generic Masters store. This estimate was with respect to a store of 13,676m² and was for a sum of $12 million, which translated to a rate of $877 per m².[68] The judge found that this was the final cost plan prepared by Rider Hunt for a generic Masters store of 13,500m² based on Design Kit Rev B, and was the generic cost plan that, thereafter, was referred back to by Rider Hunt, although the target cost plan for individual sites would vary from site to site on 3 February 2010.[69]

123 On 16 February 2010, NES adjusted the Troons estimate to reflect a store area of 10,738m², which resulted in an estimate to construct an equivalent Bunnings store on the Strathdale site of $8,375,640 plus GST for a full height precast building.[70]

124 Despite his approaching several builders, Vaughans was the only builder prepared to provide Mr Blake with a quote for the construction of the store in Strathdale. By 1 March 2010, he had been unable to secure a quote from any builder other than Vaughans.[71] On 1 March 2010, Vaughans provided NES with a quote to construct a Masters store at the Strathdale site in Bendigo based on Woolworths'

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67 Reasons [91].

68 Reasons [92].

69 Reasons, [91]. See also Reasons [109].

70 Reasons [109]. In his original brief to Troons, Mr Blake sought an estimate for a rate to construct a 10,535m² 'Woolworths' warehouse was $780 per m² plus GST, excluding head works, external boundary works and full height precast concrete panels. As to the latter, Mr Blake quoted a price of $8,467,300 plus GST as the price including the full height precast concrete panels. The original Troons estimate provided in October 2009 to NES was $780 per m² plus GST which was based on a 2,100 millimetre concrete dado wall with metal clad elevations, but subject to some exclusions. The estimate of $8,467,300 plus GST included a full height precast building.

71 Troons told Mr Blake that it would not be involved in constructing a store for Woolworths due to its commercial ties to Bunnings; Reasons [90].

final specifications.[72] That quote was $12,348,061 plus GST for a 10,923m² store, being the 10,738m² store contracted for plus a 185m² first floor equipment area.[73]

125 On the same day, Mr Blake emailed the Vaughans quote to Mr Macmillan of Woolworths.[74] Mr Macmillan reviewed the estimate that Mr Blake had sent him.

126 Having reviewed the estimate, Mr Macmillan noted: (a) Vaughans' calculations of the LWC was based on a total building area of 10,923m², which was 185m² larger than the total building area specified in the Reference Schedule to the AFL (b) Vaughans' estimate included two cost saving alternatives in relation to the rear trade roller shutter door, neither of which Mr Macmillan considered to be feasible and (c) the estimate was high considering the estimates that Masters had received from Rider Hunt and from Slattery in late 2009. Each of these quotes had been based on Design Kit Rev B for a store of 13,500m². As the Strathdale site was for a smaller store of 10,738m², Mr Macmillan considered the cost for construction the Strathdale store should have been less than the cost for construction a larger 13,500m² store.

127 On 2 March 2010, Mr Macmillan spoke to Mr Blake by telephone. He told Mr Blake that he considered the estimate provided by Vaughans to be 'too high' and that he had arranged for Rider Hunt to evaluate the costs. He told Mr Blake that (a) the cost saving alternatives in the estimate were not acceptable as they were not based on a benched and levelled site and (b) the estimate was higher than Masters' cost estimate undertaken for larger stores.[75]

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72 The judge found that the final version for the design plans and specifications for the Bendigo Masters Store was completed by Woolworths in January 2010.

73 Reasons [110]. Counsel for the NES said that, in reaching his conclusion that Woolworths breached its clause 2.2 obligation, the judge made it clear that 'he placed great weight on the documentary evidence'.

74 Reasons [110]. Vaughans had been retained by Woolworths to construct other stores. On 2 March, Mr Jordan Grigg wrote to Mr Blake explaining to him that there were features of the estimate that Vaughans had provided to Mr Blake (and which he had forwarded to Woolworths) that made it seem rather expensive.

75 Mr Blake was cross examined on how he understood the emails from Vaughans that

128 On the same day, Mr Grigg of Vaughans sent to Mr Blake what he described as 'a summary of "rate/sqm's" that we are discussion [sic] with Woolworths regarding their store specification'. The summary diagram showed the following:

Bunnings		WOW Oxygen[76]
$780/m²	Building 10,923m²	$1064/m²
$66/m²	Siteworks $693k	$66/m²
$846/m²	Bendigo Building 13500m²	$1,130m² $1047/m²

129 Mr Grigg warned Mr Blake that Woolworths may find the estimate expensive as, it appears, Vaughans was at the time providing Woolworths a quote for another store at Hawthorn. Mr Grigg explained that 'The issue is how you may be treating the siteworks component in your discussions with [Woolworths]. I am certainly not getting into any detail with Tim MacMillan (sic) on this issue but with the $/sqm numbers he has in front of him it will be an obvious question to one of us shortly.'[77] In this regard, the summary he sent indicated that Woolworths knew about the figures of $780 per m², $1,130 per m² and $1,047 per m² in the table above.

Woolworths would find the estimate too high. Inter alia, he said that he did not know that Vaughans were also working elsewhere for Woolworths. Mr Macmillan was also examined as to what he said to Mr Blake upon receiving the Vaughans estimate. He said that he told Mr Blake that the quote for the smaller Strathdale store was higher than the greater 13,500m² store. Mr Macmillan was also cross examined on whether the estimate was too expensive. Mr Macmillan explained that since the Design Kit Rev B came out, his expectation was that the extra cost of a Masters store was $1 million. His evidence about what he said to Blake at the beginning of March was not challenged.

76 As noted above at [5], the rollout of Masters stores was known as Project Oxygen. WOW was shorthand for Woolworths.

77 This is not addressed in the Reasons. At Reasons [113], the judge makes reference to Mr Grigg's pointing out why the estimate may seem expensive to Woolworths. Vaughans had undertaken significant construction work for Woolworths; Reasons [115].

130 In a later email of the same day, Mr Vaughan wrote to Mr Grigg and to Mr Blake as follows (omitting formal parts):

> The simple rate comparison is a bit simplistic and can be misleading eg
>
> The Bunnings building on the Bendigo site would need to be drawn on the Bendigo site to determine the levels etc
>
> The Bunnings building probably would not need as many retaining walls etc as does Woolworths store.
>
> The Bunning [sic] may not have the rear loading issue either deleting the retaining walls?
>
> All these changes would mean the site works/retaining walls component will be less for a Bunnings than it is for a Woolworth's [sic] layout.
>
> You see my point? The $66/m² is ok for general comparison but if we get done [sic] to tin tacks we will need to do a Bunings [sic] layout and Bunnings site works design to very accurately compare the site works costs for each occupant.
>
> See me to discuss further.

3 March – 30 March 2010

131 On 3 March 2010 (despite the advice from Vaughans that there were aspects of the estimate that Woolworths may find confusing given the other information which they had and Mr Macmillan's telling Mr Blake why the Vaughans' quote for Strathdale was too high), NES provided to Mr Macmillan its formal estimate of LWC, in the following terms (omitting formal parts of the letter from Mr Blake to Mr Macmillan):

> **Strathdale Home Improvement Centre Landlord's Works Costs] Estimate**
>
> We write regarding our recently provided Vaughan Constructions Pty Ltd cost estimate for the construction development of the Strathdale Home Improvement Centre and to complete our obligations under Sec. 2.2(a)(i)–(iii) of the Strathdale (Bendigo) Agreement for Lease and Lease.
>
> We have determined and provided the open book costing of the Landlord's Works Costs.
>
> We confirm the construction estimate is based on the plan SK04 as attached to the Agreement for Lease. The cost estimate is:
>
> **$12,348.061.00 plus GST.**

> Under the provision of Woolworths Letter of Offer of 2 June 2009 (item 13) we confirm the construction estimate for an alternative trade supply development for this site is:
>
> **$8,375,640.00 plus GST.**
>
> Accordingly we confirm the lump sum contribution the tenant is required to contribute to the Landlord's Works Costs is:
>
> **$3,972,421.00 plus GST.**
>
> Please confirm your acceptance of the Tenant's works costs for this development.
>
> We look forward to receiving your response.[78]

132 Later on 3 March 2010, Mr Grigg of Vaughans emailed Mr Macmillan with an estimate for a Masters' store at Hawthorn (that Vaughans had been retained by Woolworths to build). The estimated cost of construction was $1,047.74 per m². Mr Macmillan noted that (a) the estimate was considerably higher than that provided by Rider Hunt in December 2009 (13,465m² at $899 per m²); (b) the estimate for the tenant's contribution was between $2.5 million to $3 million for a 13,500m² store whereas the letter from NES provided for a contribution of almost $4 million on a 10,738m² store; and (c) he could not reconcile the estimates provided by Vaughans for a generic Masters store and that provided by them for Strathdale.

133 In cross examination, Mr Macmillan gave evidence that he compared NES/Vaughans quotation with those provided by Rider Hunt and Slattery late in 2009. In each of those cases, the estimate for the difference in the construction of a Masters store over that for a Bunnings store was about $1 million. In the quote from NES/Vaughans, the difference was almost $4 million.[79]

Open book costings

134 On 9 March 2010, Mr Blake told Vaughans to provide its open book costings to Woolworths. He sent an email to the builder as follows:

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78 Reasons [114].

79 As appears at [119] above, Rider Hunt had given an estimate of the tenant's contribution to LWC as $1,176,562.

Costs Estimate under the WOW AfL

Sec. 2 (a) (ii)

Last week I provided Woolworths a copy of your WOW Home Improvement Centre estimate in accordance with our AfL provision Sec. 2.2 (confidential extract attached).

I was today advised by my lawyers that my letter to WOW lacked the necessary detail to properly comply with the requirement of Sec. 2.2.

Item 2.2 (a) (ii) required the Landlord to provide its costing on an "open book" basis. The estimate I provided WOW is not considered to be "open book". I am advised that in order to properly fulfil the requirements I am required to provide all the costings to WOW, not just the final figures, or alternately, access to the workings by WOW in the likely event they will ask their assessors/QS to view the file.

Letter of Offer

Our Letter of Offer from WOW for this site requires us to ascertain the construction price of a comparable dimensioned "warehouse style hardware store, (full height pre-cast)" e.g. Bunnings and use that base cost to establish any amount the Tenant is required to contribute to the construction under Sec 2.2 (a)(iii) as the difference between the "Bunnings style" base cost and the WOW cost.

The current estimate provided by Vaughan allows a range of options not currently provided under our current comparable hardware store estimate. Could you please therefore remove the following items from your estimate and provide a fresh estimate with these items separately itemised:

- Power authority head works; and
- Site levelling with a fall greater than 300mm across the site.

This will assist us in providing comparable estimates.

Comparable Estimate

If you are able would you please assist us by providing a comparable D & C estimate for an "alternative hardware warehouse" e.g. Bunnings using the WOW site plan and external dimensions on the following basis:

- Warehouse of total dimensions 10,738m² on a 24,700m² site;
- full height pre cast panels;
- full architectural documentation;
- DA application costs excluded;
- power authority head works excluded;
- fall no greater than 300mm across the site.

> Could you also advise if you are comfortable providing the "open book" costings for WOW's inspection.
>
> Please contact me if you have any questions.

135 On 11 March 2010, Mr Grigg sent an email to Mr Blake and to Mr Matthew Vaughan which included the following:

> Further to your email request below and our discussions, I confirm we are currently undertaking the 3 items you have requested as per below:
>
> 1. Cost Estimate under WOW AFL – We confirm that a meeting with WOW & [Rider Hunt] has been scheduled for this Friday at our office to undertake an initial discussion on the difference between Warehouse Style Hardware Store Specification and WOW Project Oxygen Specification. At this meeting we will make available to WOW our Bill of Quantities for inspection and assessment at our office in an 'open book' forum and discuss any queries. I will contact you following this meeting to discuss progress and the proposed mechanism for further investigation on identified differences.
>
> 2. Letter of Offer (Comparable Construction Price) – We are currently making adjustments to our original cost estimate for the two deductions you mention below along with deletion of DA costs and will provide Revised Figure ASAP.
>
> 3. Comparable Estimate for Alternative Hardware Warehouse (Full height precast on 10,738m² Bldg area) – We are currently preparing an Estimate for this option and will confirm our cost ASAP for your comparable D&C purposes.
>
> Please contact me should you require any further information.

136 On 12 March 2010, a meeting took place between Mr Grigg, Mr Eric Law and Mr David Smith (all of Vaughans) Mr Ewan McDonald (Rider Hunt) and Mr Bob Killesteyn (Woolworths).

137 Mr McDonald gave evidence that, at the meeting, several matters were discussed. In particular, he said that he was asked to review the design briefs and to determine the differences in works between a Masters store and a generic Bunnings store. He was told that funding for fitout items that were to be supplied and installed by NES were to be paid from the retail section of Project Oxygen and were not to be considered as part of the generic base building costs. Finally, there was an agreement that Rider Hunt and Vaughans would exchange a list of differences

between a generic Bunnings hardware store and the generic Masters Design brief.

138 After the meeting, Mr Grigg (Vaughans) sent an email to Mr McDonald (2.15pm).[80] The email included a list of items that were to be followed up. It also included, as an attachment, the 1 March 2010 Vaughans estimate based on a 10,923m² store. Omitting formal parts, the email said:

> Confirming our meeting discussions today, below as an action list of items for VC/RLB to follow in terms of documentation transfer asap to facilitate a productive meeting at 3:30–4pm on Tuesday 16th March at our office:
>
> 1. VC – to provide copy of submission to developer (attached to this email).
>
> 2. VC confirm the 'Bunnings' specification referred to in our correspondence is always our recent Bunnings Hardware store at Gaffney St Coburg Vic. Due to client confidentiality we cannot provide any specific documentation for Woolworths [sic] reference. We note the current agreement with the Developer at Bendigo does not refer to any specific Bunnings store specification but merely 'warehouse style hardware store, (full height pre-cast)'.
>
> 3. VC – provide breakup of VC understood 'extra cover' list from standard Bunnings specification.
>
> 4. RLB – provide breakup of anticipated Oxygen 'extra cover' list from standard Bunnings specification.
>
> 5. RLB – confirm Fitout Brief and Items list
>
> 6. RLB – provide understood Braybrook changes 'extra over' list.
>
> If this information can be provided ASAP as possible [sic] it would be much appreciated and we look forward to our Cost & Scope Review meeting on Tuesday.

139 Mr McDonald gave evidence that he had not previously seen the estimate provided by Vaughans on 1 March 2010. When he reviewed it, he noted that it was based on a 10,923m² store and was for a total of $12,348,061 (excluding GST) or $1,130.46 per m². He said that he noted several matters, each of which he considered should be deducted: (a) site levelling costs and a rear roller shutter door; (b)

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80 Mr Grigg originally sent the same email to Mr McDonald at 2.01pm but without the attachment.

provisional sums for authority contributions (namely, substation costs and water and sewer contributions) which he considered should not be included in the estimate as base building works typically exclude authority contributions and associated charges; (c) provisional items for fitout works which he considered should have been deducted from the estimate as these works were to be either carried out and paid for directly by Masters or were to be carried out by NES and paid for separately by Masters as tenants works; and (d) costs for town planning and detailed design works for building permits and construction.

140 Later on 12 March 2010, Mr Grigg reported to Mr Blake (3.34pm) on the meeting that had taken place earlier that day as follows:

> Confirming our discussion today, Vaughans held an initial discussion meeting at our office this morning at 8am with Woolworths (Bob Killesteyn) and Rider Levett Bucknall (Ewan McDonald).
>
> At this meeting we discussed the following topics:
>
> 1. Breakup of current price for Bendigo
>
> 2. Treatment and estimate of site specific costs
>
> 3. Recommended design changes to cater for site levels
>
> 4. Identified cost differences between Woolworths Hardware and Bunnings specification (eg. $3m extra over cost on base building)
>
> 5. Open book discussion (at high level) regarding these individual extra over costs
>
> 6. Mechanism for undertaking detailed assessment and open book review of extra over cost differences between Woolworths expectations and Vaughan identified items.
>
> 7. Developer/Woolworths date for final sign off being 20th April and programme of how to ensure fast tracked process is implemented to enable agreement on final extra over cost difference well before this date.
>
> We confirm a meeting has been scheduled at our office on Tuesday 16th March at 3:30-4pm to undertake the detailed "open book" assessment and we will report to you following completion of this meeting.

141 Later that night (10.36pm), Mr Blake forwarded to Mr Macmillan the email he had received from Mr Grigg the same day. He added:

> Thank you for arranging the meeting with Jordan Grigg allowing your team to view the 'open book' constructing costing as provided by Vaughan Constructions for the Bendigo Home Improvement centre. I am advised that there is a subsequent meeting arranged for Tuesday 16th March to finalise the inspection.
>
> I would be grateful if you could advise me of any costing issues that do not accord with WOW's expectations or any amendments to the Design Kit that may influence the construction cost.
>
> We have not received any information relating to the project from you for some time.
>
> I would also appreciate an update to the progress with the Planning Minister as I have not received any information on this matter either.

142 On 15 March 2010 (8.47am), Mr Grigg confirmed to Mr Blake that there was to be a meeting at nine am on Wednesday 17 March 2010 at Vaughans' offices.

143 On 15 March 2010 (9.09am), Mr Grigg then sent Mr McDonald an email to which was attached a document entitled 'Attached Breakup of Vaughan assessed Oxygen "Extra over" list from Coburg Bunnings'.

144 Mr McDonald gave evidence that, on reviewing that document, he noted that the costs of certain items were included by Vaughans in the Masters store, but not in the Bunnings store. In particular, the estimate included $455,000 for 'Fit-out PC & Provisional Sums', which Mr McDonald considered should not be included as they were to be funded separately and not to be included in the calculation of base building costs. He also noted that Vaughans had acknowledged that the provisional sums included in its estimate were for a larger retail store and could be reduced to account for the smaller building.

145 Mr McDonald sent an email to Mr Grigg (which he copied to Bob Killesteyn and Eric Law) and asked for confirmation that the fitout items were to be excluded from the calculation of the base building works for the estimate of the LWC as follows:

> Please find attached the list of fitout items including the scope of fitout works included in the base building to be paid by Oxygen. Any queries please call. The base building offer should exclude any fitout items, a separate price is required for the items nominated as 'installed during base building

construction – (paid by Oxygen)'.

146 Later that morning, Mr Killesteyn responded to Mr McDonald's email that had been copied to him. He wrote:

> Thanks Ewen
>
> As I understand it the Bendigo Store is a smaller store than the Generic Base Bldg, hence if Vaughan's [sic] have used the PC sum schedule this would be in some cases larger sums than would be realistically required
>
> If this is the case can you have a look at this.

147 Mr McDonald discussed the matter with Mr Killesteyn and was given permission by him to send to Mr Grigg the costs comparison that had been prepared by Rider Hunt in late 2009 'for a Project Oxygen v Bunnings comparison'. Mr McDonald gave evidence that the comparison was the one that had been prepared on 18 December 2009 and had estimated the difference as $1,176,000. As indicated above at [119], he had sent that comparison to Mr Macmillan on that date.

148 Later on 15 March 2010 (5.22pm), Mr McDonald responded to Mr Griggs' email (of 9.09am) as follows:

> Please find attached our comparison with the Bunning brief for discussion tomorrow after noon. Please note that this excludes the floor. There are a number of differences between us but [I] believe these can be clarified when we meet tomorrow. [81]

149 Pausing there, it should be observed that that email is of some significance in the chronology, as it involved the communication by the Woolworths quantity surveyor to NES' building consultant of the original Rider Hunt estimate of the cost of $1 million.

150 On the same day, 15 March 2010, Mr Macmillan and Mr Blake had a discussion which referred, among other things, to the costs to be incurred by NES to

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[81] In other words, Rider Hunt gave to Vaughans the estimate that Rider Hunt had given to Mr Macmillan that estimated the tenant's contribution at approximately $1,176,000.

prepare 'the DA for the Bendigo council'.[82]

151 On 16 March 2010 (at 9.38am), Mr McDonald sent an email to Mr Grigg in which he responded to action item 6 set out in Mr Grigg's email dated 12 March 2010 to provide the Braybrook changes 'extra over' list. The email attached a list of works for the Masters hardware store in Braybrook that was different from Masters generic brief.

152 On 16 March 2010 (at 12.00pm), Mr Grigg sent an email to Mr Blake that included the following:

> As per my email below and your previous request, we confirm the following items for your negotiations with Woolworths/Bunnings.
>
> 1. **Cost estimate under WOW AFL** – Rider Levett Buckhall (sic) are coming to our office today for a detailed "open book" review BOQ review meeting.
>
> 2. **Letter of Offer (Comparable Construction Price)**
>
> - Vaughan Original Estimate = $12,348,061
>
> Deletions
>
> – Power authority & other authority head works contributions
>
> – Site levelling with a fall greater than 300mm across the site & excluding demolition
>
> – Town Planning (DA) Costs
>
> - **Vaughan Adjusted Estimate = $11,516,809 (+gst) or $1,051,36/sqm**
>
> 3. **Comparable Estimate for Alternative Hardware Warehouse (Full height precast on 10,738m² Bldg area)**
>
> – Warehouse of total dimensions 10,378m² on a 24,700m² site;
>
> – full height pre cast panels;
>
> – full architectural documentation;
>
> – DA application costs excluded;

---

82 The fact of this discussion is drawn from the email that Mr Blake sent to Mr Macmillan confirming it on 16 March 2010 (10.48pm). See below at [153].

- Power authority & other authority head works contributions excluded;
- Fall no greater than 300mm across the site & excluding demolition
- **Vaughan Estimate = $8,733,070(+gst) or $813.29/sqm**

Trusting this provides the comparable estimates you require and please feel free to contact me with any other queries.

153 On 16 March 2010 (10.48pm), Mr Blake sent an email to Mr Macmillan that included the following:

> I write to confirm our discussion yesterday with particular reference to the cost to be incurred by North East to prepare the DA for the Bendigo council.
>
> I suggested that it would be unreasonable for me to incur costs for the preparation of the DA without a solid agreement with WOW for the development of the Bendigo Home improvement store. You indicated that the cost variation under Sec. 2.2. of the AFL of approx. $3.0m is too great a variation and no alternative reductions or construction firms have been provided to date.
>
> I advised that I would be pleased to prepare the DA application if WOW provided an indemnity to reimburse the DA preparation costs in the event the development under AFL does not proceed. You advised that you would seek instructions on this and get back to me with an answer. I await your response.
>
> I confirm that we have again attempted to obtain the interest of Pellicanos at your suggestion. A Deed of Confidentiality has been provided to Michael Pellicano. I don't intent [sic] to continue to chase him as he clearly has little interest in this project.
>
> I confirm I would be pleased to request a construction estimate from any other builder you recommend.
>
> You also advised you would provide me with a copy of the Planning Minister's Terms of Reference for the Ministerial assistance.
>
> On another note, I have been advised that the 'open book' Vaughan inspection is due to be completed tomorrow and I look forward to receiving your comments in relation to the Design Kit and your construction estimate by Vaughans.

154 A meeting had been fixed for 4 pm on 16 March 2010. Mr McDonald sent an email to Mr Grigg (9.38am) attaching a 'copy of the brief changes for discussion' between them scheduled for later in the day. Mr McDonald gave evidence that the attachment was 'a list of works for Masters hardware store in Braybrook that was

different from the Masters generic brief'.

155 Also on 17 March 2010, Mr Gerald Davis of Fetter Gdanski , the solicitors for NES, wrote to Michael Graves, a Senior Associate at Allens Arthur Robinson, the solicitors for Woolworths as follows:

> **Re: North East Solution Pty Ltd ('North East') to Shellbelt Pty Ltd ('Shellbelt')(Woolworths Limited ('Woolworths') Guarantor**
>
> **Agreement for Lease: 195 McIvor Road, Strathdale, Victoria**
>
> We are instructed that our respective clients are currently in discussions with a view to reaching agreement (or otherwise) on the cost of construction of the project and the consequent contribution to the cost by your client pursuant to clause 2.2 of the Agreement of Lease ('**AfL**').
>
> We note and draw your attention to the following in this regard:
>
> 1 Such discussions are to be concluded one way or the other by 20 April 2010;
>
> 2 Under clause 2.3 of the AfL, our client is to prepare an application for Development Approval for submission to your client within 60 days after the date of AfL (24 February 2010), that is, by 25 April 2010 (25 April 2010 being ANZAC Day and 26 April 2010 being a public holiday, we consider that the period to satisfy that obligation should extend until Tuesday, 27 April 2010).
>
> 3 Clause 2.3 of the AfL requires our client to submit a draft of the application for Development Approval to your client for its approval prior to submitting it (or an amended version of it) to Council under clause 2.4. The application must be based on and consistent with the Briefing Kit.
>
> 4 The Briefing Kit effectively contains your client's requirements for the works to be constructed by our client, the cost of which is to be agreed to (or not as the case may be) by 20 April 2010 under clause 2.2.
>
> 5 It is, therefore, not possible for the Development Approval application to be commenced until the procedure in clause 2.2 has been concluded and, obviously, will not proceed at all if the AfL is terminated by either party because agreement cannot be reached on the cost of construction and consequent contribution by your client to the cost, by 20 April 2010.

156 On 17 March 2010, Troons provided Mr Blake with a quote to 'design/construct the new Bunnings warehouse at Bendigo'. Subject to several assumptions, Troons estimated the cost of constructing a Bunnings store on the Strathdale site as $8,575,640 plus GST (in his evidence, Mr Blake said that this quote referred to a construction on the 'McIvor Road site' (i.e. the Strathdale site)).

The original spreadsheet

157 On 18 March 2010, David Smith, a senior estimator with Vaughans, sent Mr McDonald a spreadsheet that was to become a significant document at the trial and on the appeal.

158 Mr McDonald gave evidence that, at the time this document was created, Rider Hunt was 'focusing on the site-specific issues and trying to extract some more detailed information from the contractor.' As at 18 March 2010, it seems that Vaughans were estimating the difference in cost between a Bunnings store and a Masters store at $3,454,674.74. At this stage, Rider Hunt had had no input into this document.

159 The spreadsheet was amended by Mr McDonald of Rider Hunt. The meaning of the spreadsheet and the amendments to it and the meaning of the amendments of Rider Hunt will be discussed below. In considering the spreadsheet, it is necessary to bear in mind that the judge considered the version as amended by Rider Hunt to be pivotal in his holding that Woolworths breached clause 2.2 of the AFL.

160 The spreadsheet took the following form:

	BUNNINGS V OXYGEN	**18th March 2010**		**VAUGHAN CONSTRUCTIONS**		
		Vaughan Values		Rider Value	Difference	Comments
		Bunnings S9 Store M²	Oxygen Bendigo M²			
1.						
2.	…	…	…	…		…
…	…	…	…	…		…

			3,454,674.74		

161 The spreadsheet is a dense document not readily contained in these reasons. However, the spreadsheet prepared by Mr Smith had the following features:

(a) the items which Mr Smith identified represented particular building works which he understood involved price differences between a Bunnings store and a Masters store;

(b) when he extracted cost items for a Bunnings store, Mr Smith was taking his information from a Bunnings Coburg store constructed in 2002;

(c) Mr Smith included particular building works which were not to form part of the base building cost, which was the subject of clause 2.2 of the AFL. For example, he included 'fitout cost' and the cost of acquiring various governmental permits, which were to be paid for separately, either by Masters or by NEC.

162 On 19 March 2010 (2.59pm), Mr Macmillan sent an email to Mr Blake as follows:

> Further to our discussion this week, I wish to confirm the contribution that you require from [Masters] towards the construction of the Oxygen Home Improvement store at Strathdale is not acceptable. As outlined in your email, we are having continuing discussions with Vaughan Constructions and our consultants regarding this matter. We hope to receive further feedback from our consultants early next week. As you are aware, we have until the 20th April to agree the landlord works costs and the manner of Woolworths' contribution.
>
> Also, I have attached the Terms of Reference from the Victorian Government regarding the 'fast track' planning process. I understand that you have also received the Terms of Reference from DIIRD. You now have all the information you require in order to prepare the planning application for the Home Improvement store at Strathdale.

163 On 21 March 2010, Mr Blake replied to Mr Macmillan's email of 19 March as follows:

> The first paragraph largely re-states what my lawyers said in their letter to your lawyers of 17 March 2010 to which I am told they have not received a response. I am well aware of the procedure and timetable.
>
> Your second paragraph clearly ignores the very important point made by them that the planning application, which is to be based on your briefing kit,

> cannot be made until agreement is reached on the construction costs and the briefing kit confirmed or amended. ***We are a long way apart on that at present.*** I believe you may seek to amend the briefing kit in light of the estimated construction costs as provided. In this circumstance the site plan may be modified to accommodate your changes and therefore the DA will require modification and additional cost.
>
> I would appreciate an update from you as to where you are at regarding the construction cost and the development contribution.
>
> As the briefing kit issue is not final, I reject your assertion that I have everything I need to make the planning application.
>
> Furthermore, it is totally unreasonable for you to expect me to outlay approximately $150,000 on a planning application which may turn out to be completely wasted if agreement is not reached on Woolworths contribution to construction costs by 20 April 2010 and the Agreement for lease is terminated.
>
> I have suggested, quite reasonably, that Woolworths indemnify me for the cost of the application if that happens. You advised me that you would seek instructions on this indemnity and reply to me. I have not received any response to date.
>
> Let's settle the costs/contribution issue one way or the other first and, if resolved to our mutual satisfaction, I will then proceed with the application.
>
> I note in the Terms of Reference that the Minister expects Woolworths to prepare and present the DA's [sic]. Is this correct?[83]

164 That letter is of significance, as it records the acknowledgment by Mr Blake that, at that stage, the respective parties were 'a long way apart' in their assessments of the LWC and the tenant's contribution to those costs. As shall be apparent from what follows, the evidence did not justify a conclusion that that gulf was bridged in the next ten days, or in the next five weeks.

165 On 22 March 2010, Mr Blake and Mr Macmillan had a telephone conversation. Later that day, Mr Macmillan sent an email to Mr Blake that responded to Mr Blake's email of 21 March 2010. It contained the following:

> Further to our telephone call this afternoon, it is agreed that the best approach is for the parties to focus on one issue at a time by endeavouring to reach an agreement on the Landlord's Works Costs. Woolworths will not indemnify you to undertake the planning application prior to agreeing on the Landlord's Works Costs.

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[83] Emphasis added.

> In regards [sic] to Landlord's Works Costs, our consultants are continuing to have discussions with your builder Vaughan's [sic]. We hope to have further feedback later this week (or early next week at the latest) regarding those ongoing discussions. As you are aware the Landlord's Works Costs as indicated by you are not acceptable to Woolworths.

166 The relevance of that email was that it confirmed to Mr Blake that the parties' respective consultants were then continuing their discussions concerning the LWC, and that that process had not been completed.

167 On 22 March 2010, Mr McDonald received an email from Mr Smith which attached a number of files that set out Vaughans' calculations for the difference between a Bunnings store and a Masters store.[84]

168 On Friday 26 March 2010, Gerald Davis of Fetter Gdanski, the solicitors for NES, wrote to Michael Graves of Allens Arthur Robinson, the solicitors of Woolworths, as follows:

> **Re: North East Solution Pty Ltd ("North East") to Shellbelt Pty Ltd ("Shellbelt") Woolworths Guarantor**
>
> **Agreement for Lease dated 24 February 2010 ("AfL")**
>
> **Property: 195 Mclvor Road, Strathdale, Victoria**
>
> We have been instructed as follows:
>
> 1. that, for the purposes of cl 2.2(a)(ii) of the AfL, your client's consultants have been given the opportunity to and did inspect all records of Vaughan Constructions Pty Ltd, our client's proposed builder, to ascertain the basis of our client's Works Costs of $12,348,061 plus GST.
>
> 2. that the inspection was completed on Tuesday, 23 March 2010 and, accordingly, our client has complied with all its obligations under cl 2.2(a)(ii) of the AfL.
>
> 3. that the contribution to the Works Costs our client requires from your client under cl 2.2(a)(ii) of the AfL. will be $3,772,421 (less the cost of any earth works and power connection costs to the land which our client will be happy to estimate on your client's request).

---

84 Because Mr McDonald could not open the files, he arranged for Mr Smith to provide him with a PDF copy of Vaughans' bill of quantities for the difference between the cost of a Bunnings store and a Masters store.

> That is the difference (less those costs) between the Vaughan price for a building constructed in accordance with your client's Briefing Kit and the cost of another building of the kind described in paragraph 13 of your client's letter of offer dated 2 June 2009 as a "major trade supply restricted retail premises (full height precast)" (which our client has ascertained would be $8,575,640 plus GST not including the aforementioned earth works and power connection costs).
>
> Our client further instructs us that, in accordance with cl 2.2(b) of the AfL, it is willing to enter into any discussions in relation to the Works Costs your client cares to have.
>
> We look forward to hearing from you in due course.[85]

169 In the context of the preceding communications between the parties, that letter was, to say the least, somewhat curious. It was premised upon the consultations between Rider Hunt and Vaughans having been completed. The contemporaneous documentation shows that the consultations were continuing (and would continue throughout the rest of March and the first three weeks of April). Secondly, although the reference is not entirely clear, Fetter Gdanski identify $8,575,640 plus GST as the cost of constructing another building of the type referred to in paragraph 13 of the LOO. That would be the cost of constructing a Bunnings store. But, that figure was taken from the quote that Mr Blake received from Troons on 17 March 2010. It was never a figure that was discussed between Vaughans and Rider Hunt.[86]

The amended spreadsheet

170 On 29 March 2010, Mr McDonald of Rider Hunt wrote to Mr Killesteyn of Woolworths (copied to Mr Macmillan) as follows:

> We have reviewed the submission from Vaughans detailing the cost difference from the Bunnings store at Coburg and the proposed Project Oxygen store at Bendigo and note the following issues;
>
> - The Bendigo store is 10,923m²
> - The Coburg store upon which the comparison is made was built to a

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85 Reasons [140]. The judge does not explain the origin of the figure: $3,772,421.

86 In cross examination, Mr Blake accepted that the figure '$8,575,640' was taken from a quote he had received from Troons on 17 March 2010, and *not* from Masters.

2002 brief. We have not sighted this brief.

- The Project O amenities, administration, mezzanine is 828m² compared with the Coburg store at 354m². The majority of the mezzanine cost difference (item 54) in the attached comparison exists because of the extra area. We question whether this is correct methodology as the rent may be struck on the area of the store which would then include for this extra cost.

- The cost difference includes $200k for light fittings. We understand that this item will now be supplied by Oxygen.

- Item 59 is the provisional sum for the floor finish at $30/m². This does not reflect our understanding of the cost of the current floor specification but is in accordance with the information used by Vaughan.

- A cost has been included for plant platform screens, these may not be required. We don't have them on Braybrook & Coolaroo but may be a planning issue for this site.

The section ***highlighted in yellow*** on the attached spreadsheet is our view of the split of the extra cost between base build, site related costs, fitout and authorities fees.

The total difference is $3,247,195 inclusive of additional Preliminaries & Supervision, design fees (2.5%) and builders margin (5%). This has not been finally agreed with Vaughan yet.[87]

171 Mr McDonald attached to his letter an *amended version of the spreadsheet* that had been sent to him by Mr Smith on 18 March 2010.

172 The amended spreadsheet took the following form:

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87 Reasons [174] (emphasis added). This letter was sent by Mr Macmillan to 'Richard Lonergan' on 31 March 2010. The spreadsheet and the meaning of the section said to be 'highlighted in yellow' were the subject of extensive argument during the appeal.

Bunnings v Oxygen	18th March 2010	Vaughan Constructions						
		Vaughan Construction estimates based on 2002 Bunnings store built by Vaughan at Coburg with precast to dado and metal cladding above						
				RLB Review				
	Vaughan Values		RLB Amended	Base Building	Site	Fitout	Authorities	Comments
Store Areas	Bunnings 29 Store M2	Oxygen Bendigo M2						
1.	…	…	…	…	…	…	…	…
Store Cost difference	…	…	…	…	…	…	…	…
40.	…	…	719,935	…	…	…	…	…
46.	…	…	200,000	…	…	…	…	…
External Works	…	…	…	…	…	…	…	…
Building Works	…	…	…	…	…	…	…	…
54.	…	…	1,172,319 (621,318)	… …	… …	… …	… …	… …
57.	…	…	455,000	…	…	…	…	…
60.	…	…	246,540.00	…	…	…	…	…
…	…	**3,454,674.74**	**3,247,194.55**	**2,573,493.26**	**32,973.07**	**533,103.22**	**107,625.00**	…

In the amended spreadsheet:

(d) the columns entitled 'RLB Review Base Building', 'Site,' 'Fitout' and 'Authorities' have been highlighted in yellow; and

(e) the items 40, 46, 54, 57 and 60 had the values extracted above. Each of the values was coloured in blue.

The description of those items (coloured blue) that appeared on the face of the amended spreadsheet is as follows:

Item	Description	Comments
40.	BWIC, Plant Platforms & Plant Screens to last	Plant platform screens may not be required
46.	B29 Lighting	Lighting to be supplied by Oxygen
54.	Gr. Floor Amenities, Main Entrance, Customer Service, Equipment Floor & Administration Floor (Areas, VC Bunnings 354m2, S9 Bunnings 422m2, Project O 828m2)	Oxygen to pay rent on area so may be double dipping here
57.	PC sums CCTV, Alarms, EAS, PA, Satellite Music, Playground equipment, IT & Structural Cabling, Cash Management Tube System, Corporate Signage & Additional Statutory Signage/Carpark	
60.	Full height precast panels in lieu of 3.00m high	This item was not included in the

	dado with colorbond above	previous Bunnings review

173 The amended spreadsheet proved to be pivotal in the finding by the judge that there was no genuine disagreement between the parties in respect of LWC after 1 April 2010. In his opening at trial, senior counsel for NES said: 'This we say, your Honour, constituted the verification of the landlord's works costs and the difference by [Rider Hunt].'

174 Further, in a document handed to the Court of Appeal by senior counsel for NES,[88] the letter dated 29 March 2010 was said to contain advice from Mr McDonald to Mr Killesteyn 'that the LWC contribution is $3.247 million having regard to various deletions from Vaughans'. As will appear below, the email contains no such thing.

175 As will be apparent from our later discussion of the amended spreadsheet, we have concluded that, with respect, the judge misconstrued the contents of that document as well as the circumstances in which it was received by Woolworths.

176 During cross examination, Mr McDonald was asked to describe the nature of his 'dialogue' with Vaughans. He said:

> Most of our dialogue with Vaughans was really to understand their offer because it took some period of time to tease out some of the detail on the variants between the Masters and the Bunnings initially and then to hone in on some of the fit-out costs that were included in their offer that we believed should have been separate, because they weren't in the $12 million generic cost that we were trying to achieve for a 13,500 square metre store.

He described the purpose of the process that took place between March and April 2010 as follows:

> The purpose of the process, from [Rider Hunt's] perspective, was to assist Masters in understanding the difference for the Bendigo store, the difference between the cost of building a Bunnings store on the site compared to a Masters store on the site.

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88 *'Respondent's Chain of Events leading up to the 22 April 2010 Meeting'*. See fn 63 above.

177 In amending the original spreadsheet:[89]

(f) **The updating of values**: Mr McDonald took into account the fact that, in the original spreadsheet, Mr Smith had used a 2002 brief for the Bunnings Coburg Store. In doing so, Vaughans had estimated the tenant's contribution at $3,454,674.74. Mr McDonald updated the values in the spreadsheet by reference to the Bunnings 2008 S9 brief, with which he was familiar. Using those updated values, Mr McDonald reworked the Vaughans estimate and, using the same items as Vaughans, concluded that their estimate should be $3,247,194.55. Accordingly, (despite a finding of the judge) the figure $3,247,194.55 was not a Rider Hunt estimate of the additional cost to develop the Masters store according to its specifications; rather, it reflected amendments made by Mr McDonald to the original estimate of Vaughans of the additional cost to develop a Masters store according to its specifications *using a more up-to-date Bunnings brief*;[90]

(g) **The highlighting in blue**: Mr McDonald coloured in blue a number of items which had been included in the original spreadsheet in respect of which he still had queries. With the exception of two items (item 57 and item 60), he explained his queries in the column entitled 'Comments'. For example, he highlighted in blue item 40 ('BWIC Plant Platforms & Plant Screens to last') and commented: 'Plant screens may not be required'. He highlighted in blue item 46 ('Lighting') and commented 'Lighting to be supplied by Oxygen'.

(h) He also highlighted in blue:

(i) item 57: to draw attention to the fact that it should not have been included on the basis that fitout sums were to be excluded from the base building costs;

(ii) item 60: to draw attention to the fact that, in identifying differences between the base building cost of a generic Bunnings brief and the proposed Masters store at Strathdale, Mr Smith had allocated an

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89 Mr McDonald described the purpose of the amended spreadsheet: 'The purpose of that document was to try to hone in on the issues that were still outstanding'.

90 In its estimate, Vaughans had estimated the tenant's contribution at $3,454,674.74. In doing so, Vaughans had used values derived from the construction of a Bunnings store at Coburg in 2002.

additional cost for full height precast for the proposed Masters store (which was not included by them in relation to Bunnings);

In his oral evidence, Mr McDonald said: 'The items marked in blue are referenced in the covering email that was sent, but this is an attachment, and they were the areas that were still under discussion with Vaughans, we were still looking for further detail and raised them as queries to Masters. This was a work in progress document. We marked them up as areas that we still needed to hone in on and finalise the costs.'

(i) It is evident from the blue highlighting that Mr McDonald considered that there were items in the Vaughans estimate (that he had recalculated to $3,247,194.55) that may need reconsideration depending upon instructions. The remaining queries totalled $2,312,181.[91]

(j) **The highlighting in yellow**: Mr McDonald then included four further columns which he had highlighted in yellow. In these columns, he identified:

(i) site costs ($32,973.07);

(ii) fitout costs ($533,103.22); and

(iii) costs associated with authority costs ($107,625.00),

which had been included in the original spreadsheet, but which were to be excluded in the comparison of base building costs. When those sums are aggregated, the amount is $673,701.29. (In cross examination, Mr McDonald was not challenged in his evidence as to the need to exclude site costs, fitout costs and authorities' costs, from the base building costs.)

(k) When the amounts to be excluded ($673,701.29) are deducted from the recalculated amount of $3,247,194.55, the balance is $2,573,493.26.

178 Accordingly, as at 29 March 2010, having used the line by line assessment originally proposed by Mr Smith of Vaughans, Mr McDonald had estimated the

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91 The detail in this paragraph is taken from Mr McDonald's reply statement. However, the reply statement was tendered in evidence. Mr McDonald also gave oral evidence along the lines anticipated by his statements.

difference between the base building cost of the proposed Masters store at Strathdale and a generic Bunnings brief to be *less than* $2,573,493.26. However, as was also plain, he did not himself consider that the $2,573,493.26 figure was a fair estimate of the tenant's contribution. On the contrary, he had (by his highlighting in blue) raised questions about the propriety of a further $2,312,181. The final amount of the difference (assessed on a line by line basis) would depend upon the resolution of those remaining queries.

Cross examination of Mr McDonald and Mr Macmillan

179 Mr McDonald was cross examined about the amended spreadsheet. He accepted that it was his way of letting Woolworths know how he was going in identifying the cost difference between a Masters store and a Bunnings store at the Bendigo site. He said: 'The purpose of that document was to try to hone in on the issues that were still outstanding'. He was asked to explain what each of the items in blue referred to and whether his queries about them had ever been resolved. He was asked to comment on the $455,000 included as item 57. He accepted that the cost comparison should include matters that were to be paid by the landlord to build the building and should not include matters that were to be paid for separately by Woolworths.[92] He said that most of the items in blue had not been resolved before the participants in the discussion changed direction and followed a new 'macro' approach suggested by Vaughans.[93]

180 The striking point about the cross examination is its relation to the

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92 In re-examination, Mr McDonald said that the $455,000 should not have been included in the comparison. He said : It is out of our generic cost plan. We are comparing back to the $12 million generic cost plan, which excluded those items. The store is made up of the base building works and then typically the tenants would come in and do some works post building completion to fit-out, including racking and computers and the rest of it.

93 In re-examination, Mr McDonald said that the abandonment of the line by line comparison and the adoption of the new 'macro' approach followed from the use by Vaughans of a spreadsheet of 15 April 2010. See [198]-[200] below. Asked to comment on the new approach, Mr McDonald said 'I think we were getting a little bit frustrated, bogged down in some of the detail. They were using a different brief to what we were using. We didn't have a really good reference design for the Bunnings store so it was open to a bit of interpretation and we were getting a little bit bogged down on some of the numbers'.

propositions with which NES had opened its case.[94] At no point in his cross examination was Mr McDonald referred to the $3,247,194.55 figure. It was not suggested to him that his explanation of it in his second witness statement was in error. It was not suggested that, as the case had been opened by NES, he had verified the LWC as at that figure. In those circumstances, in the absence of compelling evidence to the contrary, there was no basis on which to reject Mr McDonald's evidence on that aspect of the case.[95]

181 Mr Macmillan also denied that the reference to $3.247 million was a reference to the outcome of the open book process. He said: 'his email spoke about a number of the issues that Rider Hunt and Bob Killesteyn had with the Vaughans' estimate, mainly because they hadn't seen the Coburg Bunnings store brief which was built all the way back in 2002 and since 2002 there were a number of addenda that I understand that were added to that, which actually made the Bunnings store brief more expensive.' He was asked whether he had told Mr Blake that Rider Hunt had verified the cost difference at $3.247 million and responded 'No, because it [the open book process] hadn't been completed'.

182 Accordingly, ground 5.4(e) of the proposed grounds of appeal has been made out. Contrary to the judge's conclusion, the evidence does not support the conclusion that, in identifying the sum of $3,247,195 in the amended spreadsheet, Mr McDonald was providing Woolworths with an estimate of the clause 2.2(b)

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94 See [173] above.

95 Cf *Browne v Dunn* (1893) 6 R 67; *Trimble v Bulstrode* [1970] VR 840, 846–47. It was not put to Mr McDonald that the base build was not the correct basis to assess the differences or that it was inappropriate to exclude site costs, fit-out costs and the costs of authorities. It was not put to Mr McDonald that the exercise in the yellow columns in the amended spreadsheet was a frolic of his own. It was not put to Mr McDonald that the task was not to compare a generic Bunnings store with a generic Masters store and, to the extent that it was, it was rejected by him. In cross examination, Mr McDonald was asked whether he was aware of any budget or approved number for the cost difference between a Masters store and a Bunnings store on the Bendigo site. That is, an approved number or budget that was the price that Woolworths was prepared to pay for the differing costs between a Bunnings and a Masters store for Bendigo. He said 'I was never advised of a budget from Woolworths on what they were prepared to pay, no'.

amount.

(f) Grounds 5.4 (f), (h) – the Open Book Process, 29 March – 22 April 2010

183 Ground 5.4(f) is directed to the further finding by the judge that, following (what he took to be) the conclusion of the open book process on 31 March 2010, a subsequent review by Rider Hunt of the Vaughans estimate, between 12 and 18 April 2010, resulted in Rider Hunt and Vaughans arriving at a LWC estimate of $11,516,809, which equated to a tenant's contribution of $2,941,169.[96] Ground 5.4(h) is directed to the related finding by the judge that the purpose of the open book process was to verify the clause 2.2(b) amount, and that that process had been completed at the latest by 15 April 2010.[97]

184 On 29 March 2010, Mr Graves of Allens Arthur Robinson forwarded to Mr Macmillan a copy of the Fetter Gdanski letter dated 26 March 2010.

185 On 31 March 2010, Mr Grigg of Vaughans sent an email to Mr Blake as follows:

> To confirm our earlier discussions, quantity surveyors Rider have completed their "open book" assessment of your project and are reporting to Woolworths tomorrow.
>
> I have spoke[n] to Ewan McDonald this afternoon who confirmed Vaughans cannot do anymore [sic] at this stage without Riders further instruction from Woolworths. He mentioned there may be a need to further assess the "base hardware store" bill of quantities benchmark inclusions. I confirmed a BOQ is available for this purpose and we will make available at our office when requested.
>
> I believe Tim McMillan [sic] is due to call you shortly to discuss "where to from here" and please feel free to call me if you require any further assistance.

186 On 31 March 2010, Mr Macmillan telephoned Mr Blake. In this conversation Mr Macmillan said that the Vaughans estimate was not acceptable.

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96 Reasons [265].

97 Reasons [154(b)], [174], [177]–[178].

187 On 6 April 2010, Mr Davis of Fetter Gdanski wrote to Mr Graves of Allens Arthur Robinson as follows:

> Further to our letter to you dated and sent by e-mail on 26 March 2010, we confirm the following:
>
> 1. Our client's instructions that your client's Quantity Surveyor has apparently sought further information from Vaughan Constructions Pty Ltd ("Vaughan") in relation to our client's Works Costs.
>
>   That is entirely a matter for the Quantity Surveyor and in no way diminishes the fact of completion of our client's obligations under clause 2.2(a)(ii) of the AfL to provide an "open book" costing of our client's Works Costs. That was done via an inspection of Vaughan's [sic] records by the Quantity Surveyor, completed on 23 March 2010.
>
> 2. To clarify the matters referred to in paragraph 3 of our letter of 26 March, the earth works and power connection costs referred to in that paragraph, are approximately $831,252 and, deleting that amount from the contribution referred to in our earlier letter, the contribution our client expects from your client will be approximately $2,941,169.00.
>
> 3. Our client's instructions that the contribution is to be made by a lump sum cash payment to our client at the commencement of construction of the Works.
>
> 4. Our client's instructions that, if agreement is not reached by 20 April 2010 on the amount of our client's Works Costs and the contribution (including the manner of contribution) your client is to make towards them, our client reserves the right to terminate the AfL under clause 2.2(c).[98]

188 On 8 April 2010, Mr Grigg sent an email to Mr McDonald in which he provided a consolidation of the estimate prepared on 1 March 2010 with deductions made for certain site-specific items, including power authority and other authority headworks contributions, site levelling, demolition, town planning and development application costs, which totalled $831,252. In that email, Mr Grigg said that Vaughans' adjusted estimate was now $11,516,809 (plus GST).[99]

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98 The judge used this letter to find that, as at 1 April 2010, Rider Hunt had estimated the tenant's contribution on 29 March 2010 at a lower figure than that demanded by NES. On the hearing of the appeal, NES accepted that, in doing so, the judge had erred in so far as the letter was received after 29 March 2010.

99 It is notable that Vaughans are deducting site specific costs in the amount of $831,252 (plus GST). As early as 2 March 2010, Mr Grigg had warned Mr Blake that the Vaughans quote

189 Mr McDonald gave evidence that site-specific costs had not previously been discussed with Vaughans 'as they had been considering the differences between a generic Masters and a generic Bunnings, both of which assumed a benched and leveled [sic] site and therefore site-specific costs were not relevant'.

190 On 9 April 2010, Mr Graves of Allens Arthur Robinson replied to the Fetter Gdanski letter of 6 April 2010 as follows:

> Thank you for your letter of 6 April 2010 and earlier today. I am instructed to respond as follows (adopting your original numbering):
>
> 1. Noted.
>
> 2. The amount that your client requires my client to contribute towards the Landlord's Works Costs is not acceptable. I understand that my client intends to arrange a further meeting with Vaughan Constructions Pty Ltd and its Quantity Surveyor to discuss the Landlord's Works Costs and the amount that my client will be required to contribute.
>
> 3. The payment terms proposed by your client are not acceptable. If our client agrees to contribute to the Landlord's Works Costs, then that contribution will be made on the following terms:
>
> (a) 95% payable within 10 Business Days after the Commencement Date of the Lease; and
>
> (b) 5% payable within 10 Business Days after the later of:
>
> (i) expiration of the 52 week defect liability period referred to in clause 5.2(b) of the Agreement for Lease; and
>
> (ii) the date of rectification of all deficiencies or defects in the Landlord's Works notified in writing by the Tenant to the Landlord under clause 5.2 of the Agreement for Lease.
>
> 4. Noted. My client also reserves its right to terminate the Agreement for Lease pursuant to clause 2.2(c).

191 On 12 April 2010, Mr McDonald attended a meeting with Mr Grigg of Vaughans at the offices of Vaughans. At that meeting, Mr McDonald requested that Mr Grigg provided: (a) a detailed breakdown of costs included in their assessment of

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'may appear expensive for Bendigo" as it included a 'siteworks component'. See [130] above. Mr Vaughan sent the same warning to Mr Blake on 2 March 2010. That did not prevent Mr Blake sending his demand on 3 March 2010. The amount was identified on 8 April.

the LWC for site specific costs, including works for excavation and retaining walls; (b) a detailed breakdown of cost items for fitout works; and (c) a site survey for the Masters store at Strathdale to enable Rider Hunt to undertake some checks of the calculations included by Vaughans in its estimate.

192 On 14 April 2010, Mr Macmillan telephoned Mr Blake and proposed a meeting at which the LWC could be discussed. On 15 April, Mr Macmillan attended a meeting with Messrs McDonald, Killesteyn, Lonergan, Noble and another representative of Vaughans. At the meeting, Mr McDonald tabled Rider Hunt's summary schedule of the LWC. Mr McDonald said that there were a number of items which Rider Hunt and Vaughans were yet to agree and that the parties were still far apart.

193 On 14 April 2010, Mr Smith of Vaughans emailed Mr McDonald attaching a bill of costs identifying the items of works, quantities, rates and costs for fitout items and site-specific costs included in Vaughans' calculations for the LWC. The email said:

> Ewen
>
> Attached details of Fitout Items &Site Specific Costs.
>
> Balance of Site Specific Costs not included in above,
>
> a] Substation $ 75,000.00
>
> b] Headworks:- Sewer & Water $25,000.00
>
> c] Town Planning $8,000.00

194 Mr McDonald reviewed the bill of costs and noted that Vaughans had included the following works in the assessment: (a) fitout items to the value of $123,497 (which were different items of work from the PC Sum fitout works valued at $455,000 outlined in the information previously provided by Vaughans on 15 March[100] and 22 March 2010)[101]; (b) 'Earthworks — Flat Site', which were the

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100 See [143].

earthworks required to bench and level the site. Vaughans had estimated that these would cost $358,806; and (c) 'Retaining wall to North, North East and East Boundaries — Flat Site'. Vaughans had estimated that these would cost $364,469.

195 On 15 April 2010, Mr McDonald, Mr Macmillan and Mr Killesteyn met with Mr Grigg and Mr Noble. The latter gave Mr McDonald a spreadsheet that they had created and dated 15 April 2010. The spreadsheet confirmed that the estimate by Vaughans for the LWC dated 1 March 2010 for $12,348,061 had been amended to remove site specific costs thereby reducing the estimate for LWC to $11,516,809.[102]

196 The evidence does not demonstrate that, at any stage between 12 April 2010 and 18 April 2010, Rider Hunt arrived at or agreed with the Vaughans estimate of $11,516,809 which equated to a clause 2.2(b) amount of $2,941,169.[103]

197 It follows that ground 5.4(f) of the proposed grounds of appeal is made out.

The new 'macro' approach

198 It appears that there was no further meeting between Mr McDonald and representatives of Vaughans after 15 April 2010.

199 Nevertheless, after the meeting on 15 April 2010, the evidence demonstrated that the line by line exercise was not completed. In evidence, Mr McDonald said that Rider Hunt adopted a different approach. The new approach sought to determine the difference between the base building cost of the proposed Masters store at Strathdale and a generic Bunnings brief by comparing the cost of each at what he described as 'a macro level'.[104] To this end, Mr McDonald used the Vaughans rate of $813 per m² for their calculation of the comparable Bunnings store, and deducted from the Vaughans estimate for the Strathdale site items which Rider Hunt

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101 See [61].

102 Reasons [156].

103 The judge discusses the two figures at Reasons [155] and makes his finding at Reasons [265].

104 Reasons [149].

understood were incorrectly included (or which Mr McDonald considered were only to be included if an alternative option was taken up) in the Vaughans' calculations provided to that time.

200 On 16 April 2010, Mr Macmillan invited Mr Blake to attend a meeting on 19 April at Woolworths' offices to discuss the LWC. Mr Blake responded by declining the invitation. He said that he had a new general manager starting that day. On 19 April, Mr Macmillan called Mr Blake to discuss arranging a meeting to discuss the LWC. Mr Blake said he would arrange that meeting. Later that day, Mr Blake sent an email to Mr Macmillan confirming a meeting on 22 April at the offices of NES' solicitors.

The 22 April spreadsheet

201 On 21 and 22 April, 2010, Mr McDonald prepared a further spreadsheet. He sent the spreadsheet to Mr Macmillan at 8.37am on 22 April 2010. The new spreadsheet was as follows:

MASTERS

Project O – Bendigo

		Area		Comments
Basis of Offer	$813/m²	10,923	$ 8,880,399	Includes Vaughan adjustment for full height precast
excluding				
Site specific penalties				
Current Vaughan Budget Offer			$12,348,061	Based on Generic design information
Less				
Site specific costs				
Earthworks			-$ 358,806	To be discussed with VC
Retaining Walls			-$ 364,469	To be discussed with VC
Excess cars 295no. vs 270no.			nil	295 cars required
Potential Variation				
Alternative Layout 1				
Relocate trade roller shutter to side			-$ 344,477	
=($364,446) + $19,969				
Other adjustments to Align with Basis of Offer				
Revised Provisional Sums				

Mechanical	-$ 120,000
Light Fittings	-$ 80,000
Authorities	
Substation	-$ 75,000
Sewer & Water Headworks	-$ 25,000
Town Planning	-$ 8,000
Adjusted Offer for Comparison with the Agreement	**$ 10,972,309**
Less	
Provisional sums for fitout	-$ 455,000
Other fitout items included in Vaughan Offer	-$ 123,497
Work Outside Site	nil
Adjusted Offer (excl GST)	**$ 10,392,812**
Comparison to base offer	$ 1,513,413

202 The spreadsheet was described as 'the Bendigo comparison adjusted to reflect the full height precast walls, provisional sums for the size of the store and fitout costs included in the Vaughan Offer'. On this spreadsheet, he included several comments:

(l) 'Basis of Offer 813m², area 10,923m²', together with '$8,880,399 million' and '[i]ncludes Vaughan adjustment for full height'. Mr McDonald gave evidence that the reference to '10,923m²' was a reference to the gross floor area of the store, which came from the Vaughans estimate. Further, he said that that line represented Vaughans' adjusted figure for a Bunnings store with full height precast concrete. In the brief and in some of the early correspondence from Vaughans, they had costs in for a dado height precast wall and metal cladding above. They had a cost of about $8.5 million, excluding the full height precast wall penalty or extra cost. Consequently, the $8.8 million figure included that adjustment for full height precast concrete. Mr McDonald gave evidence that the effect of putting that adjustment back in would reduce Woolworths' contribution.

(m) 'Current Vaughan budget offer…$12,348,061'. Mr McDonald said that was a reference to Vaughans' starting offer in its quote dated 1 March 2010;

(n) Beside the item 'Less Site-specific costs', there was the reference '[t]o be discussed with VC'. Mr McDonald said that this was a reference to some of the site-specific costs for benching and levelling the site and for retaining walls associated with the benching that was required for the site. He explained that the reference 'to be discussed with VC', was to the fact that '[i]t

was still a work in progress. These are things that needed to be finally agreed';

(o) The item 'Potential Variation, Alternative Layout 1, Relocate trade roller shutter to side'. Mr McDonald gave evidence that in the Vaughans quote of 1 March 2010, they had included an option for relocating the roller shutter to the trade area of the store to the side, which would have generated a saving of $344,000. Mr McDonald said he had included it as a potential variation because he did not understand its exact detail. He understood it to be subject to acceptance by Masters. It was not something that he himself had the authority to agree to. But, he had to ensure that Woolworths was aware of it as it may have had impacts on the actual functionality and retailing operations within the store;

(p) The item 'Other Adjustments to Align with Basis of Offer'. Mr McDonald gave evidence that the proposed store at Strathdale 'was an odd size'. Typically, the stores were 13,500m². However, Strathdale was a smaller version. In the design brief being used by the parties to the discussion, a number of sums had been included on the basis that they would be installed in a larger store. He gave two examples: (i) the air-conditioning to the retail component of the store; and (ii) light fittings throughout the whole store would need to be reduced to reflect the fact that the Strathdale store was slightly smaller; and

(q) Mr McDonald said that before he could make a final recommendation to Woolworths about the cost differences, he needed (i) to close out and agree site specific costs; (ii) to agree on the appropriate adjustment to the provisional sums that needed to be agreed to by Woolworths; and (iii) to agree that the bottom provisional sums for the fitout and other fitout items needed to be agreed.

203 In his evidence, Mr McDonald stated that, when determining Rider Hunt's assessment of the LWC, he undertook the following calculations:

(r) under the heading 'Basis of Offer' he calculated the cost for the comparative trade supply store with full height precast walls (based on a generic Bunnings home hardware store design) by multiplying the size of the store of 10,923m², as against the rate of $813 per m². This resulted in a total quantum of

$8,880,399 for the cost of the comparative trade supply store. While he cannot now recall how, by whom or when, his recollection is that he had been told Vaughans used the rate of $813 per m² for calculating the cost of the Bunnings store.

(s) He noted the LWC, as assessed by Vaughans in the 1 March 2010 proposal was $12,348,061;

(t) He then deducted from the LWC assessed by Vaughans the following amounts:

(i) costs associated with works relating to site specific costs for retaining wall works and earthworks for $358,806 and $364,469 respectively. These were the amounts that Vaughans provided to him on 14 April 2010 in the Buildsoft files in relation to the site specific works. He deducted these amounts from the LWC as these costs were to be assessed on the basis of a level and benched site and site specific works required to provide a level and benched site were not to be included in this calculation;

(ii) costs associated with the Alternative Options to the value of $344,477 (which comprised a saving of $364,466 for Alternative Layout 1 and an expense of $19,969 for Alternative Layout 2). At the time he took the view that the alterative options to either delete the roller door or alternatively relocate the roller door, only included savings relating to additional site specific costs in providing vehicular access to the trade roller door (that is, additional to the site specific costs for retaining wall works and earthworks for $358,806 and $364,469 respectively). Therefore he considered that the 'savings' identified in Alternative Layout 2 of $344,477 needed to be deducted from the LWC (on the assumption that the alternative options would be taken up) for the purposes of the comparative assessment of any contribution to be made by Masters as those 'savings' actually represented additional site specific costs that could not be avoided but which should not have been included in the LWC. If the alternative options were not taken up, these amounts would not be deducted;

(iii) costs associated with provisional sums for light fittings ($80,000) and

mechanical works ($120,000). These figures were a pro rata calculation of the cost of light fittings and mechanical works for a generic Masters store and would need to be adjusted to take account of the smaller size of the Strathdale store which would require less light fittings and less mechanical works. He did this on the basis of the comments from Mr Killesteyn in his email dated 15 March 2010, which he had advised Vaughans of on or about 15 March 2010, and also as Vaughans had acknowledged in their 1 March 2010 estimate that the Provisional Sums could be reduced to account for the smaller store;

(iv) costs for authorities fees for substation costs ($75,000), authorities fees for sewer and water headworks charges ($25,000) and authorities fees for town planning costs ($8,000). These figures were derived from the information provided by Vaughans in their email dated 14 April 2014. He deducted these amounts from the LWC as these costs were being calculated on the basis of base building works which typically exclude authority contributions, design and planning fees and associated charges. Further amounts for these works were not included in the comparative trade supply store based on a generic Bunnings' design. Mr McDonald considered that in order to compare like with like, he needed to deduct amounts for these works from the calculation submitted by Vaughans for the LWC; and

(v) costs associated with provisional sums for fitout works valued at $455,000 and other fitout items included in the Vaughans estimate of $123,497 as sums for fit out works were to be deducted from the quantum for the LWC.

(u) After making the deductions from Vaughans' assessment of the LWC for items of works he considered were incorrectly included in this calculation, he calculated that the adjusted quantum for the LWC was $10,393,812.

(v) He then deducted the quantum for the comparative trade supply store with full height precast walls of $8,880,399, from the adjusted quantum for the LWC of $10,393,812, which resulted in the comparison base offer of $1,513,413. This was the amount Rider Hunt assessed Masters should contribute towards the LWC for the Masters Strathdale store.

Cross examination of Mr McDonald

204 Mr McDonald said that the negotiations between Rider Hunt and Vaughans remained current as at 22 April 2010. In cross examination by senior counsel for NES, he gave the following evidence:

Counsel:	As at 22 April 2010, the time of the spreadsheet and the email you were just taken to a moment ago …, your negotiations with Vaughans were not concluded, were they?[105]
Mr McDonald:	That's correct.
Counsel:	In fact would you agree with me that they were far from concluded?
Mr McDonald:	They weren't concluded. I think we were honing in on the issues. I think we were progressing.
Counsel:	Yes, but they were not concluded?
Mr McDonald:	Not concluded, that's correct.

205 Mr McDonald was cross examined about the 22 April spreadsheet as follows:

Counsel:	Leaving that one aside. It's the case, isn't it, that you had discussions with Vaughans about each and every one of the other items?
Mr McDonald:	Yes, we did; yes.
Counsel:	And you had attempted to ascertain what was included and what it would cost?
Mr McDonald:	Correct. That's correct.
Counsel:	In relation to the earthworks and retaining walls, are they the numbers taken from the Vaughans 15 April email?
Mr McDonald:	I believe they are, yes.
Counsel:	But not the fit-out; correct?
Mr McDonald:	Not the fit-out, no.
Counsel:	In relation to the other adjustments or the items

105 The context makes clear that the reference is to the spreadsheet that Mr McDonald prepared for Mr Macmillan before the 22 April meeting.

appearing under the 'Other adjustments' heading it's the case, isn't it, that the Vaughan [sic] revised offer of 11.5 million was made after discussions about each of these items?

Mr McDonald: That's correct, yes.

206 Mr McDonald was further cross examined about the 22 April spreadsheet:

Counsel: This document did not bear any relationship to your discussions with Vaughans in April, did it?

Mr McDonald: This is a summation of all the items we had just been discussing with Vaughans, I think.

Counsel: It didn't bear any relationship to your discussions with Vaughans during the open book process which resulted in you identifying a difference of $3.2 million?

Mr McDonald: This is a different exercise we are doing here. This is not a line by line comparison that was undertaken then, and that $3.2 million, that was still work in progress at the time.

Counsel: That was still a work in progress as at this time?

Mr McDonald: Yes, it was.

Counsel: You had updated various items included in that $3.2 million difference in your discussions with Vaughans in April, hadn't you?

Mr McDonald: We had discussed certain items. We hadn't actually agreed any of the numbers with Vaughans at that stage.

Counsel: But you could have given Mr Macmillan an update of where things stood in relation to the $3.2 million difference, couldn't you?

Mr McDonald: If I was requested for that I could have, yes.

Counsel: That's what you had been working on for the previous three weeks, wasn't it?

Mr McDonald: Up until about a week before this, that's probably correct, yes. We changed direction.

Counsel: Why didn't you give him the update of your work for the first two weeks in April based on the $3.2 million difference?

Mr McDonald: I can't recall why I didn't at the time.

Counsel: This is a comparison directly back to the $8.88 million

figure that Vaughans had put on the table for a full height precast Bunnings store. This, I suggest, represents the abandonment of the line by line review that you had been undertaking for the previous three weeks, moving to what you have described as the macro level review of square metre cost but then inserting some line items to get the price down. In other words, it's a hybrid approach. It's a mix of the line by line approach you followed after your $3.2 million difference identified but adjusted by taking a macro approach as to the overall cost?

Mr McDonald: I actually think it's quite different, actually.

Counsel: Is it?

Mr McDonald: Yes.

Counsel: I see. You can be asked questions about that in re-examination. Did you ever have any discussion with Mr Macmillan about the $1.5 million difference?

Mr McDonald: I sent this email to him on the morning of 22 April. I'm not sure whether I called him before he went to the meeting or not. I don't believe I did have a discussion with him.

Counsel: You didn't have any discussion with him about this?

Mr McDonald: I sent it in an email to him, and I don't believe I spoke to him. I don't have any recollection of having spoken to him.

Counsel: The bottom line for the Vaughan quote you describe here as 'Adjusted offer, 10.393 million'?

Mr McDonald: Yes.

Counsel: Do you see that?

Mr McDonald: Yes, I do.

Counsel: It's trite to say that Vaughans had never agreed to any such adjusted offer?

Mr McDonald: That's correct.

Counsel: And in fact you knew that the last number Vaughans had agreed to was 11.5 million?[106]

Mr McDonald: That's the last number I had seen from Vaughans; that's

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106 This is a reference to the figure identified in [195] above.

correct, yes.

Counsel: And had you informed Mr Macmillan the last number you had seen from Vaughans was 11.5 million?

Mr McDonald: I can't recall whether I exactly informed him specifically or whether he was included in some of that correspondence or whether someone else at Masters may have been.

Counsel: Did you have any discussion with Mr Macmillan as to what was included or excluded in the 11.5 million?

Mr McDonald: I don't believe so. I can't recall.

Counsel: Do you accept, sir, that it would have been appropriate for you to drill into what was included and what was excluded in the 11.5 million before reporting to Mr Macmillan?

Mr McDonald: If time permits. This is work in progress still.

Counsel: Why didn't you tell Mr Macmillan you needed more time to do a proper job?

Mr McDonald: It was still ongoing. It wasn't being concluded at this particular point in time. This was just an update.

Counsel: Did you tell Mr Macmillan on 21 April when you spoke to him that you needed more time to get to the final number?

Mr McDonald: I think on this spreadsheet it says here that there are items here still to be discussed with Vaughans.[107]

Counsel: Did you inform Mr Macmillan when you spoke to him on 21 April that you needed more time to the job done?

Mr McDonald: I believe I would have said that to him, yes.

Counsel: Thank you. Do you recall what his response was?

Mr McDonald: No, I don't recall his response exactly. I imagine it would be he would just accept it.

Counsel: After you sent the email on 22 April did you call him and ask whether he wanted you to do any more work on it?

Mr McDonald: I can't recall whether I spoke to him particularly about it or whether it was Bob. I was seeing some of the

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107 The spreadsheet includes several references to 'To be discussed with VC'.

people from Masters quite regularly at the time.

Counsel: Is it the case that on or shortly after 22 April you were told, 'Don't do any more work on Bendigo'?

Mr McDonald: I honestly don't recall that, to be honest. We were working on instruction. If I didn't receive instruction to keep going, then by inference I would stop. It's not uncommon in this situation for that sort of thing to occur.

Counsel: If you stopped on 22 April 2010 in relation to Bendigo the job was incomplete, wasn't it?

Mr McDonald: From my perspective, it was still work in progress. We hadn't concluded; that's correct.

207 In this cross examination, reference is made to the '$3.2 million difference'. Presumably, that was a reference to the $3,247,194.55 figure derived by Mr McDonald in the amended spreadsheet of 29 March 2010. It is to be recalled that it was never put to Mr McDonald that that figure represented anything other than what had been described by him in his supplementary statement.[108] Even so, he described the $3.2 million figure as a 'work-in-progress' when it was derived.[109]

Submissions and analysis about the open book process

208 At the hearing of the appeal, NES submitted that there was no real engagement on the cost per m^2 methodology. It submitted that NES had done all that it had to do. It said that the judge was correct to find that it was Woolworths 'almost hidden agenda' that prevented there being any 'real engagement' in relation to the LWC. In final submissions on the appeal, senior counsel for NES said that the judge was correct in identifying that the letter from Rider Hunt to Mr Macmillan showed a contribution of $3.247 million. It was submitted that the judge was right to find that NES had done what it was required to do under clause 2.2 in identifying, at the end of open book process, the LWC and the contribution required. After that, there was, in substance, silence from Woolworths.

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108 See [180] above.

109 Certain assumptions appear to have been made in the cross examination, but these were not justified by any evidence given previously.

209 However, the uncontradicted evidence of Mr McDonald was that there was continuing engagement up to 15 April 2010. After that, he worked on the new spreadsheet supplied by Vaughans and tried to reconcile the figures it contained.[110] And, as at 22 April 2010, there remained genuine items of continuing disagreement.

210 In his Reasons, the judge found that Woolworths had breached its good faith obligation by giving NES no explanation for its assertion that NES determination of the LWC was 'too high'. The judge held:

> The evidence to which reference has been made, particularly the documentary evidence referred to in the immediately preceding discussion, discloses, in my view, a continued unwillingness on the part of Woolworths to communicate to NES any differences that it may have had in relation to the estimate by NES of the Landlord's Works Costs or of Masters' contribution to those costs. I am also of the view that the evidence also reveals a continued unwillingness on the part of Woolworths to provide NES with any detailed or transparent information in support of its otherwise bare assertion that the NES estimate was 'too high' or 'unacceptable', that would enable NES to negotiate with Woolworths in any meaningful way to resolve any differences between them in relation to these calculations. This is true even at the 22 April 2010 meeting, a meeting which was called for the purpose of attempting to resolve any differences in relation to the Landlord's Works Costs. Mr Macmillan admitted that Woolworths said nothing more, in relation to the Masters' contribution amount, than that the $2.94 million that had been sought by NES was 'too high'; a position that Woolworths had adopted since receiving the report in early March.[111]

211 NES submitted that the judge had been correct to come to those conclusions. During the hearing of the appeal, NES submitted that Woolworths had breached the clause 2.2 obligation in so far as it had told NES that its LWC estimate was 'too high' but had never explained how it was that it was 'too high'. NES said that Woolworths did not explain why the NES figure was 'too high' until the meeting of 22 April when Mr Macmillan told Mr Blake that his expectation was that the LWC would be close to $1 million.

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110 No one from Vaughans was called to give contrary evidence. Further, as the judge said about this period: 'Moreover, as indicated at the outset, the contemporaneous documentation — which is quite extensive — provides a comprehensive and reliable picture in any event'; Reasons [157].

111 Reasons [208] (citations omitted).

212 It seems to us that NES could not have been in any doubt as to why Woolworths considered that NES estimation of the LWC was 'too high'. On 1 March 2010, Vaughans provided NES with a quote to construct a Masters store on the Strathdale site. On the same day, Mr Blake sent that quote to Mr Macmillan. Mr Macmillan immediately told Mr Blake that he considered the quote to be 'too high' and explained why. On the next day, Mr Grigg explained to Mr Blake why he thought that Woolworths would be dissatisfied with the quote. For the reasons that are explained in [128] above, Mr Grigg warned Mr Blake that Woolworths would find the quote expensive as at the time Vaughans were providing Woolworths with a quote for another store and they were bound to compare the quotes. Further, in December 2009, Rider Hunt had provided to Woolworths their first design brief comparison based on Design Kit Rev B. As indicated in paragraphs [14] and [119] above, Rider Hunt had estimated the cost difference with a comparable Bunnings store to be $1,176,562. On 15 March 2010, Mr McDonald (with the permission of Mr Killesteyn) made that estimate available to Mr Grigg. On 26 March 2010, Mr Blake (through his solicitors) sent a further estimate of the LWC to Woolworths. It was based on a quote he had received from Troons on 17 March 2010 which he had not disclosed to Woolworths and which was uninformed by the discussions that were being had between Rider Hunt and Vaughans.

213 Accordingly, ground 5.4(h) of the proposed grounds of appeal has been made out. On the evidence, it was not open to the judge to conclude, as he did, that all issues between the parties, concerning the assessment of the LWC, had been resolved, and the open book process had been completed by 15 April 2010.[112] Rather, in our view, the only reasonable conclusion, on the evidence, is that the open book process had not been completed by that date. It is clear on the evidence that Rider Hunt was still attempting (as late as 22 April 2010) to reconcile the figures provided by Vaughans. There is no evidence that Woolworths instructed Rider

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112 Reasons [174]–[178].

Hunt to desist from that process before 22 April 2010.

(g) Ground 5.4(i) – Were Vaughans and Rider Hunt agents for NES and Woolworths?

214 By proposed appeal ground 5.4(i), Woolworths contends that the judge erred by failing to find that Woolworths, who had retained Rider Hunt in relation to the assessment of the costs, had reasonably believed that Vaughans was the counterpart that NES had retained and that those two representatives engaged in a process and dialogue to ascertain which costs were properly characterised as part of the LWC. In particular, the ground is directed to the finding by the judge that the evidence established that Vaughans was not engaged by NES as an agent to represent it in the open book review process, and that accordingly communications between Rider Hunt (or Woolworths) and Vaughans did not discharge Woolworths' obligations to communicate directly with NES.[113]

215 In his evidence, Mr Blake stated that he satisfied his obligation to provide estimates of the LWC by providing quotes from Vaughans and Troons. He accepted that Vaughans was providing a cost comparison with Rider Hunt. He said: 'the role of Vaughans is to provide me a quote to build this store for Woolworths, that was their role. I then requested that they engage, with Woolworths' indulgence, in the LWC comparison. To my knowledge the only quote that Masters had to build a store was from Vaughans'. While denying that Vaughans was assisting him in the process of working out what was in and what was out, Mr Blake explained: 'they were requested to open up their books to Rider Hunt so there could be an open book process, they could look at all the particular items and determine the differences in costs between a Bunnings and Masters store'. He knew the process between Vaughans and Rider Hunt was going to be a detailed one. He agreed that he and Woolworths had embarked on a process whereby Vaughans and Rider Hunt were to

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113 Reasons [199].

come up with a figure for the LWC. He said: 'The Woolworths contribution would have been what the result was once Vaughans and [Rider Hunt] had completed their assessment'.

216 In cross examination, Mr Macmillan rejected a suggestion that the review of the LWC was a matter internal to Woolworths and Rider Hunt. He said that the review of costings was to be carried out by Woolworths and Rider Hunt 'in conjunction with' Vaughans. During the discussions, Mr Macmillan understood that NES was being represented by Vaughans. He said that, during the discussions, Woolworths' feedback was being presented to Vaughans by Rider Hunt. He accepted that Vaughans did not have authority to agree to anything, but it was his understanding 'they were working for Brendan Blake'. In fact, several questions in his cross examination were predicated upon Rider Hunt negotiating with Vaughans through to at least 15 April 2010. When asked why he had not reviewed all the costings before he went to the meeting on 22 April 2010, Mr Macmillan explained that Rider Hunt and Vaughans were still having discussions at that time. When it was suggested that he was frustrating negotiations with NES or Mr Blake, by not communicating with them, Mr Macmillan replied that 'we had [Rider Hunt] talking to Vaughans regularly'. He accepted that Rider Hunt did not 'have authority to negotiate differences to a conclusion without [his] approval'. In re-examination, he said that he did not consider he should tell Mr Blake what his expectations were until the process being conducted by Rider Hunt and Vaughans had been completed.

217 The documentary evidence, to which we have earlier referred, well supports the evidence of both Mr Blake and Mr Macmillan, that, to a substantial extent, they delegated to their respective consultants, namely Vaughans and Rider Hunt, the task of analysing, discussing, and refining, the quantum of the LWC, and of the tenant's contribution to that amount. It is understandable that that process was adopted by the parties. Both Mr Blake and Mr Macmillan gave evidence, accepted by the judge, that they did not understand the detailed breakdown of the cost items contained in the various estimates provided by the consultants, and that accordingly each of them

relied, significantly, on the process that was taking place between Rider Hunt and Vaughans to identify the relevant differences. As the judge himself acknowledged, it was 'hardly surprising' that the parties conducted the process in that way.[114] While, as the judge found, in a strict sense, that may not have constituted Vaughans and Rider Hunt the agents for the respective parties,[115] nevertheless the evidence compelled the conclusion that the discussions undertaken between Vaughans and Rider Hunt constituted a necessary and significant aspect of the process contemplated by clause 2.2(b) of the AFL.

218 In particular, the evidence made it plain that the parties left the calculation of the LWC and the tenant's contribution to be worked out by Vaughans and Rider Hunt. Undoubtedly, the figures would have remained subject to agreement between NES and Woolworths. But, to the extent that an effort was made by the parties to determine those figures on an objective basis, the task had been left by the parties to the landlord's builder and the tenant's quantity surveyor. There was no evidence that Woolworths had instructed Rider Hunt to frustrate the process, to prevaricate or to terminate it. The process was terminated by the parties themselves at their meeting on 22 April 2010. For those reasons, ground 5.4(i) of the proposed grounds of appeal is made out.

219 Before the judge, NES had contended that Woolworths had excluded Mr Blake from the 'open book' process. The judge seems not to have made a finding on this contention, but he went close to it. He said:

> In any event, NES was not invited to participate in the process, did not participate in it and was, if not excluded or not invited to attend the 'open book' process, they were not provided with information about the progress of the review and the differences to be resolved, in spite of repeated requests for information in this respect by Mr Blake. No informative response was provided to these requests. More particularly, in spite of these requests for information arising from the open book process and despite Woolworths having been provided with detailed information from Rider Hunt on 29 March 2010 and again on 22 April 2010, these reports from Rider Hunt

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114 Reasons [128].

115 Reasons [199].

> were never provided to NES. Nor did Mr Macmillan provide Mr Blake with an update as to the progress of the open book process at the meeting of 22 April 2010, as he said they simply 'didn't get to that'. It is hardly surprising that the repeated failure by Woolworths to provide NES with details of any difference in the Landlord's Works Costs calculation that may have been identified in the open book process made it impossible for any negotiation to take place in accordance with cl 2.2(b) of the Agreement for Lease.[116]

220 So far as we can determine no complaint was made by Mr Blake during the open book process that he was being excluded from the process. First, he had quite plainly established Vaughans as his proxy during the attempts by the parties to determine the LWC. Further, on 17 and 26 March 2010, Fetter Gdanski, on behalf of NES, wrote to Allens Arthur Robinson and, on each occasion, relied upon the fact that both NES and Woolworths had delegated the negotiations about the LWC to their respective consultants.[117] Those letters are innocent of any suggestion that the process was miscarrying in so far as Mr Blake was being excluded from it.

(h) Summary of conclusions on Grounds 5.4(e), (f), (h) and (i)

221 Before considering the remaining grounds on the issue of breach, it is useful, first, to summarise the conclusions we have so far reached in respect of proposed grounds 5.4(e), (f), (h) and (i).

222 It is to be recalled that, in opening its case at trial, senior counsel for NES described the amended spreadsheet and the letter dated 29 March 2010 from Rider Hunt to Woolworths as having provided Woolworths with an estimate, at the end of March 2010, that the LWC contribution of Woolworths was $3,247,195. Senior counsel for NES described the letter of 29 March 2010 as follows:

> This is a document of critical importance in this case. This is the result of the open book review of the landlord's works costs and the tenant's contribution to them. … [T]here is a reference to the square meterage of the Bendigo store, a

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116 Reasons [184] (citations omitted).

117 See [155] and [167] above.

reference to the Coburg store, then various comments in relation to items such as amenities, mezzanine, light fittings, provisional sum for floor finish, a cost for plant platform screens and so on. Then we get to the conclusion: 'The total difference is $3,247,195 inclusive of additional preliminaries and supervision, design fees 2.5 per cent and builder's margin 5 per cent. This has not been finally agreed with Vaughans yet.' This we say…constituted the verification of the landlord's works costs and the difference by [Rider Hunt].

223 As is plain, the judge accepted this submission. But, that conclusion is untenable on the evidence. NES had appointed Vaughans to represent it in discussions with Woolworths about the LWC and the tenant's contribution to it. Woolworths had appointed Rider Hunt to represent it in those discussions. The finding that the tenant's contribution had been estimated by Rider Hunt as at 29 March 2010 depended upon a misconstruction of the contents of the amened spreadsheet. And, Woolworths is correct in characterising that finding as 'pivotal or central' to the reasoning of the judge. Finally, the evidence shows that Vaughans and Rider Hunt had continued to engage with each other until the parties themselves terminated their dialogue on 22 April 2010.

Other grounds of breach

224 The remaining grounds, in ground 5.4 and ground 5.5, address the reasons which, the judge found, motivated Woolworths not to negotiate and agree with NES in relation to the LWC and the tenant's contribution to those costs. Each of those conclusions by the judge, in part, were based on findings by the judge relating to the Rider Hunt estimate, that we have so far discussed, and which we have concluded were contrary to the evidence. In addition, the judge also relied on other matters to support his conclusion that Woolworths did not negotiate the LWC in good faith, because they had other ulterior reasons not to agree to those costs with NES. For the reasons that follow, we have concluded that the inferences drawn by the judge to that effect were not supported by the evidence.

(a) Grounds 5.4 (a), (b), (c), (d) - the undisclosed budget

225 Grounds 5.4(a), (b), (c) and (d) are directed to the finding by the judge that Woolworths did not accept NES' offer of 6 April 2010 of $2,941,169, and terminated the AFL, because the lowest offer made by NES to Woolworths was substantially in excess of an amount of $1.7 million, that was the limit that had been set for the Strathdale store by Woolworths in a budget, which had not been disclosed to NES. In essence, it is submitted by Woolworths that there was no sufficient evidentiary basis for that conclusion by the judge.

226 The origins of the finding by the judge, to that effect, were in a submission summary dated 22 July 2009 that was put to the Property Committee, and the minutes of the meeting of that Committee on 4 August 2009. In the submission summary, it was stated that the proposed capital cost of the store of $7.11 million included $5 million for fit out of the store, as well as an additional $1.7 million allowance 'should the Home Improvement design brief cost more than the specification agreed by the Lessor'. That submission was approved at the meeting of the Property Committee of 4 August, the minutes of which noted:

> Submission dated 22 July 2009
>
> Good location. Will pursue one store in the foreseeable future.

227 The budgetary limit of $1.7 million, so approved by the Property Committee, was the basis of a number of findings by the judge as to the reason why Woolworths did not agree to the contribution amount sought by NES pursuant to clause 2.2(b) of the AFL, and as to why Woolworths terminated the AFL on 6 May 2010. It is necessary to refer, in a little detail, to the judge's reasons, in order to appreciate the importance that that factor assumed in the conclusions reached by the judge that Woolworths had breached the terms of the agreement with NES.

The judge's reasons about the undisclosed budget

228 After discussing the content of the obligation of the parties under clause 2.2(b), the judge noted the submission by NES that Woolworths had taken

into account extraneous matters not contemplated by the AFL, including (inter alia) Woolworths' 'undisclosed budget', so that Woolworths did not act in good faith or in a manner that was 'faithful' to the contractual object as required by clause 2.2(b) of the AFL. Referring to that submission, the judge stated:

> For the reasons which follow I am of the view that the position put by NES in these series of submissions is made out on the evidence.[118]

229 The judge proceeded to consider the events relevant to the transaction between 3 March and 22 April 2010. As mentioned earlier, the judge set out the email dated 29 March 2010 from Mr McDonald to Mr Killesteyn, copied to Mr Macmillan, referring to the 'total difference' of $3,247,195. The judge noted that that amount was 'materially greater' than the revised contribution amount that NES 'had sought' from Woolworths of $2,941,169. Having referred to the telephone conversation between Mr Blake and Mr Macmillan on 31 March 2010, his Honour concluded that 'the only explanation' for Mr Macmillan stating that the Vaughans estimate was 'not acceptable' on 31 March 2010, was '… that the Landlords' Works Cost still exceeded Woolworths' approved but undisclosed budget'.[119]

230 The judge then referred to the events of 6 April 2010, and, in particular, the note in the minutes of the meeting of the Property Committee of that date that noted that the deal was 'likely to fall over'. The judge stated that because no negotiations had yet taken place between NES and Woolworths regarding the LWC, that notation in the minutes could only have been a reference to the fact that the Rider Hunt estimate of 29 March materially exceeded Woolworths' 'approved but undisclosed budget'. In that respect, his Honour observed that in cross examination Mr Champion had 'admitted' that Mr Macmillan had the authority to terminate the AFL in the event that the project could not be constructed within the approved budget.[120]

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118 Reasons [87].

119 Reasons [122].

120 Reasons [151].

231 The judge then turned to the meeting of 22 April 2010. His Honour concluded that the parties did not engage in relation to the LWC at that meeting.[121] Having discussed the evidence relating to the meeting, he considered the allegations made by NES that Woolworths had breached the terms of the AFL. His Honour again returned to his finding that the Rider Hunt estimate of the LWC at 29 March exceeded the Vaughans estimate of that amount. The judge (again) held that it was a 'reasonable inference' for the Court to draw that the revised amount sought by NES ($2,941,169) was not accepted by Woolworths 'as Mr Macmillan had no authority to accept it'.[122]

232 The judge accordingly accepted the submission by NES that Woolworths had failed to act reasonably to identify or negotiate the differences in the calculation of the LWC, and the contribution to be paid by Masters. Having recited evidence given by Mr Blake that he had been prohibited from attending the meetings between Rider Hunt and Vaughans, the judge accepted, as a matter of inference, that Mr Macmillan had sought to exclude NES from that process 'until such time as the construction cost could be reduced to a level that was within Woolworths' approved but undisclosed budget'.[123] The judge accepted that it was a 'reasonable inference' that Mr Macmillan was not prepared to negotiate any differences in relation to the LWC because the tenant's contribution, that had been identified by Rider Hunt, exceeded his authorised but undisclosed budget.[124]

233 The judge then turned to the submission made on behalf of NES that Woolworths did not act in good faith to identify and resolve any differences between the parties. In that context, the judge again accepted the submission by NES that Mr Macmillan was not free to negotiate a Masters contribution amount that exceeded Woolworths' undisclosed budget. The judge rejected the submission made on behalf

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121 Reasons [162].

122 Reasons [175].

123 Reasons [183].

124 Reasons [187].

of Woolworths that that matter had not been put to Mr Macmillan in cross examination,[125] and concluded as follows:

> Consequently, it would appear to be the case that Woolworths had set an internal budget that limited the amount that Woolworths would contribute to the construction cost of $1.7 million, at a time when the true cost difference between constructing a store to Masters and Bunnings specifications was not known, and by requiring Mr Macmillan to operate within that budget unless there was some business case that warranted an increase. In spite of the fact that the true cost difference far exceeded that amount, Woolworths, through Macmillan, was not able or willing to engage with NES in the way that the agreement for lease, which did not contemplate any budget, required of Woolworths.[126]

234 For those reasons the judge found that Woolworths had breached its obligation to act reasonably and in good faith in accordance with clause 2.2(b) of the AFL.[127] It is thus clear that the judge regarded the issue relating to Woolworths' 'undisclosed budget' as one of substantial importance, first, because it established a motive for Woolworths not to engage in reasonable discussions with NES as to the contribution that Woolworths should make to the LWC, and, secondly, because it informed the judge's conclusion that Woolworths had not acted 'reasonably and in good faith' in attempting to resolve any differences they had with NES relating to those matters, as required by clause 2.2(b) of the AFL.

Submissions about the undisclosed budget

235 Senior counsel for Woolworths submitted to this Court that the conclusion by the judge, that Woolworths had been motivated by the limitations specified by the undisclosed budget, was not open on a proper assessment of the evidence. Counsel noted that, notwithstanding that reference had been made to the undisclosed budget in the particulars of breach pleaded in NES' amended statement of claim, Mr Macmillan was not cross examined at all in relation to the 'undisclosed budget issue'. Counsel also referred to the evidence of Mr Champion in re-examination,

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125 Reasons [213].

126 Reasons [215] (citations omitted).

127 Reasons [216].

that, if necessary, Mr Macmillan could have sought an increase in that budget by submitting a business case, and that Masters had previously undertaken a number of developments in which such a variation of the original budget had been approved. Thus, counsel submitted, there was not a sufficient evidentiary base for the conclusion drawn by the judge that the budget limitation, set in August 2009, had constituted an undisclosed motive for Woolworths not to negotiate reasonably and in good faith concerning the quantum of the LWC, and the amount of contribution to be made to those costs by Woolworths.

236 In response, senior counsel for NES submitted that the judge correctly inferred that Woolworths was motivated by its knowledge of the undisclosed budget limit, set by the Property Committee, in negotiating the amount of the LWC and the contribution to be made by Woolworths to those costs. Counsel noted that the business case for the Bendigo Masters store had not changed between August 2009 and April 2010, so there was no cause for the Property Committee to revise the budget limit that had been set in August 2009. Counsel submitted that the only reasonable explanation, for the failure of Mr Macmillan to communicate with Mr Blake the reason why the cost estimate was too high, was because Mr Macmillan was conscious that the budget limit had remained set at $1.7 million. He further contended that it was appropriate not to have cross examined Mr Macmillan in relation to that matter, because, when Mr Macmillan was in the witness box, NES had not apprehended that the $1.7 million figure, referred to in the submission to the Property Committee of July 2009, was a budget figure. It was only when Mr Champion gave evidence that that matter became clear.

Analysis about the undisclosed budget

237 The finding by the judge, as to the role of the 'undisclosed budget' in the conduct of Woolworths in their negotiations with NES relating to the LWC and the contribution to be made by Woolworths to those costs, was the product of an inference drawn by the judge. The judge based that conclusion, it would seem, on three primary facts, namely:

(1) On 4 August 2009, the Property Committee approved the proposed Bendigo Masters store, on the basis of a submission that that proposal might require an additional $1.7 million contribution should the home improvement design brief cost more than the specification agreed by the lessor.

(2) In the course of the discussions that took place between Rider Hunt and Vaughans in March and April 2010, the amount of the LWC, and thus the potential contribution required to be made by Woolworths to that cost, exceeded $1.7 million.

(3) In discussions with Mr Blake, Mr Macmillan stated that the LWC, that was discussed between Rider Hunt and Vaughans, was too high, but he did not explain to Mr Blake the reasons why the estimate of those costs was excessive, nor did he seek to discuss or negotiate them with Mr Blake.

238 The question raised by appeal grounds 5.4(a), (b) and (c) is whether those facts were a sufficient foundation for the inference drawn by the judge.

239 In applying the applicable principles for drawing inferences, it is significant that no question was put to Mr Macmillan, in cross examination, that his conduct in the negotiations with NES concerning the LWC, and concerning Woolworths' contribution to those costs, was guided or affected in any way by the 'undisclosed budget limit' found by the judge. Mr Macmillan was responsible for the day to day negotiations relating to the matter, while Mr Champion only had an 'administrative oversight role' in relation to Mr Macmillan. The allegation by NES, that Mr Macmillan, and Woolworths, were constrained by the 'undisclosed budget limit' in their negotiations with NES, was an important aspect of the claim by NES that Woolworths had failed to act reasonably and in good faith in negotiating the LWC. In those circumstances, the long established principles of cross examination,

described as the rule in *Browne v Dunn*,[128] made it fundamental that if NES were to rely on the proposition that Mr Macmillan was motivated, in the negotiations, by an ulterior factor such as an undisclosed budgetary limit, that matter must be put to him, so that he might have the opportunity to address and respond to that proposition.

240 In submissions before this Court, senior counsel for NES contended that it was reasonable not to have put the matter to Mr Macmillan, because (according to counsel) the representatives of NES 'didn't apprehend by reason of the way in which it was expressed in the approval that the $1.7 million figure was a budget'.

241 That explanation is not sufficient to account for the failure of counsel to cross examine Mr Macmillan about a matter which, ultimately, became so fundamental to the submissions made by NES in final address, and which was accepted by the judge. As pointed out by senior counsel for Woolworths, particular 15 (vii), to the pleading of breach of contract in the amended statement of claim, alleged that Masters had set a budget cost of NES' works without any authority under either the LOO or the AFL, that it had never disclosed that budget, and that it had wrongfully terminated the AFL on the ground that the LWC, and the tenant's contribution, exceeded that budget. That particular was repeated in the further amended statement of claim that was filed and served during the trial, on the day before Mr Macmillan gave evidence. While it is correct that it was Mr Champion who first mentioned the budget limit in the course of cross examination, counsel quickly seized on that response, and asked questions of Mr Champion based on the submission to the Property Committee dated 22 July 2009.

242 In those circumstances, it is clear that before Mr Macmillan gave evidence, NES had included, in its pleaded case, an allegation that the undisclosed budget

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128 (1893) 6 R 67, 71 (Lord Herschell LC), 76 (Lord Halsbury)('*Browne v Dunn*'); see also *Bulstrode v Trimble* [1970] VR 840, 846–7 (Newton J); *Reid v Kerr* (1974) 9 SASR 367, 374 (Wells J); *Allied Pastoral Holdings Pty Ltd v Federal Commissioner of Taxation* (1983)44 ALR 607, 623 (Hunt J); *Toula Holdings Pty Ltd v Morgo's Leisure Pty Ltd* [2014] QCA 201 [121] and following.

figure was the reason why Woolworths did not enter into genuine negotiations concerning the quantum of the LWC and the tenant's contribution to it. The matters put to us by senior counsel for NES do not provide an adequate explanation why that allegation was not put to Mr Macmillan in cross examination.

243 In some cases, an allegation that is clearly made in pleadings, or in opening, may be so prominent that it is not necessary for it to be put in cross examination, because there is a fair expectation that, in any event, the other party's witnesses will have sufficient notice of that allegation to answer it. In a commonly cited passage, Lord Herschell LC in *Browne v Dunn* stated that proposition in the following terms:

> of course I do not deny for a moment that there are cases in which that notice has been so distinctly and unmistakably given, and the point upon which he is impeached, and is to be impeached, is so manifest, that it is not necessary to waste time in putting questions to him upon it.[129]

244 However, this was not such a case. The particular in the pleading, to which we have referred, was but one of 12 particulars of breach. It was not addressed in the opening by senior counsel for NES. In the further amended statement of claim (served one day before Mr Macmillan gave evidence), the particulars of breach were expanded to 15. The fifteenth particular alleged that Masters did not act in good faith, because it terminated for reasons other than not being able to agree as to the amount of the LWC or of the tenant's contribution. That particular specified five reasons for that proposition, none of which related to the undisclosed budget amount. In those circumstances, Woolworths were not put on sufficient notice of the allegation about the undisclosed budget sum to excuse counsel from cross examining Mr Macmillan about it.

245 At the least, the failure of counsel to cross examine Mr Macmillan on such a fundamental matter, and thus the fact that Mr Macmillan did not have the

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129 (1893) 6 R 67, 71; See also *Allied Pastoral Holdings Pty Ltd v Federal Commissioner of Taxation* (1983) 44 ALR 607, 624 (Hunt J); *Seymour v Australian Broadcasting Commission* (1977) 19 NSWLR 219, 225 (Glass JA), 236 (Mahoney JA); *Toben v Nationwide News Pty Ltd* [2016] NSWCA 296 [58] (Ward JA).

opportunity to answer it, should have given the judge significant cause to pause before drawing the inference, adverse to Mr Macmillan and Woolworths, that was the foundation of a number of findings by him, and to which we have referred. The rule in *Browne v Dunn* is fundamentally based on the general principle of fairness.[130] At trial, ultimately, NES contended that the judge should draw an inference adverse to both Mr Macmillan and to Woolworths, without giving a fair opportunity to Mr Macmillan to comment on or respond to it. In that way, the failure of counsel to cross examine Mr Macmillan on that matter was directly relevant to whether it was open to the judge to conclude, on the evidence, that it was probable that Mr Macmillan had been motivated by the 'undisclosed budget' in his negotiations with NES.[131]

246 In that context, the evidence, given by Mr Champion relating to this matter, is significant. In cross examination, Mr Champion stated that if Mr Macmillan had wanted to obtain an approval for a higher budgetary limit, he would have submitted a variation request, seeking additional capital, which would have been given consideration. Mr Champion stated that Mr Macmillan did not ever put such an additional submission to the Property Committee. He further stated that while, in theory, Mr Macmillan could have terminated the deal without authority, it was Mr Champion's very firm expectation that Mr Macmillan would first have spoken to him before doing so. In that connection, he said that the $1.7 million figure had been based on a 'ballpark' assessment of the cost of certain items that distinguished a Masters store from a Bunnings store. Mr Champion stated he had not been specifically informed that there was a gap between the budget limit of $1.7 million and the contribution that had been requested. Rather, Mr Champion was told that there was a gap which he 'inferred' related back to the $1.7 million figure.

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130 *Bulstrode v Trimble* [1970] VR 840, 846 (Newton J); *Allied Pastoral Holdings Pty Ltd v Federal Commissioner of Taxation* (1983) 44 ALR 607, 625 (Hunt J).

131 See *Bulstrode v Trimble* [1970] VR 840, 848–50 (Newton J); *Allied Pastoral Holdings Pty Ltd v Federal Commissioner of Taxation* (1983) 44 ALR 607, 630–632 (Hunt J); *Precision Plastics v Demir* (1975) 132 CLR 362, 370-371 (Gibbs J); *Seymour v Australian Broadcasting Commission* (1977) 19 NSWLR 219, 237 (Mahoney JA).

247 Pausing there, there was nothing in the cross examination of Mr Champion that suggested that he, or to his knowledge Mr Macmillan, had been motivated by the undisclosed budget figure, in negotiating the LWC or the tenant's contribution to those costs with NES. Indeed, some of the questions asked of him in cross examination seemed to suggest that the budget limit could be altered, but that no request for an increase to it had been made, because there were other reasons why Woolworths did not wish to proceed with the transaction. Thus, later in cross examination of Mr Champion, it was put that the reason why Woolworths did not proceed with the negotiations was because there were planning difficulties associated with the Strathdale site.

248 There was no aspect of Mr Champion's evidence which could, properly, form a foundation for an inference as to the role of the budget limit, as found by the judge. No suggestion was put to Mr Champion that that undisclosed limit was the hidden motive for the conduct by Woolworths of the negotiations relating to the LWC and the tenant's costs.

249 In re-examination, Mr Champion stated that it was not uncommon for the original budget approval for a Masters store to be increased subsequently. He stated that, to his recollection, previous applications for the increase in budget limits in respect of at least 10 other Masters stores had been approved by the Property Committee.

250 That evidence of Mr Champion was not contradicted by any other evidence, nor did counsel seek leave to cross examine Mr Champion about it. While the judge had reservations about other aspects of evidence given by Mr Champion, he did not reach any adverse conclusion about Mr Champion's evidence concerning the budget figure set by the Property Committee, and its role in relation to the negotiations between the parties. That evidence, of itself, militated cogently against the inference, relating to the budget limit, contended for in final address by NES, and accepted by the judge.

251 In addition, it is relevant that Mr McDonald, in cross examination, stated that he was never informed of a budget figure by Woolworths, or what Woolworths was prepared to pay. From the point of view of Woolworths, Mr McDonald played an important role in endeavouring to reduce the amount of the LWC, and thus the tenant's contribution under clause 2.2 of the AFL. If the budget limit was as significant as that found by the judge, it would be expected that Mr McDonald would have been apprised of it. The fact that he was not informed of that figure, also tends relevantly against the inference drawn by the judge.

252 In the upshot, the first and principal piece of evidence, relied on by the judge — the resolution of the Property Committee — was not itself a sufficient foundation for the inference that the budget limit was a type of 'hidden agenda' motivating Woolworths not to negotiate reasonably and in good faith with NES. Logically, the resolution of the Property Committee could only be an adequate basis for such an inference, on the balance of probabilities, if the budget figure set by that resolution was fixed and immutable, or if the evidence demonstrated that Mr Macmillan had an expectation that he would not be able to procure an increase in it. Neither of those facts were established by the evidence. On the uncontradicted evidence, the budget figure was not inflexible and immutable but, rather, the evidence of Mr Champion was that it was the type of figure that could, in an appropriate case, be increased on submission to the Property Committee.

253 The other principal fact relied on by the judge concerned the manner in which Mr Macmillan related to Mr Blake during the discussions, and, in particular, the fact that Mr Macmillan did not enter into any detail when he told Mr Blake that the amount of the LWC was too high. As we have already discussed, the difficulty with relying on that fact was that it was not put to Mr Macmillan that he had refrained from discussing the matters with Mr Blake because of the undisclosed budget limit. Further, that suggestion had not even been put to Mr Champion in cross examination. In addition, as we have mentioned, if the undisclosed budget figure was such a significant constraint on Mr Macmillan communicating with Mr Blake, it

is incongruous that Mr McDonald was not informed of it.

254 In those circumstances, and for those reasons, we consider that it was not reasonably open to the judge to conclude, on the balance of probabilities, that Woolworths did not accept NES' revised estimate of $2,941,169 because that sum exceeded the undisclosed budget figure of $1.7 million.

(b) Ground 5.4(g) — Exclusion of NES from negotiations

255 In light of the conclusions that we have so far reached, it is convenient, next, to address Ground 5.4(g). That ground is directed to findings by the judge to the effect that, because on or about 29 March 2010 Rider Hunt had estimated Woolworths' contribution, under clause 2.2(b) of the AFL, to be in the sum of $3,247,195, Mr MacMillan sought to exclude NES from negotiations and Woolworths did not enter into direct negotiations with NES.

256 In particular, in a section of the reasons entitled 'Woolworths did not act reasonably to identify and resolve any differences', the judge drew an inference that Mr MacMillan sought to exclude NES from the open-book process, and that he was not prepared to negotiate any differences relating to the LWC, because Woolworths' contribution, that had been identified by Rider Hunt on 29 March 2010, far exceeded his authorised but undisclosed budget limit.[132]

257 That conclusion was based on a combination of three factual findings by the judge, each of which we have concluded were not supported by the evidence. Those findings were each basic premises to the judge's conclusion that is sought to be impugned by ground 5.4(g).

258 The first premise was that, by 29 March, Rider Hunt had estimated that the contribution by Woolworths to the LWC, under clause 2.2(b) of the AFL, was a sum of $3,247,195. As we have already concluded, under grounds 5.4(e) and (f), that

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132 Reasons [183], [185], [215].

factual premise, found by the judge, was contrary to the evidence.

259 The second premise was that Woolworths (and in particular Mr MacMillan), did not engage in negotiations with NES because that amount, so fixed by Rider Hunt, substantially exceeded his authorised but undisclosed budget limit of $1.7 million. We have concluded, under grounds 5.4(a) (b) and (c), that the evidence did not support the conclusion that the reason that Woolworths did not accept NES' revised estimate of $2,941,169, was because that sum exceeded the undisclosed budget figure of $1.7 million. It follows, from our conclusions in respect of those grounds, that the evidence does not support the proposition that the undisclosed budget figure caused or motivated Mr MacMillan to refrain from entering into negotiations directly with NES concerning the contribution of Woolworths to the LWC.

260 The third premise, to the conclusion that the judge addressed by ground 5.4(g), is that Woolworths did not engage, and indeed deliberately refrained from engaging, in negotiations with NES relating to the contribution to the LWC. In our view, that factual premise cannot be properly supported by the evidence. We have earlier, when considering grounds 5.4(e) and (f), summarised the on-going discussions and contacts between Vaughans and Rider Hunt relating to that matter. Further, under ground 5.4(i), we have concluded that it was not open to the judge to accept that it was reasonable for Woolworths to consider that Vaughans was, in effect, retained by NES as a counterpart to Rider Hunt for the purpose of discussing and revising the costs that were properly to be characterised as part of the LWC. As we have earlier noted, it is understandable that the detailed discussions, concerning those matters, were undertaken by NES' building consultant (Vaughans) and Woolworths' quantity surveyor (Rider Hunt). At the least, it is unsurprising that Woolworths would have expected that those two parties were to play a substantial role in discussing and refining those costs.

261 In that context, in support of his conclusions on this aspect of the case, the

judge set out and relied on a passage from the cross examination of Mr MacMillan, in which his Honour considered that Mr MacMillan made 'admissions' relating to the approach of Woolworths to the process of establishing the LWC.[133] In that passage, Mr MacMillan was repetitively cross examined as to whether it would have been 'reasonable' for him to discuss the differences relating to the LWC with Mr Blake. It is significant, that in seeking to answer those questions, Mr Macmillan, on more than one occasion, made the point that the process of estimating those costs was still ongoing. Thus when asked whether he accepted that it would have been 'reasonable' to discuss the report of Rider Hunt of 29 March with Mr Blake, Mr Macmillan responded:

> The only difficulty with that is the process was still going and there was still further discussions in that regard.

262 The evidence, to which we have earlier referred, supports that answer given by Mr Macmillan in cross examination. In particular, the process of discussion and analysis undertaken by Vaughans and Rider Hunt continued well into April 2010.

263 For those reasons, we are persuaded that ground 5.4(g) of the application is made out.

(c) Grounds 5.4(o), (p), (q) — the Hume & Iser issue

264 Grounds 5.4(o), (p) and (q) are directed to the finding by the judge that one of the reasons that Woolworths did not take all reasonable steps to resolve differences it may have had in relation to the LWC was that, before the open book process had been completed, the Property Committee had decided to terminate the AFL and pursue a site known as the Hume & Iser site instead.[134]

265 The background to that finding is set out in some length in the reasons of the primary judge. A brief summary is sufficient for present purposes.

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133 Reasons [181].

134 Reasons [225], [236].

266 From late 2008, or early 2009, Danks had embarked on an expansion strategy, in the course of which it identified the Hume & Iser hardware store in Bendigo as a key acquisition target. Subsequently, on 25 August 2009, Woolworths launched a takeover bid to acquire Danks. On 11 November 2009, the Australian Competition and Consumer Commission (ACCC) announced its decision not to oppose the acquisition. By February 2010, Woolworths began incorporating the Danks business into its own business, which included incorporating Danks' expansion strategy. That strategy included the acquisition of the Bendigo Hume & Iser store. By late February 2010, discussions had taken place between Mr Stephen Iser, the director of Hume & Iser, and Mr Graeme Danks of Danks Holdings. Subsequently, on 9 March 2010, Mr Danks, along with Mr O'Brien of Woolworths, and others, met with Mr Iser to discuss the potential purchase of the Hume & Iser store by Danks. Between 2010 and 2012, various offers were made to acquire the Hume & Iser business. Ultimately, by 16 February 2012, the Hume & Iser board had rejected all offers from Danks, and resolved not to entertain any further such offers. As a result, negotiations between Danks and Hume & Iser ceased.

The judge's reasons about Hume & Iser

267 The judge dealt with the issue, relating to Hume & Iser, in two parts of the reasons, first, when outlining the background to the negotiations between Woolworths and NES relating to the LWC,[135] and, secondly, in the section of the reasons entitled 'Other Matters Affecting Woolworths' Performance of its Obligations'.[136]

268 In the earlier part of the reasons, when outlining the background to the acquisition by Danks of Hume & Iser, the judge noted that the strategy of Danks, to incorporate Hume & Iser into its business, was 'inconsistent' with a decision of the Property Committee on 4 August 2009 to pursue only one store in Bendigo, and to

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135 Reasons [98]–[108].

136 Reasons [218]–[225].

approve the Strathdale site.[137] In that respect, the judge referred to Woolworths' home improvement strategy, which contemplated that Woolworths would protect the Danks key Home Timber and Hardware store customer base, and avoid or minimise competition between Oxygen and trade focused retail stores.[138]

269 In the later section of the reasons, the judge noted that on 9 March 2010 a meeting had taken place between Mr Danks, Mr O'Brien, and others with Mr Iser to discuss the potential purchase of the Hume & Iser site by Danks. The judge observed that no explanation was given why Mr O'Brien was not called to give evidence in the proceeding about the substance of that meeting.[139] The judge set out, in summary form, the state of ongoing discussions relating to the purchase of the Hume & Iser site, including discussions between Mr Danks and Mr Macmillan, and between Mr Iser and Mr Macmillan, in relation to that matter.[140] He referred to the meeting of the Property Committee on 16 March 2010, which resolved to pursue the Hume & Iser site. As a result, the status of the Strathdale site was recorded in the log of the Property Committee as follows:

> Landlord has funding issues. Alternative site being pursued. Check legal position in relation to negotiation on site.

270 His Honour then noted that the minutes of the Property Committee meeting of 6 April 2010 recorded, in relation to the Strathdale site: 'Deal likely to fall over'.

271 The judge next referred to an email from Mr Macmillan to Mr Danks dated 23 April 2010, stating that Woolworths was willing to walk away from the Strathdale site, and that the preference was to progress the Hume & Iser site as an Oxygen site, as it had a better location, and would be supported by council. On 30 April, Mr Macmillan sent Mr Iser a confidentiality and exclusive dealing agreement with

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137 Reasons [100].

138 Reasons [101].

139 Reasons [105].

140 Reasons [220].

an exclusive dealing period of six months. The judge also noted that the minutes of the Property Committee meeting of 4 May stated: 'Deal on Bendigo will fall over. Pursuing alternative site'.

272 Having recited those matters, the judge noted that, at that stage, unless Woolworths decided to abandon the Strathdale site, the strategy of pursuing the Hume & Iser site was inconsistent with the Property Committee's decision of 4 August 2009 that Woolworths would pursue only one store in Bendigo. Further, the judge observed that it would have been contrary to Woolworths' home improvement strategy for it to pursue both sites in Bendigo.[141] The judge considered that the evidence by Mr Macmillan, that he advised Mr Champion that the AFL could not be terminated in order to pursue the Hume & Iser site, lacked credibility and was inconsistent with the contemporaneous documents which showed that there was no change in position by the Property Committee. The judge also rejected, as 'equally incredible', Mr Macmillan's evidence that the Hume & Iser site was only considered as a potential site for a Masters store after the meeting of 22 April 2010. The judge considered that that evidence was inconsistent with contemporaneous documents, and that it was 'inherently implausible' that Mr Macmillan formed the view, stated in his email to Mr Danks on 23 April, less than 24 hours after the 22 April meeting. The judge again noted that Woolworths did not call Mr O'Brien or any other person who attended at the 9 March meeting, which led to the Property Committee decision to pursue the alternative site on 16 March.[142]

273 The judge then referred to the negotiations between Woolworths, Mr Danks and Mr Iser between June 2010 and early 2012, and concluded as follows:

> For these reasons, I am of the view that in breach of clause 2.2(b) of the Agreement for Lease, another reason that Woolworths did not take all reasonable steps to identify, communicate and resolve any differences it may have had in relation to the Landlord's Works Costs, was that, before the open book review process could be contemplated or any differences identified, the

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141 Reasons [222].

142 Reasons [223].

> Property Committee had decided, for strategic reasons, to terminate the Agreement for Lease and pursue the Hume & Iser site instead. In reaching this position, primary reliance has been placed on contemporaneous documents. It is a conclusion reached on this basis and not, as Woolworths contends, the product of characterising the contentions of NES with respect to this issue as, in effect, allegations of some conspiracy on the part of Woolworths and various individuals.[143]

Submissions about Hume & Iser

274 Counsel for Woolworths submitted that the finding by the judge concerning the Hume & Iser issue was not supported by the evidence, and indeed was contrary to the evidence. In particular, counsel referred to evidence by Mr Macmillan that the Masters stores and the Danks stores were separate, and that there were a number of instances where Danks stores were opened near Masters stores. Counsel also referred to evidence by Mr Champion that he had explicit instructions to disregard the location of Danks stores when selecting Masters sites. It was submitted that the judge did not consider, or 'engage with', that evidence.

275 In addition, it was contended, when Woolworths executed the AFL on 24 February 2010, it already knew of the Danks strategy to pursue the Hume & Iser site. Thus, if Woolworths had preferred to pursue the Hume & Iser site, in lieu of the Strathdale site, it could have refrained from entering into the AFL. Counsel further submitted that the judge failed to take into account the evidence of Mr Champion that the Strathdale site remained the preferred Masters store site until after 22 April 2010, and that the discussions which took place in relation to the Hume & Iser site, before that date, were in respect of a separate Danks acquisition, as well as being a fall-back position in the event that the issues with the Strathdale site precluded the completion of the transaction in relation to it. In addition, it was contended, the judge failed to take into account, or give appropriate weight to, Woolworths Corporate Property Report of 23 April 2010, which gave a 41 to 60 per cent probability of the Strathdale site then proceeding to completion. It was submitted further that there was no evidence that before 22 April 2010, the Hume & Iser store

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143 Reasons [225].

was preferred by Woolworths, or was considered to be other than an opportunity either for the Danks hardware business, or as a fall-back site, should the Strathdale site not proceed. It was further contended that the judge erred in considering that Woolworths had a 'one store policy' which precluded the establishment of both a Masters store and a Danks store in Bendigo on separate sites.

276 In response, counsel for NES noted that the judge had rejected the evidence of Woolworths' witnesses that the Strathdale site was a preferred site, and drew an inference that there was another, and more favoured site, in the Hume & Iser store. Counsel submitted that Woolworths Corporate Property Report dated 23 April (recording that the Strathdale store was in a 41 per cent to 60 per cent probability band) was of little consequence, because the next report, dated 11 May 2010, contained the same notation, notwithstanding that by then the AFL had been terminated by Woolworths.

277 Counsel submitted that, on the evidence, the judge was correct in finding that in March 2010 Woolworths had made a decision to pursue the Hume & Iser site as an alternative Oxygen acquisition, and not as a separate Danks acquisition. In support of that submission, he referred to the meeting between Mr O'Brien, Mr Danks and Mr Iser on 9 March 2010, and to the Property Committee meeting minutes dated 16 March 2010, which referred to an 'alternative site' being pursued at that stage. Counsel submitted that it was significant that those minutes referred to an 'alternative', not an 'additional', site. He submitted that the extrinsic evidence demonstrated that the 'alternative' site was Hume & Iser. Counsel noted that, shortly after the meeting of 22 April, an exclusive dealing agreement was signed with Hume & Iser on 30 April, and that on the day after the meeting of 22 April, Mr Macmillan had sent an email to Mr Danks stating that Woolworths were willing to 'walk away' from the Strathdale site, and that the preference was to progress the Hume & Iser site as an 'Oxygen site'. Counsel also referred to an email sent by Mr Macmillan to Mr Danks on 30 April, noting that Mr Iser was very interested in progressing negotiations with Oxygen. Finally, counsel referred to the diary note of

Mr Champion of 4 May, that the agreement to lease the Strathdale site was expected to 'fall over' on that day, and that Mr Macmillan had met with Mr Iser, who was very interested in selling his store to Woolworths.

278 Counsel submitted that the combination of the facts, referred to above, were a sufficient basis for the inference drawn by the judge that one of the reasons, that Woolworths did not engage reasonably with NES in respect of the LWC and the tenant's contribution, was because it had already decided to pursue the Hume & Iser site instead of the Strathdale site.

279 In reply, counsel for Woolworths submitted that there was no reason why Woolworths would have made a false entry on 23 April to record that Strathdale had a probability of occurring of 41 per cent to 60 per cent, if that were not then its genuine estimate of the prospects of the transaction proceeding. It was not suggested to Mr Champion in cross examination that the document was a façade. In re-examination, in relation to that document, Mr Champion stated that he still regarded Hume & Iser to be an inferior site to the Strathdale site. Counsel further submitted that there was nothing on the face of the minutes of the meetings of 16 March, 6 April or 4 May, to indicate that the Hume & Iser site was being pursued in preference to the Strathdale site. Counsel again referred to Mr Champion's evidence that at all times the Strathdale site was the preferred site, but the Hume & Iser site was being examined because there was a concern that the transaction relating to the Strathdale site might not be completed. Counsel also referred to the evidence, contained in the documents, that Woolworths were also considering other sites, such as the Iceworks site. That evidence, he submitted, contradicted the proposition that Woolworths had fixed on an intention to acquire the Hume & Iser site, in lieu of the Strathdale site.

Analysis about Hume & Iser

280 In essence, the judge's reasoning, on the Hume & Iser issue, comprised the following propositions:

(1) By March 2010, Woolworths had become interested in acquiring the Hume & Iser site.

(2) By that time, Woolworths viewed the Hume & Iser site as a preferable site to the Strathdale site.

(3) Woolworths had a policy that it would only establish one store in Bendigo.

(4) Accordingly, by mid-March 2010, and before the open book process had been completed, Woolworths had determined that it would pursue the purchase of the Hume & Iser site, and that it would no longer proceed with the AFL to establish a Masters store on the Strathdale site.

281 The implications of these findings by the judge were that, from at least mid-March 2010, the discussions which were entered into by Woolworths relating to the LWC and the tenant's contribution — including the discussions between Rider Hunt and Vaughans — were, effectively, a charade on the part of Woolworths, conducted by it in the false pretence that Woolworths had remained interested in entering into a lease of the Strathdale site. Such a conclusion, that Woolworths had engaged in conduct involving commercial subterfuge, necessarily reflected adversely on the ethics and reputation of Woolworths. In those circumstances, it was important to ensure that the principles, relating to the drawing of inferences in a civil case, be applied with an appropriate degree of rigour when examining the evidentiary foundation for the contentions made by NES on this aspect of the case.[144]

282 It is not suggested by Woolworths that there was an insufficient basis for the judge's finding on the first proposition outlined above. The evidence clearly demonstrates that, after the acquisition of the Danks business, Woolworths became interested in pursuing the strategy of Danks acquiring the Hume & Iser store in Bendigo. As a consequence, serious negotiations were undertaken with Mr Iser from

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144 *Briginshaw v Briginshaw* (1938) 60 CLR 336, 362–3 (Dixon J); *Rejfek v McElroy* (1965) 112 CLR 517, 521; *Neat Holdings Pty Ltd v Karajan Holdings Pty Ltd* (1992) 110 ALR 449, 450; *Xu v Jinhong Design & Constructions Pty Ltd* [2011] NSWCA 277, [91]–[97] (Macfarlan JA).

9 March 2010, and they continued for a period of more than two years.

283 In that context, we disagree with the judge's view that it was relevant that Mr O'Brien was not called to give evidence on behalf of Woolworths. NES did not adduce any evidence that, in the course of negotiations with Mr Iser, it was represented to Mr Iser that if the Hume & Iser store was acquired by Woolworths, Woolworths would not proceed to establish another Masters store in Bendigo. Mr Iser was not called on behalf of NES. The evidence presented by NES did no more than demonstrate that, from early March 2010, there were genuine negotiations undertaken by Woolworths with a view to acquiring the Hume & Iser store.

284 In his reasons for decision, the judge placed substantial weight on the minute of the Property Committee meeting of 16 March, which recorded that the landlord (NES) had funding issues, and that an 'alternative site' was 'being pursued'. On its face, and also in context, that minute is a slender basis upon which to conclude that, by that date, Woolworths had determined not to proceed with the Strathdale site, but to pursue the possible purchase of the Hume & Iser site instead.

285 Clearly, Woolworths had some concerns as to whether NES would be able to fulfil its side of the bargain, and as to whether the preconditions relating to the Strathdale site could be fulfilled. In those circumstances, it made good business sense for Woolworths to seek out an alternative site, in the event that the Strathdale transaction did not reach fruition. Neither the minute, nor the circumstances attending that meeting, could support a conclusion on the balance of probabilities that, rather than considering the Hume & Iser site as a 'fall back' site, Woolworths were then fixed on pursuing the Hume & Iser site instead of, and to the exclusion of, the Strathdale site.

286 On the other hand, the inference by the judge — that by that stage Woolworths had determined to abandon the Strathdale site — has a number of difficulties. In the first place, Woolworths had completed the purchase of the Danks business before it executed the AFL on 24 February 2010. By the time Woolworths

purchased that business, the Danks policy of pursuing the Hume & Iser store had been in place for more than six months. If Woolworths, at that time, had wished to pursue the Hume & Iser store, to the exclusion of the Strathdale site, it would not have executed the AFL. There is no evidence that, in the three week period between the signing of the AFL on 24 February, and the Property Committee meeting of 16 March, there had been any relevant change in circumstances which would have caused Woolworths to have abandoned its interest in the Strathdale site in favour of the Hume & Iser site.

287 In that respect, it is relevant that, even after 22 April, Woolworths pursued an interest, not only in the Hume & Iser site, but also in other alternative sites, including the Iceworks site and the Rocklea Homemaker site. In cross examination, Mr Macmillan gave evidence that when Woolworths decided to consider the Hume & Iser store, it was also considering other options for a Masters store in Bendigo, including on the two sites that we have just mentioned. That evidence was supported by documents tendered in the proceeding evidencing interest by Woolworths in those sites in the period of May to June 2010. It militates against the notion that such was the attraction of the Hume & Iser site that Woolworths abandoned its plan to lease the Strathdale site in order to pursue it.

288 The conclusion by the judge, that Woolworths preferred the Hume & Iser site, to the exclusion of the Strathdale site, is also contrary to the uncontradicted evidence of Mr Champion. In his evidence in chief, Mr Champion stated that as at 16 March 2010, Woolworths' strong preference for the Strathdale site remained. He said that Woolworths had spent considerable time investigating Bendigo, and that it had identified the Strathdale site as the best location for such a store. He further stated that the Hume & Iser site was considered secondary, and that, at that stage, it was considered only as an alternative in the event that Woolworths missed out on the Strathdale site.

289 In addition, in cross examination, Mr Champion stated that the business

conducted by Masters stores was quite different to the business conducted at a Danks store. In particular, while the Masters store business comprised 80 per cent retail, and 20 per cent wholesale, conversely, the Danks business comprised 80 per cent wholesale, and only 20 per cent retail. When cross examined about the 16 March meeting, he stated that at that time Hume & Iser was being looked at as part of the Danks business. However, in light of the issues relating to funding for NES, it was proposed at that meeting that the Hume & Iser site might be a fall-back alternative site should the Strathdale site not proceed. When further pressed on the matter he stated:

> one of the first things we would do if there was concern about a particular site not proceeding, would be to look at alternatives.

290 The judge did not deal with that evidence given by Mr Champion. There was no aspect of the cross examination of him about that topic from which it could be inferred that the judge did not accept, as truthful and accurate, the evidence so given by Mr Champion. As such, that evidence militated strongly against the inference, drawn by the judge, that by 16 March, Woolworths had abandoned interest in the Strathdale site in preference for the Hume & Iser site.

291 Finally, in this context, a Woolworths Corporate Property Report dated 23 April 2010 is also relevant, as it attributed a 'probability band' to the Bendigo store proceeding as 41 per cent to 60 per cent. The previous report did not contain such a notation. The fact that the next report — dated 11 May — still retained that notation, did not eliminate the significance of the fact that, as at 23 April 2010, the Strathdale site was still in contention. Certainly, by that date, as found by the judge, both Woolworths and NES had reached the position that they could not agree the LWC and the tenant's contribution. However, at that stage, Woolworths were still considering whether to purchase from NES the option to acquire the land. The fact, that that prospect was still rated by Woolworths in the probability band, is a further relevant piece of evidence militating against the inference, drawn by the judge, that by that time Woolworths had abandoned interest in the Strathdale site.

292 Taking into account the matters so far discussed, and based on those matters, we do not consider that it could be concluded, on the balance of probabilities, that from approximately mid-March 2010, Woolworths had determined not to proceed with the Strathdale site, because they preferred to pursue the acquisition of the Hume & Iser site for the purposes of establishing a Masters store on that location.

293 In order to draw that inference, the judge relied on the third proposition that we have outlined above, namely, that at all times Woolworths had a policy that it would only establish one store in Bendigo. However, as a matter of analysis, we do not consider that there was an adequate evidentiary basis for that proposition, and in particular, for the proposition that Woolworths had a fixed policy that it would only pursue one store in Bendigo.

294 The judge's finding to that effect was based, in substantial measure, on the minute of the Property Committee dated 4 August 2009, noting that the Strathdale site was a 'good location. Will pursue one store in the foreseeable future'.[145]

295 That resolution, of itself, could not be a sufficient basis to prove the existence and application of an inflexible policy that bound Woolworths some seven months later. First, the resolution of the Property Committee was not expressed as an immutable policy, but, rather, was recorded as an intention to purchase one store 'in the foreseeable future'. Secondly, there is no evidence that Woolworths treated the resolution as a fixed and inflexible policy. Thirdly, and to the contrary, the sequence of events, in which Woolworths entered into the LOO, and subsequently the AFL, while at the same time incorporating the Danks business, demonstrated that Woolworths did not regard that policy as precluding the incorporation of both the Strathdale site and the Hume & Iser site into its business together.

296 As the judge noted, as early as February 2009, Woolworths had identified the Hume & Iser site in Bendigo as a priority site to acquire as part of its acquisition of

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145 Reasons [221].

the Danks business.[146] That did not preclude Woolworths from considering the acquisition of the Strathdale site, which, as we have noted, was approved by the Property Committee on 4 August 2009. Nor did the resolution of that committee preclude Woolworths, three weeks later, launching its bid to acquire Danks. Having received the approval of the ACCC to proceed with the takeover, Woolworths, at the same time, engaged Rider Hunt to assist it in its intended purchase of the Strathdale site. Further, notwithstanding that by February 2010 the Danks business had been incorporated into the Woolworths business, on 24 February, Woolworths (and Masters) entered into the AFL. That short recitation of the background circumstances demonstrates that at no time, following the resolution of the Property Committee dated 4 August 2009, did Woolworths consider itself to be constrained to pursue or acquire only one of the Strathdale or Hume & Iser sites, to the exclusion of the other.

297 The judge also placed weight on Woolworths home improvement strategy. However, an analysis of that document reveals that it did not, on its face, preclude Woolworths purchasing the Danks store in addition to the Strathdale store. Indeed, in that document, in response to the 'Issue/Risk' item 'Potential clash of trade focus retail network/small box acquisitions with Oxygen network', one of the approaches noted was:

> Would not acquire any small box retail operations in an Oxygen catchment area unless it was a defensive plan to protect a key Home member being targeted by a competitor.

298 During discussions between Mr Iser and Mr Danks, Mr Iser told Mr Danks that he had previously had discussions with Bunnings, which had progressed to the stage at which Mr Iser had signed a confidentiality agreement with Bunnings and had shared the Hume & Iser financial accounts with Bunnings. In that context, as noted by the judge,[147] a potential acquisition of the Bendigo Hume & Iser store by

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146 Reasons [23].

147 Reasons [104].

Bunnings would have presented a significant difficulty for Woolworths and Danks, because the Strathdale site was within ten kilometres of the Hume & Iser store in Bendigo. Thus, it would have made good sense for Danks to have purchased the Hume & Iser store, as a defensive move to protect the Strathdale site for Woolworths. Further, and in any event, we do not consider that there is anything in Woolworths home improvement strategy document that precluded or prevented Woolworths proceeding to purchase the Strathdale site in addition to the Hume & Iser site, particularly in light of the evidence of Mr Champion that the two sets of businesses were quite different.

299 Based on those matters, we consider that there was not an adequate evidentiary foundation for the judge to conclude, as he did, on the balance of probabilities, that Woolworths had a fixed policy that it would only pursue one store in the Bendigo area, so that, in light of its preference for the Hume & Iser store, it decided that it would not proceed with the transaction to acquire a store at the Strathdale site. That conclusion, by the judge, was of central importance to the finding that one of the reasons, that Woolworths did not take all reasonable steps to resolve differences it may have had in relation to the LWC, was that, before the open book process had completed, Woolworths had decided to terminate the AFL and pursue the Hume & Iser site. Accordingly, for the reasons set out above, we do not consider that the evidence was sufficient to found an inference on the balance of probabilities that Woolworths did not take reasonable steps to identify and resolve differences it may have had in relation to the LWC because it had decided to terminate the AFL and pursue the Hume & Iser site instead. It follows that Grounds 5.4(o), (p) and (q) should succeed.

(d) Ground 5.4(n) — 'the lump sum' payment motivation

300 Ground 5.4(n) is directed to the finding by the judge that the proposal by Woolworths in the letter by Allens Arthur Robinson dated 9 April 2010, that the tenant's contribution to the LWC be paid in two instalments, rather than by lump

sum, was an intentional attempt by Woolworths to bring about a difference between the parties which it could rely on as a basis to terminate the AFL.[148] In particular, the judge stated:

> As observed by NES, the letter from Allens Arthur Robinson is instructive on a number of levels:
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> …
>
> (c) Thirdly, the form of the contribution that was to be made by Woolworths, that is, a "lump-sum" payment toward the construction costs, had been long since agreed—including in the Letter of Offer. Woolworths' attempt to vary this payment term for the first time, so as to enable the contribution to be made in stages, up to more than one year after the completion of the development, was inconsistent with what had been agreed. It may be inferred, in light of the Property Committee's decision to pursue an alternative site, that this requirement was an attempt by Woolworths to bring about a difference between the parties that it could rely on as a basis for termination of the Agreement for Lease.

301 That finding by the judge was based on two premises, each of which, we have concluded, are without appropriate factual foundation. The first premise is that Woolworths had 'long since' agreed that the payment by the tenant to the LWC be by way of lump sum. It is clear that that matter was in contention. Indeed, as we have concluded, the view taken by Woolworths was correct.

302 The second premise, relied on by the judge, was that, by 9 April 2010, the Property Committee of Woolworths had decided to pursue an alternative site, namely, the Hume & Iser site. Again, as we have already concluded, there was not an adequate evidentiary foundation for the judge to conclude that Woolworths had decided to pursue the Hume & Iser site instead of the Strathdale site.

303 Ground 5.4(n) is made out.

(e) Grounds 5.4(j), (k), (l) — the 22 April 2010 Meeting

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148 Reasons [154(c)].

304 Grounds 5.4(j), (k) and (l) are directed to the conclusions by the judge concerning the conduct of Woolworths at the meeting of 22 April 2010, and between that date and the date of the termination of the AFL on 6 May 2010.

305 The meeting of 22 April was attended by Mr Blake, NES' solicitors Mr Michael Fetter and Mr Gerald Davis of Fetter Gdanski, Mr Macmillan, and Woolworths' solicitor, Mr Michael Graves of Allens Arthur Robinson. Each of those persons gave evidence in the trial. Unsurprisingly, there were a number of differences between the accounts that they gave relating to the discussions that took place at the meeting. The judge made a series of findings on that evidence, and concluded that, in breach of clause 2.2(b) of the AFL, Woolworths did not act reasonably, or in good faith, at the meeting, or in the period leading to the termination of the AFL, to identify and resolve differences it had with respect to NES estimate of the LWC or with respect to the tenant's contribution to that sum. The gravamen of these grounds of appeal is that those conclusions were not open to the judge on the evidence.

306 For the purposes of addressing those grounds, it is only necessary to summarise the evidence of the witnesses in short compass. Mr Blake's evidence was that, at the commencement of the meeting, Mr Graves stated that the estimate by Vaughans' of Woolworths' contribution to the LWC was too high. Mr Macmillan and Mr Graves did not elaborate on that statement. Mr Blake said that they then discussed potential reductions from the Bunnings design, and he suggested that there were not many that could be deducted. The meeting then addressed the issue as to how the contribution to the LWC was to be paid. Mr Graves reiterated the position, previously stated in Woolworths' solicitors' letter of 9 April, namely, that 95 per cent should be paid at the commencement of the lease, and 5 per cent 12 months thereafter. Mr Blake stated that after discussing those matters, he asked whether Woolworths would consider purchasing the options to buy the land, and Mr Graves said that Woolworths would consider that proposition and get back to him. In cross examination, Mr Blake agreed that, at the conclusion of the meeting, he 'respected' the position of Woolworths that the cost estimate was too high, and that

accordingly 'the deal was done, it was cancelled, it was all over'.

307 Mr Fetter took brief notes at the meeting that were tendered in evidence. In his outline of evidence, that was tendered as part of his evidence in chief, he also stated that at the beginning of the meeting Mr Graves said that the Vaughans estimate of the LWC was too high, but that Mr Graves did not give any explanation why that was so. He also said that Mr Graves and Mr Macmillan did not offer any alternative to the Vaughans' estimate or make a counter offer. Mr Graves said that Woolworths would not pay a lump sum contribution, but would pay 95 per cent of its contribution at the commencement of the lease and pay five per cent after the expiration of the 52 week defect liability period.

308 In his evidence in chief, Mr Fetter's evidence somewhat differed. With the assistance of his notes, he recalled that Mr Blake's position at the meeting was that the tenant's contribution should be $2.9 million and that it should be paid as a lump sum. One of the representatives from Woolworths said that the contribution by the tenant should be under $1 million. Mr Fetter could not recall any detailed discussion relating to either of those two figures. He agreed that, at the conclusion of the meeting, there was discussion about Woolworths buying the options held by NES over the Strathdale site.

309 Mr Davis took the most detailed notes of the meeting. In his outline of evidence, that constituted part of his evidence in chief, Mr Davis stated that, at the commencement of the meeting, Mr Graves said that the tenant's contribution of $2.9 million, requested by NES, was too high. Mr Davis also said (in that document) that neither Mr Graves nor Mr Macmillan explained why they considered that figure to be too high nor did they make a counter offer. In evidence in chief, with the assistance of his notes, Mr Davis said that Mr Graves and Mr Macmillan had said that the Vaughans' figure of $2.9 million was too high, and that they had in mind $1 million, not the $2.9 million that was in the quotation of Vaughans. Mr Blake then suggested that some matters could be removed from the Bunnings specifications.

The parties then discussed the terms of payment. Mr Blake wanted the payment to be made 'upfront', and Woolworths representatives wanted to adhere to the payment schedule stated in the letter of 9 April.

310 In cross examination, Mr Davis agreed that Mr Blake's general position at the meeting was that the contribution made by Woolworths should be $2.9 million. Mr Blake said that he had received a quotation which, with some adjustments, came to $2.9 million. Mr Davis also agreed that the conversation then related to the manner in which payment was to be made. Mr Blake wanted the payments 'upfront', but Woolworths' position was that it would pay 95 per cent at the commencement of the lease and five per cent at the conclusion of the defects liability period. Those matters were discussed, but no agreement was reached.

311 In his evidence, Mr Macmillan stated that while he was en route to the meeting, he received an email from Rider Hunt on his BlackBerry Pearl, which he found difficult to read. Accordingly, he telephoned Mr McDonald, who told him that the LWC at that stage was around $1.5 million. However, they were unable to discuss the matter in detail. At the commencement of the meeting, Mr Blake, or his solicitors, said that the LWC amount was $2.94 million. There was some brief discussion about that amount. Mr Macmillan said that it was a lot higher than Woolworths' expectations. The conversation then turned to how any contribution would be paid. Mr Blake wanted the lump sum amount paid at the commencement of construction. Mr Macmillan responded that that was not the normal practice of Woolworths, and that Woolworths would pay 95 per cent at the completion of the works, and five per cent at the completion of the defects liability period. No discussions took place as to whether NES was prepared to negotiate the $2.94 million figure.

312 Mr Macmillan further said that after the parties had discussed the manner of the payment of the contribution, Mr Blake and Mr Graves agreed that the agreement could be terminated, but Mr Blake suggested that Woolworths could purchase the

option held by NES over the site. Accordingly, after the meeting Mr Macmillan reported to Mr Champion that the deal had changed, and that Woolworths were now considering purchasing the site, as opposed to leasing the site.

313 In cross examination, Mr Macmillan stated that he did not tell anyone at the meeting that he had received a report from Rider Hunt that morning, and he did not tell the meeting that he had been given a different figure for the LWC by Rider Hunt that morning. He agreed that he told Mr Blake that the $2.94 million figure was too high, but he did not say why that was so, because Mr Blake had said that the figure was non-negotiable. He said that he did not provide the Rider Hunt report to the meeting, because the discussion turned to other matters. In addition, he was not sure what discussions were taking place between Vaughans' and Rider Hunt, and he assumed that those discussions were continuing. He accepted that he might have said at the meeting that the maximum contribution that Woolworths would pay was $1 million. He disagreed with the proposition that every document that he had seen comparing the cost of a Bunnings store to a Masters store, had a significantly larger difference than $1 million. In particular, he said that in December 2009 the cost difference between a Masters and a Bunnings store was estimated to be $1 million, and the same estimate was contained in a cost plan in February that Rider Hunt had put together.

314 In his evidence, Mr Graves said that at the commencement of the meeting of 22 April, Mr Macmillan stated that the parties needed to agree about the manner in which a contribution payment would be made. Mr Blake said that NES wanted the payment to be made as a lump sum before the commencement of the works. Woolworths' position was that 95 per cent of the contribution should be payable at the commencement of the lease, and five per cent at the completion of the defects liability period. Mr Macmillan then stated that the Troons costing had been calculated incorrectly, and he explained why that was so. Mr Macmillan said that he thought that the Vaughans' costing was too high, and there was discussion about removing some of the items from the specification.

315 Mr Graves then detailed a number of matters that he said were the subject of discussion in that respect. He said that the conversation then returned to the manner in which the tenant's contribution would be paid. He also said that they discussed the amount of the contribution. He said that NES wanted $2.9 million, and did not offer any alternative figure. In response, Mr Macmillan said that he was expecting $1 million. Mr Fetter said that Masters had had long enough to look at the numbers, and that Masters had gone through the open book process. He said that the figure therefore was $2.9 million. After that discussion, there was no further negotiation of the amount to be paid. In cross examination, Mr Graves said that at the meeting the parties discussed the open book process, and Mr Macmillan pointed to 'numerous examples' where he thought that the Vaughans costings were wrong. We interpolate that no other witness gave evidence to that effect, and the judge did not accept that aspect of Mr Graves' evidence.[149]

The judge's reasons about the 22 April 2010 meeting

316 Based on that evidence, the judge made the following findings of fact:

> In my view, the critical points or issues arising from this evidence, somewhat diverse at times as it is, is provided by the following submissions of NES:
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> While the accounts of those present differ as to what happened at that meeting, it is common ground that:
>
> (a) NES stated the position that was contained in its letter of 6 April 2010.
>
> (b) Mr Graves and Mr Macmillan restated Woolworths' position that the Landlord's Works Costs contribution sought by NES was too high having regard to the Rider Hunt calculations. Those calculations were not disclosed.
>
> (c) Mr Graves and Mr Macmillan said that any contribution that was to be paid by Masters would not be paid in a lump sum and would be paid after commencement of the lease and a defects rectification period. Mr Blake said that NES was looking for a lump sum contribution in accordance with the Letter of Offer to be paid before construction, but would be

149 Reasons [189].

open to negotiate some other arrangement.

(d) Woolworths did not provide or make available the reports it had obtained from Rider Hunt or any other information that would have reasonably enabled the parties to identify, with any precision, or to resolve, the differences that Woolworths had in relation to NES estimate. The parties were therefore unable to, and did not, resolve any of their differences in relation to the Landlord's Works Costs or agree on a contribution figure.

(e) Mr Blake, on behalf of NES, offered to sell the options to purchase the Bendigo site to Woolworths, and Mr Graves and Mr Macmillan said they would take a few weeks to consider that offer.

In my view, this summary is substantially consistent with the account of Mr Graves and others to which reference is made and does, in the present context, identify the critical aspects of and issues arising from this 22 April 2010 meeting.[150]

317 The judge then noted that Mr Macmillan had not read the Rider Hunt further report that had been emailed to him shortly before the commencement of the meeting. His Honour considered that it was 'all the more surprising' therefore that Mr Macmillan expressed the view at the meeting that Woolworths expectations, relating to LWC, were around $1 million. The judge stated that whatever version of the evidence was accepted, it was clear that the parties '… simply never engaged in relation to the issue of the Landlord's Works Costs'. His Honour considered that the failure of Woolworths, to make clear that its expectations were $1 million at the commencement of discussions between the parties, was indicative of a lack of desire on the part of Woolworths to enter into serious further discussions relating to the LWC.[151]

318 The judge further considered that the failure of Woolworths to provide the Rider Hunt report dated 22 April 2010 to NES was indicative of an absence of good faith on behalf of Woolworths.[152] The judge considered that a reasonable person,

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150 Reasons [161] (citations omitted).

151 Reasons [162].

152 Reasons [163].

acting in good faith, in the position of Woolworths at the meeting of 22 April, would have provided some explanation as to why it rejected 'out of hand' the Vaughans quotation as being too high.[153] Accordingly, the judge concluded that Woolworths did not act reasonably to identify and resolve differences it may have had with NES' estimate of the LWC or the contribution of the tenant to those costs.[154] For the same reasons, the judge was persuaded that Woolworths had failed to act in good faith to identify and resolve any such differences.[155]

319 The judge further found that if in fact the open book process was continuing, it would have been expected that the differences, identified in the Rider Hunt report of 22 April, would have been communicated to NES, and that attempts would have been made by Woolworths to negotiate any differences in relation to the LWC subsequent to the 22 April meeting and before the termination of the AFL.[156]

Submissions about the 22 April 2010 meeting

320 On behalf of Woolworths, it was submitted that the judge erred in finding that the parties did not engage in relation to the LWC at the 22 April 2010 meeting, and that the judge erred in concluding, from the evidence, that Woolworths had acted in breach of clause 2.2(b) of the AFL at that meeting and in the period between the meeting and the date of termination of the AFL.

321 Senior counsel for Woolworths commenced by pointing to the evidence that Woolworths had initiated the meeting, and had agreed to an extension of the time for the period prescribed by clause 2.2 of the AFL, in order to accommodate Mr Blake. Counsel submitted that the parties did not engage in detailed discussion about the LWC, and the contribution to be made to it by the tenant, because, at an early stage in the meeting, they recognised that they were too far apart on that issue.

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153 Reasons [167], [188]–[189].

154 Reasons [194].

155 Reasons [208]–[211].

156 Reasons [193].

That recognition, by the parties, was understandable and reasonable, in light of the fact that, for more than one month, the discussions that had been taking place between Rider Hunt and Vaughans had left the two sides in substantial disagreement as to the quantum of the LWC. Counsel further submitted that the judge failed to take into account that there was a genuine disagreement between the parties as to the manner and timing of the payment of the contribution by the tenant to the LWC. In that respect, he submitted, the judge did not give that factor sufficient consideration, because the judge had erroneously formed the view that, on its proper construction, the AFL provided for the payment by Woolworths of the tenant's contribution by way of a lump sum.

322 Counsel further submitted that the judge erred in finding that Woolworths failed to negotiate reasonably and in good faith concerning the LWC after 22 April. Counsel pointed to the evidence of Mr Blake and of Mr Macmillan to the effect that, at the conclusion of their meeting of 22 April, the parties had formed the view that negotiations in relation to that matter had come to an end, and that the only remaining issue was whether Woolworths were prepared to acquire the option held by NES to purchase the Strathdale site.

323 In response, senior counsel for NES submitted that, based on the findings set out by the judge in the passage to which we have referred, the judge correctly concluded that the parties never engaged in relation to the issue of the LWC at the meeting of 22 April, because Woolworths, at that meeting, had failed to enter into discussions as to the aspects of the Vaughans estimation of the LWC with which they disagreed. Counsel submitted that the judge's findings, in that respect, were based on his conclusions as to the evidence of the five witnesses as to their recollections of the discussions that took place in the meeting. Based on that evidence, it was submitted, the judge was correct in concluding that Woolworths had made no attempt at the meeting, or after it, to negotiate the amount of the LWC, or the contribution that was to be made to those costs by Woolworths. Accordingly, the judge correctly found that Woolworths had acted in breach of the obligation to

negotiate reasonably and in good faith, concerning the LWC, and Woolworths' contribution to that amount, at the meeting of 22 April and subsequently.

Analysis about the 22 April 2010 meeting

324 The judge's conclusions, concerning the conduct of Woolworths at, and after, the meeting of 22 April 2010, focused on three aspects of the evidence concerning the meeting, namely: first, that Mr Macmillan did not provide, or reveal to the representatives of NES, the content of the Rider Hunt report of 22 April; secondly, that Mr Macmillan stated that the expectation of Woolworths, in relation to the contribution to be made to the LWC, was in the region of $1 million, whereas the Rider Hunt report of 22 April indicated that the contribution would be in the sum of $1,513,413; and, thirdly, that Mr Macmillan did not explain how or why the Vaughans estimate of $2.94 million, as the amount of that contribution, was too high.

325 In relation to the first matter, the evidence demonstrated that the Rider Hunt report of 22 April was emailed by Mr McDonald to Mr Macmillan at 8.37 am. The evidence of Mr Macmillan and Mr Graves was that Mr Macmillan received the report, on his BlackBerry, while they were walking together to the office at which the meeting was to take place. Mr Macmillan spoke to Mr McDonald, and his evidence was that Mr McDonald was unable to talk about the report in any detail at that time. On the other hand, Mr McDonald was unable to recall that conversation. However, in evidence he described the document as a 'work in progress' which required further discussion with Vaughans. In that respect, it is relevant that two of the items, listed on the report to be subtracted from the Vaughans figure, were annotated with the comment 'to be discussed with VC'. Those items totalled approximately $720,000.

326 Taking those matters into account, it is understandable that Mr Macmillan might not have wished to have produced, or spoken about, the Rider Hunt report at the meeting that he attended a short time after receiving it. It might have been preferable if the meeting had been adjourned, so that Mr Macmillan could have

gained a better appreciation of the effect of the report by having the opportunity to discuss it properly with Mr McDonald. However, the standard of conduct, prescribed by clause 2.2(b) of the AFL, was not one of perfection, and a court must be cautious about applying the wisdom of hindsight in determining whether a party has complied with such a clause. In light of the matters we have discussed, however, we do not consider that it could be reasonably concluded that the conduct of Mr Macmillan, in not revealing or producing the Rider Hunt report at the meeting, was unreasonable, or was an indication of a lack of good faith on his behalf, or on behalf of Woolworths.

327 The second matter, relied on by the judge, in respect of the conduct of Woolworths at the meeting of 22 April, was the statement by Mr Macmillan at the meeting that the expectation of Woolworths had been that the tenant's contribution would be in the region of $1 million. In our view, considered in the context of the evidence at the time, that position taken by Mr Macmillan could not be properly characterised as unreasonable.

328 As the judge recorded earlier in his reasons,[157] in mid-December 2009 Design Kit Rev B had been prepared and costed, and an estimate had been prepared by Rider Hunt of the cost difference between the construction of a Masters store with a total enclosed area of 13,465m² and a Bunning 'S 9' store with a total enclosed area of 14,072m². The Rider Hunt estimate of the cost difference to the comparable Bunnings store was $1,176,562. In a footnote to the judgment,[158] the judge noted that that estimate was for a store that was larger than the 10,923m² store that was planned for the Strathdale site. In that footnote, the judge also noted, by reference to evidence given by Mr Macmillan in cross examination, that, based on that estimate, Woolworths' expectations were that the tenant's contribution in respect of the Strathdale store would be roughly $1 million.

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157 Reasons [91].

158 Reasons fn 184.

329 Later in cross examination, Mr Macmillan stated that the cost plan that Rider Hunt had compiled in February 2010 also indicated a tenant's contribution of $1 million. That evidence was consistent with the evidence of Mr McDonald (in his outline of evidence) that on 3 February 2010 he had sent to Mr Killesteyn (of Woolworths) an email attaching an estimate for a 13,676m² store in the sum of $12,000,000, or $877 per m². That estimate was tendered in evidence as part of Mr McDonald's evidence.

330 In those circumstances, in our view, Mr Macmillan had a sufficient basis upon which to state at the meeting of 22 April that Woolworths' expectation of its contribution to the LWC would be in the region of $1 million. Based on that evidence, we do not consider that the conduct of Mr Macmillan, in expressing the position of Woolworths at that meeting in that manner, could reasonably be concluded to be unreasonable or wanting in good faith.

331 As noted by the judge, there was little discussion at the meeting of 22 April concerning the difference between the amount sought by NES as the contribution by the tenant to the LWC ($2.94 million) and the position taken by Woolworths that they only expected to contribute in the region of $1 million. In that respect, the evidence of Mr Graves, that the parties descended to some detail in discussing the differences, was not supported by the other witnesses who gave evidence, and the judge did not accept it. However, in the circumstances, it is not surprising that little discussion ensued between the parties as to the different positions taken by them as to the amount that should be paid by the tenant as its contribution to the LWC. The meeting was held after a number of discussions that had taken place between Rider Hunt and Vaughans concerning the quantum of the LWC. While, in the course of those discussions, Vaughans had reduced its estimate of the LWC, there was still a significant difference between, on the one hand, the figure sought by NES, as at 6 April 2010, and again at the meeting on 22 April, and, on the other hand, the amount that Rider Hunt had advised Woolworths was correct quantification of the LWC, and therefore the potential contribution of Woolworths to that cost.

332 In this connection, if in fact the estimates of the LWC by Vaughans and Rider Hunt were not materially different, then clearly the approach taken by Woolworths at the meeting would have been contrary to its obligations under clause 2.2(b) of the AFL to negotiate reasonably and in good faith at the meeting. However, as we have concluded in the previous sections of this judgment, notwithstanding the ongoing work being undertaken by Vaughans and Rider Hunt, there was still a significant gap between the Vaughans estimate of the LWC and the Rider Hunt estimate of that cost. As a consequence, there was a substantial difference between the amount of contribution that NES considered that it was entitled to seek from Woolworths to the LWC, and the amount that Woolworths, on the other hand, considered that it was obliged to contribute.

333 In those circumstances, notwithstanding that apparently there were still discussions proceeding between Rider Hunt and Vaughans, it is understandable that, in light of the substantial gulf that existed between their respective estimates, the parties had reached the stage, at the meeting of 22 April, that there was little point in negotiating their differences concerning the LWC, and the tenant's contribution to it. It is correct that, in a sense, the parties did not really engage in relation to that matter. However, their failure to do so was understandable in light of the circumstance that, despite the work being undertaken by Vaughans and Rider Hunt, the differences between the parties as to their expectations of the tenant's contribution to the LWC remained substantial.

334 In addition, at the meeting of 22 April, the parties discussed the manner and timing of the contribution that was to be made by Woolworths to the LWC under clause 2.2 of the AFL. The parties were not able to resolve their differences relating to that matter. As that issue remained outstanding between the parties, it is understandable that they may not have sought to persist in discussing the differences they had relating to the quantification of the LWC.

335 It is clear on the evidence of both Mr Blake and Mr McDonald that, at the

conclusion of their meeting of 22 April, the parties were in mutual agreement that it was not worthwhile to undertake further negotiations concerning the quantification of the LWC, or of the tenant's contribution to it, or in relation to the timing and manner of payment of that contribution. Instead, the parties did not proceed to terminate the agreement immediately, so as to give Woolworths the opportunity to consider whether they wished to seek to acquire the option that NES held to purchase the Strathdale site. In those circumstances, the lack of any further negotiations, as to the LWC, by either party, could not be characterised as unreasonable or lacking in good faith.

336 For the reasons we have stated, we consider that there was no sufficient basis for the judge to conclude that the conduct of Woolworths at the meeting of 22 April, or in the period between that meeting and the termination of the agreement on 6 May, constituted conduct that was in breach of the obligation of Woolworths under clause 2.2(b) of the AFL. It follows that Woolworths have succeeded on grounds 5.4(j), (k) and (l).

(f) Ground 5.5 — 'Other Considerations'

337 Ground 5.5 is directed to the finding by the judge that in 'exercising [their] powers and performing [their] obligations' under the AFL, Woolworths wrongly took into account that NES had, or might have, funding issues, and that there were difficulties relating to obtaining planning approval from the council for the construction of the Masters store on the Strathdale site. That part, of the judge's reasons, immediately followed the finding by the judge that Woolworths had decided, from 16 March 2010, to pursue the Hume & Iser site instead of the Strathdale site. The section of the judgment, which is the subject of ground 5.5, is entitled 'Other Considerations'.

Judge's reasons about 'Other considerations'

338 The judge commenced that section of the reasons by noting that by the time

Mr Macmillan received NES estimate of the LWC in March 2010, he had become aware of other issues, or potential issues, relating to the development at the Strathdale site, including opposition from the council and residents, and potential funding issues affecting NES. The judge considered that those matters were 'irrelevant to the obligations and powers imposed and conferred on Woolworths' under the AFL, but that nevertheless the evidence 'does support the view that they affected the discharge of its obligations under that agreement'.[159] In that respect, the judge referred to the minutes and matters arising out of the Property Committee meetings of 16 March, 6 April, 23 April and 11 May 2010, which contained references to the landlord having funding issues, an alternative site being pursued, and the council not being supportive.

339 The judge then considered the matters relating to the council issues, under the subheading 'Greater Bendigo City Council opposition'. The judge referred to Mr Champion's notes dated 6 May 2010, that were made immediately before termination of the AFL. The notes recorded:

> The grounds are that the parties have not reached agreement on cost of building. Reality is that Council will not support that site.

340 The judge rejected the explanation that Mr Champion gave of that note, namely, that the use of the word 'reality' meant 'in any case' or 'in addition to'. The judge concluded:

> Accordingly, I find that Woolworths did take into account Council opposition in performing its obligations under the Agreement for Lease, including exercising its power to terminate the Agreement for Lease. In other words, the inferences in this respect should be made as submitted by NES.[160]

341 The judge next, under the subheading 'Financial Position of NES', considered the question whether Woolworths had been affected by its concerns about NES' capacity to obtain funding, when exercising its powers under the AFL. The judge

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159 Reasons [226].

160 Reasons [229].

commenced by accepting the submission by NES that 'Woolworths also took into account — in discharging its obligations and exercising its powers under the Agreement for Lease — a misperception that NES may have had funding issues'.[161]

342 The judge noted that those concerns emanated from an email sent by Mr Blake to Mr Macmillan dated 16 November 2009, in which Mr Blake raised the question whether Woolworths would finance the development. The judge accepted Mr Blake's evidence that he had raised that matter with Mr Macmillan because Woolworths did not require cross-collateralisation of securities. His Honour rejected the evidence of Mr Macmillan that Mr Blake had asked several times whether Woolworths would fund the development.[162] The judge further noted that after Mr Macmillan became aware that there had been an issue in another development between Mr Blake and Woolworths, namely the Kennington Village Development, Mr Macmillan wrongly assumed that the issues with that development were caused by NES experiencing financial difficulties. The judge considered it likely that those concerns by Mr Macmillan were relevant to the decision by Woolworths to pursue the Hume & Iser site. His Honour observed that there was no evidence of any attempt by Woolworths to verify the financial positions of Mr Blake or of NES.[163]

343 The judge considered that, whether or not Mr Macmillan's fears about NES' financial position were genuinely held, that was not a matter that Woolworths was entitled to take into account 'when exercising its powers and performing its obligations under the Agreement for Lease'.[164] The judge referred to Woolworths' documents, including the minutes of the Property Committee of 16 March and 6 April, and the table setting out the status of the sites dated 23 April and 11 May, together with the email from Mr Macmillan to Mr Danks dated 23 April 2010, and

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161 Reasons [230].

162 Reasons [232].

163 Reasons [234].

164 Reasons [235].

Mr Champion's notes of 6 May 2010.[165] His Honour concluded:

> NES submits that it is open to the Court to find on the evidence, and that the court should find, that each of the matters which have been discussed in the preceding reasons, including that the Masters contribution was likely to exceed Woolworths' approved but undisclosed budget, that the Property Committee had decided to pursue the Hume & Iser store, and that the Council was not supportive of the Bendigo development and that there were fears that NES may be experiencing funding issues, were all matters that Woolworths took into account in deciding to terminate the agreement for lease. For the preceding reasons and for those which now follow, I am of the view that the findings contended for by NES are properly made.[166]

Ground 5.5 — the 'Other considerations'

344 Ground 5.5 is expressed in the following terms:

> The learned judge erred in finding that Woolworths and Masters were not entitled to take into account, in deciding following the meeting on 22 April 2010 to terminate the AFL, issues relating to NES's ability to fund the development (Reasons [235], [237], [238]) or council opposition to the development (Reasons [229]).

Submissions about the 'Other considerations'

345 Counsel for Woolworths submitted that the judge's conclusions, relating to the consideration by Woolworths of the funding issues relating to NES, and the issues relating to council approval, were erroneous for two reasons. First, provided that Woolworths acted reasonably and in good faith to resolve the differences relating to the three issues specified in clause 2.2(b) of the AFL, Woolworths was entitled to take into account other risks that might affect the development. In particular, it was entitled to take into account those matters in considering the manner in which the tenant's contribution to the LWC was to be made. It was submitted that those matters were directly relevant to that issue, and that Woolworths would not have breached their obligations to act reasonably and in good faith by taking those factors into account in determining the manner in which contribution was to be made, and particularly the timing of that contribution.

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165 Reasons [237].

166 Reasons [238].

346 Secondly, and in any event, it was submitted that the judge erred in concluding that Woolworths was not entitled to take into account issues relating to NES' funding capacity, and council approval, in exercising its power to terminate the agreement under clause 2.2(c)(v) of the AFL. Counsel submitted that at the conclusion of the meeting of 22 April, the parties had each agreed that it would not be possible to resolve the differences between them relating to the LWC and the amount of the tenant's contribution to the LWC. Accordingly, as and from that time, Woolworths was entitled to terminate the agreement. The obligation, under clause 2.2(b), to act reasonably and in good faith, did not extend to the exercise by Woolworths of their contractual right to terminate the agreement.

347 Counsel further submitted that there was no evidence that Woolworths' concerns about NES' capacity to obtain funding, and their concerns about gaining council approval, affected Woolworths' approach to resolving the differences between the parties relating to the amount of the LWC and the tenant's contribution. In particular, there was no evidence that those factors had led Woolworths to act unreasonably and otherwise than in good faith in attempting to resolve the differences relating to that matter.

348 In response, counsel for NES noted that Mr Macmillan had never sought a financial reference in respect of NES, and that he never made any inquiries in connection with its financials. He therefore submitted that there was no basis for concern by Woolworths as to the capacity of NES to obtain funding for the development. He further submitted that there was no basis for Woolworths to be concerned about the planning approval for the development, since the State government had appointed a panel to deal with the issue, and so far the panel had approved every store except one. Counsel also submitted that the judge's conclusions were that Woolworths had taken into account council opposition, and the funding issues, in performing its obligations under the AFL, including (but not confined to) exercising its power to terminate the AFL.

Analysis about the 'Other considerations'

349 In considering the competing submissions relating to this aspect of the judge's decision, it is first necessary to determine precisely what the judge concluded in finding that the planning issues, and the concerns relating to NES' funding, wrongly influenced or affected the discharge by Woolworths of its rights and obligations under the AFL. In particular, as a threshold issue, it is necessary to consider whether the judge determined that Woolworths wrongly took into account the planning issues and NES' funding issues when deciding to terminate the AFL; or whether the judge determined that Woolworths wrongly took those factors into account when negotiating the three matters prescribed by clause 2.2(b) of the AFL.

350 In our view, the former construction of the judge's conclusions is more probable. In particular, when considering the planning issues, the judge focused on the diary note of Mr Champion dated 6 May 2010, and concluded from that note that Woolworths did take into account council opposition in performing its obligations under the AFL 'including' exercising its power to terminate the AFL.[167] Similarly, in the passage in the reasons to which we have earlier referred,[168] the judge accepted the submission by NES that the planning issues, and the concerns relating to NES's funding, were (among other things) all matters that Woolworths had taken into account 'in deciding to terminate the Agreement for Lease'.

351 On the other hand, the section of the judge's reasons, relevant to those issues, commenced with the observation by the judge that the evidence supported the view that likely opposition from council, and potential funding issues with NES, affected the discharge by Woolworths of its obligations under the AFL.[169] Further, in a passage in a section entitled 'Agreement for Lease terminated by Woolworths for reasons not contemplated by its terms', the judge referred to his earlier conclusion

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167 Reasons [229].

168 Reasons [238].

169 Reasons [226].

that well before the open book review of the Vaughans estimate had been completed on 1 April, and before negotiations between the parties to resolve differences in relation to the LWC were to be completed, Woolworths had already determined to terminate the AFL and to pursue acquisition of the Hume & Iser site.[170] It was in that context that the judge concluded that the council planning issues and the funding issues were (among other things) matters that Woolworths took into account in deciding to terminate the AFL.[171]

352 Thus, although it is more likely that the judge's conclusions, relating to the effect of the planning issues and NES' funding issues, were directed solely to the conduct of Woolworths in deciding to terminate the AFL, the position is not entirely clear. We will therefore proceed on the basis that the judge found that those factors wrongly affected the conduct of Woolworths, both in negotiating the amount of the LWC and the tenant's contribution, and in determining to terminate the AFL.

353 It is clear, on the face of the AFL, that the obligation of either party (including Woolworths), under clause 2.2(b), to act reasonably and in good faith, did not attach directly to the decision of such party to terminate the AFL pursuant to clause 2.2(c). Rather, clause 2.2 provided that the obligation to act reasonably and in good faith applied to the obligation of the parties to negotiate to resolve differences that they may have in relation to the landlord's determination of the LWC, the amount that the tenant must contribute towards the LWC (if any), and the manner in which that contribution would be made (pursuant to clause 2.2(b)). In other words, provided that Woolworths acted reasonably and in good faith in attempting to resolve differences that it had with NES in relation to those matters, and provided that, notwithstanding those negotiations, the parties were unable to agree on the LWC, or the amount of the tenant's contribution to the LWC, or the terms and conditions on which that contribution would be made, Woolworths was entitled to terminate the

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170 Reasons [236].

171 Reasons [238].

AFL pursuant to clause 2.2(c). The AFL did not preclude Woolworths from taking into account other considerations, such as potential funding issues of NES, and difficulties in obtaining planning approval, when determining whether to exercise its power to terminate the agreement under clause 2.2(c). As earlier noted, the evidence of Mr Blake and Mr Macmillan was that at the conclusion of the meeting of 22 April, the parties were in agreement that the negotiations had come to an end, and that the agreement would be terminated. Accordingly, (contrary to the judge's conclusion) we consider that Woolworths did not act in breach of the AFL by taking into account NES' funding issues, and the planning difficulties attaching to the Strathdale site, in deciding to terminate the AFL.

354 In addition, Woolworths is correct in contending that the obligation, under clause 2.2(b), to act reasonably and in good faith, did not preclude it taking into account NES' funding issues, and the difficulties of obtaining council approval, in negotiating the manner in which the tenant's contribution was to be paid to NES under clause 2.2(b)(ii) of the AFL. Each of those matters related to the risks attaching to the development of the premises that were to be leased, and thus the viability of the development. In that way, those matters would be directly relevant to a commercial decision made by the potential tenant as to the manner and timing of the contribution made by it to the cost of the construction of the premises that were to be leased by the tenant. If Woolworths took those matters into account in determining the manner in which the tenant's contribution was to be paid, it could not be concluded that Woolworths had acted unreasonably, or capriciously, or in a manner that was not faithful to the bargain.

355 On the other hand, it is clear that considerations such as the developer's funding difficulties, and planning problems, could not be relevant to the negotiation by the parties of the amount of the LWC, or of the tenant's contribution to it. Thus, Woolworths would not have acted reasonably and in good faith, if they took a position in the negotiation of the LWC, and of the tenant's contribution, on account of, or as a result of, those considerations.

356 Nevertheless, the fact that Woolworths might have had concerns regarding those issues, at the time that it was entering into negotiations with NES concerning the LWC, would not, of itself, justify a conclusion, on the balance of probabilities, that Woolworths took those considerations into account, and was relevantly affected by them, in the manner in which it negotiated the LWC or the tenant's contribution. In the commercial context of the case, it would be understandable that Woolworths was cognisant of all of the commercial issues relating to the proposed development at that time. The fact that Woolworths was noting those issues, at the same time at which it was negotiating the amount of the LWC and the tenant's contribution, could not, of itself, constitute a sufficient basis to draw an inference, on the balance of probabilities, that Woolworths was motivated by those matters in taking a particular stance in the course of those negotiations.

357 The question, then, is whether there was sufficient evidence for the judge to conclude (if his Honour did), on the balance of probabilities, that Woolworths wrongly took into account NES' funding issues, and the expected attitude of council to the development, in negotiating the LWC and the tenant's contribution to it.

358 Before addressing that issue, it is necessary to attend to an observation made by the judge, and submissions by NES, as to the basis upon which Woolworths had concerns relating to the capacity of NES to obtain funding to finance the development. The judge observed that Mr Macmillan did not make any attempt to verify the financial position of NES or of Mr Blake. As already noted, counsel for NES submitted that Mr Macmillan never sought a financial reference relating to NES' financial position, and that there was no basis for Woolworths to entertain concerns relating to the financial capacity of NES to complete the development. The submission so made by counsel for NES, and the observation by the judge, did not address the issue raised on the appeal, namely, whether Woolworths was influenced by its perception of NES' financial position in negotiating the LWC and the tenant's contribution to it. In determining whether Woolworths acted in breach of its obligations under clause 2.2(b) of the AFL, the issue is whether Woolworths took

into account the funding difficulties of NES, and not whether, if Woolworths did so, it had a sufficient basis for their concerns relating to that matter.

359 It is clear that Woolworths did have concerns relating to the capacity of NES to fund the development, and also as to whether approval for the development could be obtained from council. The question is whether it was open to the judge to be satisfied, on the balance of probabilities, that those matters influenced Woolworths in the position that it took in negotiating the LWC and the tenant's contribution in such a way as to justify the conclusion that, contrary to clause 2.2 of the AFL, Woolworths did not act reasonably and in good faith in those negotiations.

360 In respect of the funding issues, the judge referred to the minutes of the Property Committee dated 16 March 2010, and of the Property Committee dated 6 April 2010. Both of those minutes contained the notation, 'Landlord has funding issues. Alternative site being pursued. Check the legal position in relation to negotiations on site'. In addition, the judge referred to the email sent by Mr Macmillan to Mr Danks on 23 April 2010, which noted that the AFL expired on 4 May, and that Woolworths was willing to 'walk away' from the Strathdale site for four reasons, namely, that council was not supportive of the development, that there would be significant resistance to the proposal from neighbouring residential community, that the developer had funding issues, and that the parties could not agree on finalising commercial terms.

361 In our view, those facts were not sufficient to base an inference, on the balance of probabilities, that the concerns of Woolworths relating to NES' funding situation influenced the position taken by Woolworths in negotiating the LWC and the tenant's contribution. The inference, to that effect, was no more probable than the competing inference that, in the circumstances, Woolworths had those concerns, and therefore that it was necessary for it to pursue an alternative site, and to check its legal position relating to the negotiations, in the event that the landlord should be unable to proceed with the development. In the commercial context of the case, it

was understandable that, in circumstances in which there were some doubts as to whether NES had the capacity to complete the development, Woolworths would be looking to an alternative site, and considering its legal position in respect of the AFL. The fact that Woolworths had those concerns was not a sufficient basis for an inference, on the balance of probabilities, that Woolworths took them into account in determining its attitude to negotiations in respect of the LWC and the tenant's contribution.

362 Similar considerations apply to the concerns by Woolworths that the local council was not supportive of the proposed development on the Strathdale site. The judge concluded that Woolworths took those matters into account in negotiating the LWC and the tenant's contribution to it, based on the following evidence:

(w) A table that set out the status of various sites dated 23 April 2010, that recorded a 41 to 60 per cent likelihood of completion of the Strathdale site, and that contained a notation: 'Council not supportive'.

(x) A similar table setting out the status of the various sites on 11 May 2010, and containing the same notation.

(y) The part of the letter from Mr Macmillan to Mr Danks dated 23 April 2010, to which we have referred, and which (among other things) noted that one of the reasons that Woolworths were willing to 'walk away' from the Strathdale site was because council was not supportive of the development, and there would be significant local resistance to it.

(z) Mr Champion's handwritten notes of 6 May 2010 that stated 'Reality is that council will not support that site'.

363 Each of those documents came into existence after the 22 April meeting, and thus after the parties had determined that the AFL would be terminated. At that stage, Woolworths was considering purchasing the option held by NES over the site. In that context, it was understandable that the documents of the Property Committee would record the concerns of Woolworths as to the position that might be taken by council in respect of the development. In those circumstances, in our view it was not

open to the judge to conclude that those documents established on the balance of probabilities that Woolworths took into account planning difficulties in negotiating the LWC and the tenant's contribution.

364 For those reasons, we are persuaded that the judge incorrectly concluded that Woolworths, in breach of clause 2.2(b) of the AFL, took into account NES' funding issues and the difficulty of obtaining council approval, in deciding to terminate the AFL, or in negotiating the LWC and the tenant's contribution to it. It follows that Woolworths have made out ground 5.5 of the application for leave to appeal.

(g) Grounds 5.4(r), (s) — bad faith in terminating

365 Ground 5.4(r) concerns the judge's finding that Woolworths acted in bad faith in termination the AFL by acting on matters which were not contemplated by the AFL. Ground 5.4(s) is directed to the judge's finding that Woolworths was unwilling to engage with NES in any meaningful way to seek to resolve any differences with respect to the clause 2.2(b) amount. It follows from what we have said in the preceding sections that Woolworths has made out these grounds.

(h) Ground 5.4(m) — Mutuality of obligations

366 Ground 5.4(m) is based on the principle that the obligation to act reasonably and in good faith was, necessarily, a reciprocal and interdependent concept.[172] Woolworths did not address any separate oral submissions in relation to this ground, rather, it relied on its written submissions. In response, NES relied on its written submissions in opposition to the ground.

367 In its written submissions, Woolworths contended that the judge should have found that, in determining whether the obligation of good faith and reasonableness was satisfied by Woolworths, the sufficiency of their conduct was to be informed by

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172 *Esso Australia Resources Pty Ltd v Southern Pacific Petroleum NL* [2005] VSCA 228 [2]–[4].

the conduct of NES. That conduct included the following: the warning by NES to Woolworths that developers were experiencing funding issues; the request by NES that Woolworths fund the development (which was rejected); NES' interaction with real estate agents in relation to the proposed sale of the Strathdale site; NES' subsequent assertion that the AFL was conditional on Woolworths purchasing the Redan supermarket owned by Mr Blake; NES' demand of a contribution which included site work costs even though Vaughans had warned NES that this made the estimate appear very expensive compared with other quotations; the failure of Mr Blake to participate personally in any of the discussions between Rider Hunt, Vaughans and Woolworths; the multiple meetings by Mr Blake with Bunnings, Woolworths' competitor, in which Bunnings offered to purchase the site; the rejection by Mr Blake of the request by Mr Macmillan for a meeting before the critical date of 20 April 2010; Mr Blake's stance at the 22 April meeting of putting forward a non-negotiable figure of $2.9 million; and the objective of Mr Blake that Woolworths purchase the site.

368 Woolworths submitted that, instead of regarding the obligation to act in good faith as a mutual obligation, the judge explained NES' conduct as a negotiating position, while criticising the position that Woolworths took in relation to the same as expectations of the amount of the LWC. Woolworths contended that the judge thereby held the parties to different standards, and disregarded the conduct of NES when determining the scope of Woolworths obligations under clause 2.2 of the AFL.

369 A number of the matters raised by Woolworths, under this ground, have already been dealt with, in particular in our analysis of grounds 5.4(e), (f), (i), (k) and (l) and ground 5.5. In light of the conclusions that we have reached so far, it is otherwise not necessary for us to address this ground separately.

(i) Grounds 5.2 and 5.3 — Steps Woolworths was required to take and whether there was any breach of its obligations under clause 2.2(b)

370 Ground 5.2 is that the judge erred in holding that Woolworths and Masters

had breached their obligations under clauses 2.2(b) and (c). Ground 5.3 is directed to steps that the judge held Woolworths were required to take to satisfy the obligation to act reasonably and in good faith under clause 2.2(b) of the AFL. The judge said:

> In my view, it is clear, as is submitted by NES, that a reasonable person, in the position of Woolworths, which had the object of identifying and resolving differences in the calculation of the Landlord's Works Costs in mind, but no other object, would have, at a minimum:
>
> (a) Invited NES to attend and participate in the open book review process and encourage its involvement, so that NES would be informed of any differences identified during that process and be better able to resolve them;
>
> (b) Informed NES of any differences it had identified in relation to the calculation of the Landlord's Works Costs and Masters' contribution and of any other expectations Woolworths' may have had in relation to those costs;
>
> (c) Communicated to NES the basis of any conclusion that the Landlords' Works Costs or Masters' contribution were "too high" or "unacceptable", particularly where the estimate provided was a detailed estimate from an experienced builder whose estimates were known to be reliable from other tenders;
>
> (d) Assisted NES in identifying and obtaining quotes from alternative builders;
>
> (e) Provided NES with any documentation, such as reports prepared by Rider Hunt, that identified the differences and the basis of the differences Woolworths had identified;
>
> (f) Read, considered and communicated to NES the contents of the Rider Hunt report of 22 April 2010, assuming Woolworths sought to rely on that report as identifying any differences between it and NES in relation to the calculation of the Landlord's Works Costs and Masters' contribution;
>
> (g) If—as Woolworths submits but NES rejects—the open book process had not been completed, adjourned or postponed the negotiations, if necessary, until the open book process had been completed and any differences identified and to enable all parties to consider any reports relied upon by the parties.
>
> I accept that only then could any constructive negotiation to resolve any differences have taken place; a position which was admitted by Mr Macmillan. On any view, on the evidence, Woolworths failed or refused to take any of these reasonable steps before terminating the Agreement for

Lease.[173]

371 Woolworths submitted that the judge had imposed a contractual duty more onerous than good faith and reasonableness, with the duty being more akin to the subordination of self-interest which attaches to fiduciary duties. As an example, Woolworths submitted that a commercial party could not reasonably be expected to inform the counterparty about its internal budget or allocated capital contribution for the very matter the subject of negotiation.

372 NES submitted that the correctness of the judge's decision did not turn on whether the judge was correct as to how the parties should have (but did not) conduct themselves, although it contended that the judge's analysis was correct. So far as the example that Woolworths relied upon, NES submitted that if the internal budget or allocated capital contribution constituted or gave rise to a difference in relation to the tenant's contribution to the LWC, the dollar amount, if not the underlying reason for it, would have to be disclosed in order to discharge the obligation under clause 2.2.

373 We agree with NES that whether there was any error in the judge's decision does not turn on the steps which he identified that Woolworths should have taken in the passage above. In any event, the basis for many of the steps is founded on reasoning from which we have departed. For example, (a) in the passage above at [370] is founded on the idea that NES would participate in the open book review process. For the reasons we have given, the parties left it to Rider Hunt and Vaughans to deal with one another to represent them in discussions about the LWC and the tenant's contribution.[174] In addition, at least step (g) conflicts with the terms of the AFL. The AFL specified that if the parties had not resolved their differences by 20 April 2010, either party may terminate the agreement. There could be no

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173 Reasons [244] (citations omitted).

174 See [223] above. Other examples are steps (b), (e) and (f) which proceed on the basis that the amended spreadsheet represented Rider Hunt's estimate for the tenant's contribution (which we have concluded was not so).

obligation imposed on the parties to extend that date under the rubric of the requirement to act reasonably and in good faith. The steps in (b) (to inform NES of 'any other expectations Woolworths may have had') and (d) (to assist NES to identify and obtain alternative quotes) take the obligation to act reasonably and in good faith too far.[175]

374 It follows from what we have said in this and the preceding sections that both grounds 5.2 and 5.3 are made out.

375 There was no breach of the AFL by either Woolworths or Masters. The appeal must be allowed.

DAMAGES AND INTEREST (Grounds 5.6 to 5.12)

376 In view of the conclusions which we have reached in respect of breach, it is not strictly necessary to consider the grounds of appeal concerning the damages and interest awarded by the judge. Consequently, we will address only some of those grounds and then more briefly than would otherwise be the case.

377 Woolworths' submissions in relation to damages were predicated on the assumption that there was a breach of the obligation to act reasonably and in good faith to resolve differences in respect of each of the matters in clause 2.2(b) (rather than a breach in respect of only one of those matters). Our reasoning proceeds on that hypothesis.

378 In broad terms, the grounds of appeal concern the nature of the opportunity that was lost, the methodology to assess loss and its application, the discount to be applied in accordance with the principles laid down in *Sellars*[176] and the award of interest. On the hearing of the appeal, most of the focus was on the grounds concerning methodology and the *Sellars* discount. Our reasons address those issues.

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175 See [99] above.

176 (1994) 179 CLR 332.

379 In the opinions of the expert witnesses, the value of the lost opportunity ranged from about $1.4 million to $2.9 million. The judge rejected the methodology endorsed by the experts and applied an alternative methodology based on calculations performed by one of them. The judge then applied a 25 per cent discount. The result was that the judge awarded damages of $10.875 million. He also awarded damages by way of interest of $4,297,636.13. Woolworths contends that the judge erred in respect of both awards.

380 It is common ground that the date of breach was 6 May 2010 when Woolworths terminated the contract. It is also common ground that had the project proceeded, the anticipated date for completion of the works and commencement of the lease would have been 1 July 2011. The date of judgment was 18 March 2016.

(a) The expert evidence and the judge's reasons

381 The judge observed that the first step was to identify the lost opportunity and to determine whether and (if so) how NES would have acted on it.[177] He held that NES lost the opportunity to develop and lease the Strathdale site to Masters for the duration of the lease rather than to develop and sell that site with the lease in place at the completion of the development.[178] The judge also held that NES would have pursued the former opportunity.[179] The next step in his Honour's analysis was to consider whether NES could have pursued that opportunity such that the benefit would have been yielded.[180] He rejected Woolworths' contentions that NES could not have pursued the opportunity and that it therefore had no value.[181] The judge then turned to quantification of the loss. He observed that 'clearly assessment of value and associated risks almost 40 years into the future is difficult and carries a

177 Reasons [252].

178 Reasons [259], [323].

179 Reasons [262].

180 Ibid.

181 Reasons [263]-[319].

degree of uncertainty.'[182] However, he took the view that the reality of the uncertainty was accommodated by the methodology which he adopted.[183]

382 The judge reviewed the expert evidence. Mr Owain Stone was the expert called by NES. He was initially instructed to provide his opinion about the appropriate methodology to assess the loss and damage suffered by NES as a result of the development not proceeding and the calculation that he would apply in that regard. Mr Stone's opinion was that the appropriate methodology was to compare the cash flows NES would have incurred or earned if the development had gone ahead, with the actual cash flows it did incur ('actual versus but for analysis'). Ms Dawna Wright, the expert called by Woolworths, agreed that this was the correct methodology. Having taken on board some criticisms that Ms Wright made of his calculations, Mr Stone estimated the loss at $2,788,901 as at 6 May 2010 (that being the date of the alleged breach). That figure was calculated as follows:

182 Reasons [323].

183 Ibid.

Expectation Loss Calculation (Woolworths Contribution Paid after construction)			
Cash Flow	Actual	But For	Damage
Option fees	(50,000)	(50,000)	0
Deposits paid			0
- 201 McIvor Road	(1,818)	(1,818)	0
- 203 McIvor Road	(909)	(909)	0
Funding from Bendigo Bank		14,714,050	14,714,050
Borrowing costs incurred during construction		(572,126)	(572,126)
Settlement for land purchases			0
- 195, 197 & 199 McIvor Road		(5,000,000)	(5,000,000)
- 201 McIvor Road		(354,545)	(354,545)
- 203 McIvor Road		(362,727)	(362,727)
- Stamp Duty on all properties		(346,060)	(346,060)
Landlord's Works Costs incurred		(11,516,809)	(11,516,809)
Contribution from Woolworths		2,941,169	2,941,169
Other costs incurred in relation to the anticipated development			0
- Caveat fees	(136)	(136)	0
- Architectural fees	(2,805)	(2,805)	0
- Surveying fees	(5,294)	(5,294)	0
- Town planning consulting fees	(12,685)	(12,685)	0
- Traffic engineering consulting fees	(1,430)	(1,430)	0
Value of the completed development		18,000,000	18,000,000
Repayment of funding	0	(14,714,050)	(14,714,050)
	(75,077)	**2,713,824**	**2,788,901**

383 As indicated in the table, when undertaking his calculation, Mr Stone used an assumed illustrative value for the property of $18 million. He stated that he could not provide an opinion as to the value of the property because he did not have expertise as a property valuer. He arrived at the illustrative value of $18 million using the rental figure set out in the copy of the lease provided to him ($1.289 million) and an assumed yield of seven per cent. He noted that his calculation was sensitive to the yield used and that if a yield of eight per cent was used, loss and damage would reduce to less than $1 million but if a lower yield of 6 per cent was used, loss and damage would increase to almost $6 million. Having noted his understanding that it was not the intention of NES to sell the property, Mr Stone stated:

> However it is appropriate to use the illustrative value of the property at completion as a proxy for the present value of all the future cash flows which NES would have incurred/earned after the completion of the development (other than the repayment of the loan itself), risk adjusted for the time value

> of money and the likely risks (as estimated by the market) regarding the future cash flows likely to be enjoyed by the owner...

384 Mr Stone and Ms Wright arrived at different figures essentially because they used different assumptions.

385 The judge observed that the $18 million figure used by Mr Stone was arrived at by applying a capitalisation of income method ('CI method').[184] The judge described the CI method as involving 'valuing the property by capitalising the (pre-tax) net rental income the property produces at a capitalisation rate based on the yield reflected in contemporaneous sales of comparable income producing properties.'[185] The judge continued:

> Lonergan comments in *The Valuation of Businesses, Shares and Other Equity*, that the Capitalisation of Income method assumes a continuation of the rental income at the date of the valuation. For this reason NES submits this method is not applicable for valuing the rent, which was not fixed under the Agreement for Lease. The Capitalisation of Income method also assumes that the potential for rental and capital growth risks associated with investing in the property and any tax deductions available to an owner are all reflected in the yield. While it is accepted that the yield will implicitly incorporate some discount to reflect the purchaser's—or the market—perception of the risks associated with the cash flows from the property being achieved, at the point of sale, it will also necessarily incorporate other dynamics of the market (such as supply and demand, interest rates etc.) at the time of sale. It is for this reason that market yields change over time. These market dynamics bear no relationship to the risks associated with achieving the particular cash flows in question.
>
> This is not to say that the Capitalisation of Income method has no application. On the contrary, NES does accept that where the property is to be sold, or the cash flow capitalised, at or near the time of valuation, at which point the dynamics of the market will be highly relevant to the price achieved, the valuation of the property by this method may be appropriate. It is for this reason that the method is appropriate to value the property at the end of the Lease when it may realistically be sold. In contrast, where the property is to be sold, and the income capitalised, at a much later point in time, under different market conditions, the application of this method, which assumes the risk of cash flows being achieved is reflected in the yield, which yield is derived under different market conditions, may not be appropriate. It is for this reason that NES does not accept the use of the Capitalisation of Income method to value the cash flows of the property 'at the date of completion of

184 Reasons [348].

185 Reasons [336] citing Wayne Lonergan, *The Valuation of Businesses, Shares and Other Equity* (Allen & Unwin, 4th ed, 2003) 378.

> the development.' Another reason that the selection of a yield that is reflective of the underlying risks of achieving the cash flows in question is that the Capitalisation of Income method of valuation is extremely sensitive to the yield selected with a percentage change in the yield having a disproportional effect on value.
>
> The Capitalisation of Income method is also highly dependent on there being sufficient sales of 'truly comparable properties' at or around the valuation date to allow an appropriate yield to be identified. The evidence reveals that there had been no sales of Masters stores at the time when Woolworths contend NES's cash flows should be valued. There had been a small number of sales at the date Mr Sutherland derives his yields for the purpose of Mr Stone's end value estimate.
>
> In applying the Capitalisation of Income method the yield to be applied is selected based on observable market yields from the sale of comparable properties. The yield is determined by dividing the price by the rental return.
>
> Given the relationship between the market dynamics and yields, and the critical role that yields play in this methodology, Lonergan, in *The Valuation of Businesses, Shares and Other Equity*, states that in determining the yields property valuers should consider the underlying supply and demand dynamics of the market including the level of development activity.[186]

386 The judge stated that although the CI method is a common and simple method of valuing income producing properties it was not the most appropriate method in this case.[187] The judge viewed as critical the fact that NES did not intend to sell the property on completion of the store.[188] He continued:

> where the injured party intends to hold onto the property and the market yields are not stable, as is the case here, the Capitalisation of Income method has the real potential to undercompensate the injured party when yields are falling or overcompensate the injured party when yields are rising by fixing the injured party with a yield that reflects the dynamics of the market and not any inherent risk associated with the cash flows that are intended to be valued.[189]

387 The judge then set out his reasons which, in his view, supported this proposition:

> The Capitalisation of Income method views an investment or income producing property as no more than the stream of revenues that it may

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186 Reasons [336]–[340] (citations omitted).

187 Reasons [351], [353]–[358].

188 Reasons [352].

189 Reasons [353].

generate and values those revenues based on the market price for the property at a particular point in time. In this sense, this method uses the estimated market value of a property at a particular point in time as a "proxy" for the value of all future cash flows generated by the property including from its ultimate sale. Importantly, this method does not directly seek to identify or value the cash flows that the property will generate or identify and measure the risks associated with those cash flows being achieved. Instead, the Capitalisation of Income method looks to the relationship between the market price of comparable properties relative to their rent (the yield), which is assumed to incorporate whatever discount that the market would apply to reflect time value of money and investment risks at the time of purchase. The Capitalisation of Income method then applies that same relationship between market price and rent (yield) to the known rental return on a property to estimate the market price for that property, being the value the market would place on the stream of cash flows the property would generate at that point in time. As already observed, the Capitalisation of Income method of valuation is extremely sensitive to the yield selected such that a very small change in the yield will have a disproportionally large effect on value.

The difficulty with the Capitalisation of Income approach, in this case, is that the yield that an investment property is capable of commanding in the market is a reflection of the market's perception of investment risk of the property relative to its income stream as well as other dynamics of the market at a particular point in time when a property is sold. Features of a property such as its location, specifications, age, tenants, rent and outgoings, as well as the dynamics of the market and investor sentiment, will all influence the market value of a property to an investor and therefore the applicable yield. By dividing the expected rental return by a yield based on comparative sales at the date of completion of the development, as a proxy for the value of all future cash flows and residual equity that would be earned by NES, the Capitalisation of Income method implicitly discounts those future cash flows, including the equity that would have been available at the end of the Lease, on the basis of the dynamics of the property market, including the sentiments of purchasers of comparative properties, as at the date of completion.

As stated in the preceding reasons, the evidence is that the Strathdale site would not have been sold on completion of the development. Accordingly, it is not, in my view, appropriate to fix the loss and damage intended to compensate NES by reference to an implicit discount based on market dynamics and sentiment at a time when the property would not have been sold, or the income capitalised. Instead, the Court should, in my view, look to value the actual cash flows NES would have achieved, having regard to when these would have been achieved and the risks of those cash flows not being achieved. Where it is necessary or desirable to apply a yield, for example to determine the market value of the land at the end of the Lease, the yield that should be applied is the yield that best reflects the market dynamics and sentiment at that time, being the time at which the property may otherwise have been sold....

Moreover, to fix NES's loss and damage by reference to a yield as at the date of completion, while simple and expedient as a means of valuation, is inappropriate and unrealistic in the circumstances. The effect of capitalising

> NES's expected income at the date of completion, by reference to the yield that prevailed at that date, when this date has no relation to the date on which the property might have been sold, and where yields are increasing, will have the effect of undervaluing the cash flows that NES would in fact have obtained from the property. This is particularly so for the residual (capital) value of the land which would not have been sold for some time. In doing so, this method would put NES in a far worse position than the position that it would have in fact been in had NES held onto the Strathdale site, and enjoyed the full cash flows and capital at a lesser discount, as it intended.
>
> The Capitalisation of Income method is also inappropriate in the present case for other reasons, including that the rental income under the Lease was not fixed; there were no comparable sales of Masters stores from which to select a yield; and the assessment of the applicable yield did not, and could not have, taken into account the risks associated with investing in the property and underlying market dynamics as at the likely date of sale, which date had not yet arrived.[190]

388 In contrast to the methodology endorsed by the experts, NES claimed that its loss should be calculated by adding the net present values of:

(a) the 'loss of rental surplus,' being the net rental income NES would have achieved during the term of the lease (assuming all six options to renew were exercised and the lease ran for the maximum 42 years); and

(b) the 'capital loss' or 'net equity', being the capital value of the land less any loan balance as at the conclusion of the lease (assuming all options were exercised and the lease ran for the maximum 42 years).

389 In essence, the judge accepted that this was the appropriate method for assessing loss.

390 After the initial letter of instruction was sent to Mr Stone, he was asked some additional questions including questions which went to the calculation of loss on the basis contended for by NES. In this regard, Mr Stone was asked about the net revenue or surplus rent NES would have achieved over 42 years under the lease, the net present value of that revenue or surplus and the net equity there would have

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190 Reasons [354]–[358] (citations omitted).

been in the Strathdale property at the conclusion of 42 years. Mr Stone performed a calculation of the surplus rent on the basis of his instructions. Taking into account comments made by Ms Wright and other matters, he calculated that the net present value of that surplus was $10,722,842 and that the net present value of the net equity as at 6 May 2010 was between $3,705,216 and $3,906,035 (using the estimated annual rental at year 42 of the lease and a yield of 6.75 or 6.5 per cent to arrive at a net equity value of the property at the end of the lease of between $36,959,738 and $38,962,912).[191] He said:

> In performing this calculation I have applied a discount rate reflective only of the time value of money over this period. I have assumed this rate to be [5.54%][192] per annum, based on the 10-year Commonwealth Bond rate as at 6 May 2010.

391 Mr Stone made a number of assumptions in performing his calculations including that NES would have incurred running costs of $32,000 each year, that rental receipts would have increased at 2.5 per cent each year after June 2014, that NES would have obtained a loan from Bendigo Bank during the construction phase and that interest only payments would have been made on that loan for the whole 42 year period (assuming all options under the lease were exercised).

392 Extrapolating from Mr Stone's calculations, the judge settled on a figure of $14.5 million for loss and damage before applying a discount for risk.[193] The judge stated that Mr Stone had applied a discounted cash flow method ('DCF method') in arriving at his estimate of the value of the surplus rent and the CI method for the

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191 Mr Stone was originally instructed to and did use a yield rate of 8.4 per cent which resulted in a figure of approximately $42 million. Mr Grant Sutherland gave evidence that the appropriate yield at the end of the lease was between 6.5 and 6.75 per cent.

192 Mr Stone originally used a rate of 5.4% but agreed with Ms Wright that the correct rate was 5.54 per cent.

193 Reasons [345]-[346], [368], [377], [387]. The calculation is discussed in Reasons [346] and is $10,722,842 (net present value of the net rent over the life of the lease) + between $3,705,216 and $3,906,035 (exit value of the property at the end of the lease) = between $14,428,058 and $14,628,876 or approximately $14.5 million (net present value of stream of surplus rent and net present value of the exit value of the land, using the Discounted Cash Flow method).

residual value of the property at the end of the lease.[194] The judge stated:

> Mr Stone calculates the end or exit value of the property at the end of the Lease—when the land may be sold—using the Capitalisation of Income method based on the rent that the property would have earned in the last year of the Lease and the yield that applied on the date of his report. This assumes that the property would have been properly maintained and could continue to have realised that level of rent. Where the Lease required the property to be maintained and the rent was fixed to the lesser of CPI or 4 per cent—which does not even preserve the real value of the rent—NES submits that this assumption is not unrealistic.[195]

393 Ms Wright was critical of Mr Stone's calculations. First, she stated that a discount rate ordinarily takes into account both the time value of money and the risk profile of the underlying cash flows. Ms Wright identified a number of risks including inflation, that the construction of the store may result in time delays, cost increases, unforeseen costs and that the tenant may not exercise all of the options under the lease. In regard to this, the judge stated:

> It is clear from this list of risks, being precisely the same risks that the Court must consider when determining what *Sellars* discount to apply, that it was appropriate for Mr Stone to have determined the net present value of the stream of rent and equity on a risk-free basis. Had Mr Stone done otherwise, there would have been duplication once the Court applied a *Sellars* discount to any estimate of loss and damage. Ms Wright agreed that where discounts were applied for the same risks, this may result in a double-counting of risk.[196]

394 The passage from the transcript of Ms Wright's evidence to which the judge referred reads:

> If a discount rate to reflect risk had been applied by Mr Stone and the court also applied its own discount rate, that may raise the possibility of double counting of risks; do you agree with that as a general proposition?---Not necessarily, but I suppose it's possible if they were addressing the same risks.

395 Ms Wright was also critical of Mr Stone's estimate of the value of the property at the end of the lease. In her opinion, it was flawed because it incorporated the

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194 Reasons [331].

195 Reasons [333].

196 Reasons [363].

rental income in the last year of the lease and consequently assumed ongoing rental income and a yield beyond the 42 year period even though no lease agreement would exist. During cross examination, Ms Wright accepted that depending on the type of opportunity one is assessing, more than one method can be used to value loss and damage. When asked if a discounted cash flow methodology was possible, she responded that that method could be used if 'sufficient information is available to assess the cash flows on a specific basis.' Ms Wright testified that the main anticipated cash flow from the Strathdale site was the expected rental income. When it was put to her that a sale of the property in the future would also produce cash, Ms Wright agreed.

396 Woolworths also called evidence from Mr Grant Jackson, an expert property valuer. In his opinion, the CI method was an appropriate approach to value a property with a lease to Masters. He noted that both the net income per year and the yield (capitalisation rate) are critical to such a calculation, with the yield being derived from an analysis of comparable market evidence. In Mr Jackson's opinion, in valuing the Strathdale property, eight per cent was the appropriate yield rate to apply as at 1 July 2011 (that being the date that he was instructed to assume as the lease commencement date). He arrived at that figure for yield having considered the market evidence in relation to eight Bunnings stores (four in Victoria, two in Queensland and two in New South Wales).

397 During cross examination, Mr Jackson testified that it was not a normal approach to valuation to value the land and value the income generated from it separately and then bring them back to a net present value. Mr Jackson was asked in cross examination if the income under a lease could be valued whether, for example, the lease was to be assigned or sold for value. He responded:

> I think I'munderstanding you correctly, you would be splitting the freehold interest to a lessor and a lessee's interest.

398 The transcript of his evidence continues:

Counsel: Perhaps?

Mr Jackson: I've never heard of it happening on an asset like this but that's right, it has happened. So you would be selling the lessee's interest. So if I'm understanding you correctly, you would be retainingthe freehold land and selling effectively the rights to the income for the term - --

Counsel: Exactly right, you could do that?

M Jackson: Yes.

Counsel: You could value that income as if it was an annuity over the period of the lease, for example, and bring it… back to a net present value, couldn't you?

Mr Jackson: Yes, and then you would have to add on the underlying value of the land….

Counsel: You would have that which was the value of the stream of income and separately you would have the underlying value of the land and what it was worth over time, would you agree with that?

Mr Jackson: Whether they would add up to the freehold value is problematic.

Counsel: Different question, but you could value the land, couldn't you, and you could value the stream of income separately?

Mr Jackson: Yes.

399 Mr Jackson was asked to comment in his written report on Mr Stone's use of the CI method to calculate the net equity of the property at the end of the 42 year lease. As noted above, that resulted in a value of about $39 million. Mr Jackson was critical of the use of the CI method to value a property at a date so far into the future. He noted:

> The Masters store in 2052 will be approximately 42 years old. At that time the initial lease term and each further option will have expired. Therefore the value of the property should be assessed on the basis that there is no lease in place and potentially in a vacant state.
>
> Based on my experience it would be reasonable to assume that a 42 year old warehouse of the nature referred to in my instructions may have reached the end of its economic life. A development of this age in my experience would either require considerable upgrading and refurbishment or demolition for redevelopment purposes.
>
> If the property were to be upgraded to be able to secure a tenant and derive an ongoing income stream, a considerable allowance would need to be made for capital expenditure.

If a capitalisation of income approach were to be adopted, the yield would need to reflect that the property is 42 years old. Further the rent adopted for capitalisation purposes should be reflective of a very dated 42 year old building. To simply escalate a rent upwards over 42 years without taking into account the ageing condition of the building is in my opinion and experience incorrect.

Based on my experience there is a real prospect that in 2052 the underlying value of the land may represent the highest and best use of the property. History demonstrates that in the long term the price of land increases and therefore over such a long period it would not be unreasonable to assume there may be some considerable appreciation in land value.

The prospect of the appreciation of the underlying land value coupled with the depreciation of the building in my experience would suggest that the likely highest and best use of the property in 2052 may be for redevelopment purposes.

A 40 plus year period is also a very long time in which retail and bulky goods trends and designs may change significantly. Over the past 30 years I have witnessed a remarkable transformation of the design and layout of retail stores. With the ongoing developments in technology and innovation I would expect that rate of change to continue.

Therefore in my opinion it would not be unreasonable to assume that in 42 years the nature, design, tenant requirements and customer expectation may change to the extent that the Masters store is obsolete.

In my experience there is also a strong likelihood that a new and superior store would be developed to secure tenants such as Masters and Bunnings in 2052 that would be far superior to a 42 year old store. This would most likely lead to the conclusion that the store could not compete in the market to secure a tenant and reliable income stream.

400 The judge did not accept Mr Jackson's evidence in this regard. The judge stated:

NES contends…, in my view correctly, that while the rental figure used by Mr Stone to determine the exit value of the property is the amount that would have been payable for the last year of the Lease, which by definition would have been terminated as at that point, the rental amount is nevertheless the best estimate of what the market rent is likely to be at that time. This is particularly so where the rent under the Lease is fixed at the lesser of CPI or 4 per cent which does not even preserve the real value of the current market rent. It is appropriate for Mr Stone to have calculated the exit value in the way that he did and his estimate should be accepted.

Moreover, Mr Jackson's concerns about the need for capital expenditure to upgrade the site in order for it to be rented are misconceived in that they fail to take into account that more than $2.3 million of "additional costs" of maintaining the property have already been built into Mr Stone's Discounted Cash Flow calculations. Ms Wright conceded in cross examination that it was

> likely the Lease required the landlord to maintain the premises in good order. When cross-examined on the basis of his conclusion that the appreciation of the underlying land value of the Strathdale site coupled with the depreciation of the building would likely mean that the highest and best use of the property at the end of the Lease would be as vacant land for redevelopment purposes, Mr Jackson was not able to estimate the rate at which the underlying land might appreciate. Mr Jackson admitted that he had not considered that point. Mr Jackson was also unable to estimate what the appreciation of the land might be from his own experience. Having not considered the appreciation of the land or the obligation to maintain the premises, it is difficult to see how Mr Jackson can have drawn the conclusions that he did that the best use of the land at the end of the Lease would be for redevelopment.
>
> I do, however, accept, as a general proposition, when considering the exit value of the Bendigo site, the conclusion of Mr Jackson that, in addition to the net income NES would have earned under the Lease, there would likely have been 'some considerable appreciation in land value' over the term of the Lease which NES would have been entitled to the benefit of at the conclusion of the Lease.[197]

401 In respect of this last point, the judge concluded that Mr Stone's estimate of the value of the property at the end of the lease represented approximately a 2.5 per cent (compound) increase in the value of the land each year. As a matter of common experience, the judge accepted that such an assumption is 'conservative and far from unrealistic.'[198]

402 NES called Mr Grant Sutherland as an expert property valuer. Mr Sutherland was asked his opinion as to the value of the Strathdale site assuming it had been developed and leased to Woolworths. He was instructed to provide a valuation as at the date of his report (27 May 2015). He calculated that the annual rental as at 25 May 2015 would have been $1,390.531.90. In his opinion, the appropriate yield to apply was in the range of 6.5 to 6.75 per cent indicating a value range of about $20.6 million to $21.4 million.

403 The judge noted that there was no dispute between the parties that any damages payable to NES must be discounted to the date of breach.[199] Their

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197 Reasons [365]–[367].

198 Reasons [367].

199 Reasons [375].

disagreement, he stated, related to the date on which the property should be valued.[200] The judge held that the 'appropriate date on which to capitalise the net income NES would have earned, for the purposes of fixing loss and damage, is at the date of judgment' rather than at what had been the earlier anticipated date of completion of construction of the store.[201] He did so principally because 'the market conditions for the sale of land were improving over time (yields were decreasing); NES intended to retain rather than sell the property; the later date enabled account to be taken of the sale of comparable Masters stores;[202] account could be taken of the increased supply of stores in the market arising from the Masters rollout.[203] Consequently the judge accepted Mr Sutherland's evidence as to the appropriate yield to be applied, that being the 'most recent yield estimate.'[204] The judge also rejected Mr Jackson's evidence as to yield on the basis that his opinion was not supported by adequate comparable sales (that is, he only relied on sales of Bunnings not Masters stores); for the purpose of comparison, he took into account only the four highest property sales in other States (ignoring others) and preferred them to property sales in Victoria (where a yield of 8 per cent had not been achieved); and he did not take into account later comparable sales.[205] The judge formed the view that the approach adopted by Mr Sutherland was 'far more comprehensive both in terms of the number of stores and the range of yields considered.'[206]

404 The judge concluded that there was nothing in the evidence of Ms Wright or Mr Jackson that should dissuade the Court from 'accepting Mr Stone's estimate of NES' loss and damage, based on Mr Sutherland's yield, being approximately

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200 Ibid.

201 Reasons [377].

202 No Masters stores had been sold at the proposed date for completion of construction of the store on the Strathdale site. At that date, only Bunnings stores had been sold.

203 Reasons [375]–[376].

204 Reasons [371], [377].

205 Reasons [382]–[385].

206 Reasons [385].

$14.5 million before the application of a *Sellars* discount to reflect the risks of the opportunity not being realised.'[207]

405 In considering the amount of discount to be applied to the figure of $14.5 million, the judge assessed the risk as follows:

(a) the risk of the parties not reaching agreement in relation to the LWC or Masters' contribution if Woolworths acted reasonably and in good faith was very low;

(b) there were only the usual risk of delays associated with the development or risks of inflation;

(c) no allowance should be made for the risk of variations or unforeseen cost increases associated with the development;

(d) the overall risk of the options not being exercised was no more than moderate;

(e) the risk that NES may not have been able to exercise its options to purchase the Strathdale site was extremely low;

(f) the risk that NES would not have obtained funding for the development was low; and

(g) the risk that NES would not have been able to obtain planning approval for the development was real, but this risk was very unlikely to eventuate.[208]

406 The judge determined that a discount of 25 per cent should be applied such that damages were fixed at $10.875 million plus interest.[209]

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207 Reasons [368]. See also [377], [386]–[387].

208 Reasons [390].

209 Reasons [391].

407 The judge delivered separate reasons in relation to interest.[210] Section 60(1) of the *Supreme Court Act 1986* relevantly provides that where a claim for damages is made and interest is sought, then unless good cause is shown to the contrary, the Court must give damages in the nature of interest. At the heart of the dispute about interest in this case was s 60(3)(b). That section provides:

> (3) If the damages awarded by the Court or jury include or if the Court in its absolute discretion determines that the damages awarded include any amount for —…
>
> (b) compensation for loss or damage to be incurred or suffered after the date of the award;
>
> the Court must not allow interest in respect of any amount so included or in respect of so much of the award as in its opinion represents any such damages.

408 The judge identified that NES was to be compensated for a single loss being the loss of an opportunity to complete a development.[211] The judge stated that that loss should not be confused with the method by which the opportunity was to be valued.[212] The judge concluded:

> The damages awarded in this case, if properly characterised, are not compensation for the loss of rent or capital that is to be incurred in the future, but is the amount of compensation that Woolworths or Masters would have had to pay to NES on 6 May 2010 in order to put NES in the same financial position that it would have been in had Woolworths not breached their duty of good faith and thereby deprived NES of the opportunity to develop the Bendigo site. Failing to recognise that the award of damages represents the financial value of the opportunity lost by NES, on 6 May 2010, and failing to pay interest on that amount for the duration of the proceeding, would, in my view, deprive NES — as a successful plaintiff — of the compensation to which it is entitled for having been kept out of the lost opportunity — or its financial equivalent — for the duration of the proceeding.
>
> For the preceding reasons, it follows, in my view, that on the proper construction of s 60(3) of the Act, and having regard to the usual principles relating to interest, NES is entitled to interest on the entire judgment amount

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210 *North East Solution Pty Ltd v Masters Home Improvement Australia Pty Ltd (No 2)* [2016] VSC 87 ('Interest Reasons').

211 Interest Reasons [23].

212 Ibid.

from the date the proceeding was commenced until judgment.[213]

409 The judge awarded $4,297,636.13 as damages by way of interest.[214]

(b) Grounds of appeal in relation to damages and interest

410 The grounds of appeal concerning damages and interest are:

Failure to distinguish between the value of the opportunity and the probability of realising the opportunity

5.6 The judge erred in assessing any loss of opportunity, by:

(a) failing to distinguish between (a) the value of the opportunity and (b) the probability of realising the opportunity (*Sellars* discount); and

(b) considering in the assessment of the *Sellars* discount matters that were properly part of the determination of the value of the opportunity.

Use of alternative methodology

5.7 The judge erred in assessing the value of any loss of opportunity by rejecting the methodology which both parties' expert witnesses had considered to be appropriate, and by adopting an 'alternative methodology' which was not founded in or supported by evidence.

Application of 'alternative methodology'

5.8 The judge erred in applying the 'alternative methodology':

(a) by assessing the likely value of the property in 2052 without any evidential foundation;

(b) by applying a risk-free rate for the entire period of 42 years, without any evidential foundation; and

(c) by failing to account for other findings made which bear on the quantification of loss (irrespective of the methodology applied), such as the judge's finding in relation to the costs required to mitigate any flood-related issues (assuming they could be mitigated), with the result that the learned judge erroneously quantified loss at $14.5 million.

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213 Interest Reasons [29]–[30].

214 Interest Reasons [30], [42], Sch A. Orders made 18 March 2016.

Date for determination of applicable yield

5.9 The judge erred in holding that in assessing damages, the capitalisation of the net income NES would have earned ought be determined as at the date of judgment, instead of the date of breach.

Sellars discount

5.10 The judge erred in the assessment of the *Sellars* discount at 25 percent, which did not properly or sufficiently reflect the substantial uncertainties surrounding the commercial opportunity actually materialising, in terms of the prospects that no agreement would be reached between the parties as to the relevant commercial terms of a lease, or that no development approval would be granted, or that no funding would be achieved for the development.

5.11 The judge erred in making a number of findings leading to the determination of the *Sellars* discount applied, namely:

(a) the erroneous finding that the development would have proceeded and the benefits promised under the AFL would have been realised;

(a) the erroneous findings that the parties would have agreed to pay the revised contribution amount as a lump sum, and that the risk of the parties not reaching agreement in relation to the Clause 2.2(b) Amount, if Woolworths acted reasonably and in good faith, was very low;

(b) the erroneous finding that it was highly likely that Bendigo Bank would have provided full funding for the development (minus any Clause 2.2(b) Amount) to NES, and that the risk that NES would not have obtained funding for the development was low;

(c) the erroneous finding that, had Woolworths and Masters acted reasonably and in good faith and with the contractual object of progressing the development in mind, they would have agreed any changes to the design that were reasonably necessary to mitigate inundation issues;

(d) the erroneous finding that the risk that NES would not have been able to obtain planning approval was very unlikely to eventuate.

Interest

5.12 The judge erred in finding that none of the loss that NES suffered was 'loss or damage to be incurred or suffered after the date of the award' for the purposes of s 60(3)(b) of the *Supreme Court Act*, and in doing so:

(a) failed to follow appellate authorities which require the Court to undertake a practical inquiry, rather than a juristic or conceptual approach; and

(b) failing to find, on the practical analysis, that the loss suffered by NES was, as to a small part pre-judgment loss, but predominantly post judgment loss.

(c) Legal principles — damages for loss of opportunity

411 In considering damages for loss of a commercial opportunity, the court asks first whether there was a commercial opportunity of *some* value (which is more than speculative or negligible); that is, was there a chance?[215] Secondly, the court looks to whether that opportunity has been lost; that is, would the plaintiff have pursued the opportunity?[216] The third step is to consider what amount should be awarded having regard to the prospects of success if the opportunity had been pursued.[217] In taking this third step, the courts' task is to apply a discount which reflects the prospects of success. This is sometimes referred to as a *Sellars* discount.

412 There was no challenge to the judge's finding that NES would have pursued the opportunity. Rather, the attack by Woolworths focusses on other aspects of the judge's assessment.

(d) What is the opportunity that has been lost?

413 As set out above, we are assuming (for this part of the judgment) that Woolworths breached its obligation to act reasonably and in good faith to attempt to resolve differences under clause 2.2(b) of the AFL.

414 As a starting point for damages, it is essential to ascertain what opportunity has been lost. The judge found that the opportunity that had been lost was the opportunity to develop and lease the Strathdale site to Masters for the duration of the lease and not the opportunity to develop and sell that site with the lease in place

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215 *Sellars* (1994) 179 CLR 332, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ), 364 (Brennan J); *Malec v JC Hutton Pty Ltd* (1990) 169 CLR 638, 643 (Deane, Gaudron and McHugh JJ) ('*Malec*').

216 *Sellars* (1994) 179 CLR 332 , 355 (Mason CJ, Dawson, Toohey and Gaudron JJ), 364 (Brennan J).

217 *Sellars* (1994) 179 CLR 332, 355 (Mason CJ, Dawson, Toohey and Gaudron JJ); *Malec* (1990) 169 CLR 638, 643 (Deane, Gaudron and McHugh JJ).

at the completion of the development.[218]

415 NES characterised the opportunity that it lost as the chance to obtain the full benefit of the AFL including the chance to purchase the land, to develop it, to enter into the lease, to receive the net income under the lease and to realise the residual value of the development.

416 Woolworths submitted that the judge had mischaracterised the opportunity as both the opportunity to acquire the land and the income from it. Woolworths contended that the opportunity was an opportunity to enter into a lease in the future with very valuable covenants, plus a capital contribution to the construction of the building. Most importantly, Woolworths submitted that the opportunity did not include the land, nor the building on it, both of which NES would have held at the end of the lease and could have sold.

417 On the hypothesis that Woolworths breached its obligation under clause 2.2(b), in our opinion, as a result of that breach, NES lost the opportunity to conclude negotiations in respect of the matters relating to the LWC, and thus to enter into the lease that was the subject of the AFL. We accept Woolworths' characterisation of the lost opportunity as the opportunity to have the benefit of the lease together with the contribution by Woolworths to the capital cost of constructing the store on the Strathdale site.

418 It is true that if negotiations for the lease had concluded, NES would have exercised its right under the option to acquire the Strathdale property. However that does not mean that, because of the (hypothesised) breaches by Woolworths, NES lost the opportunity to buy the land, or lost the value of the property. The hypothesised breaches did not affect the legal rights of NES to exercise the option to purchase the Strathdale property. Its decision not to proceed with the purchase of the property, was based on commercial considerations, namely, that it did not wish to purchase or

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218 Reasons [259], [323].

develop the site for other purposes.

419 The lost opportunity was attended by one obvious risk — the risk that, acting reasonably and in good faith, Woolworths and NES may never have been able to resolve their differences about the LWC and the tenant's contribution. Embedded in the lease itself was another substantial risk, being the number of options and the total length of them.

(e) Legal principles — expert evidence

420 Where expert evidence is concerned, the Court's role is to evaluate it critically. Where the evidence is cogent, it should not be ignored. In this regard, it is not part of the Court's role to bring a third set of opinions into the arena,[219] nor to piece together its own valuation.[220] However, where there is conflicting expert evidence, it may be necessary to accept part of each expert's evidence and reject other parts. In some circumstances, it may be necessary for the Court to make adjustments to the conclusion reached by an expert[221] when that expert's opinion is shown to be flawed in one or more respects or based on an incorrect assumption. Moreover if, after careful examination, the Court forms the view that a piece of expert evidence is not cogent, then it may be disregarded.

421 Bearing these matters in mind, it is clear that judges should not take on the role of an expert.[222] If an evaluation of the whole of the evidence demonstrates that the experts' opinions are not well founded, then the judge is left in the position of having to do the best that he or she can if satisfied that the plaintiff has sustained loss.[223]

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219 *Brewarrana Pty Ltd v Commissioner of Highways (No 2)* (1973) 6 SASR 541, 544–5 ('*Brewarrana*').

220 *101 Collins Street v City of Melbourne* (unreported, Batt J, 2 April 1996) 81.

221 Ibid.

222 *Brewarrana* (1973) 6 SASR 541, 544-545.

223 See, for example, *Fink v Fink* (1946) 74 CLR 127, 143 (Dixon and McTiernan JJ); *Commonwealth v Amann Aviation Pty Ltd* (1991) 174 CLR 64, 83 (Mason CJ, Dawson J), 102 (Brennan J), 125

(f) Elements of loss, the methodology to assess it and the discount to be applied (Grounds 5.6, 5.7, 5.10 and 5.11)

Submissions about loss

422 Woolworths submitted that there are two elements to the assessment of the loss of the opportunity. First, the assessment of the loss resulting from the transaction (the value of the opportunity) and secondly, the application of a discount (*Sellars* discount) to account for the risk that the transaction would not have occurred (the probability of realising the opportunity). Woolworths submitted that the judge blurred the distinction between the two. In Woolworths' submission, a discount had to be applied to cater for the probability that the lease would never have been entered into (the risk of the project proceeding at all) in addition to a discount for the risks associated with the lease itself (the risks if the project proceeded).

423 Woolworths submitted that the value of the opportunity which was lost was a matter for the experts yet the judge had rejected their consensus view and applied an alternative (and erroneous) methodology which lacked an evidentiary foundation. All that NES had done was have Mr Stone perform some calculations.

424 Woolworths contended that two matters seemed to have influenced the judge; first, a passage from Mr Lonergan's text book and secondly, the submission that NES intended to keep and not sell the property. Woolworths noted that the experts had taken into account the second of these matters.

425 Woolworths submitted that NES had failed to lead evidence as to the value of the property at the conclusion of the lease in 2052, with Mr Jackson having identified various risks in attempting to provide such a valuation.

426 Woolworths submitted that the judge had applied the *Sellars* discount to matters bearing upon both the value of the lost opportunity as well as to the probability of the occurrence of the lost opportunity. Whilst Woolworths accepted

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(Deane J), 153 (Gaudron J).

that it was open to the judge to apply a global discount, in its submission, the judge was required to give full weight to the true effect of the separate considerations relevant to each risk. It submitted that the global discount of 25 per cent significantly understated the appropriate discount factor concerning the probability of the occurrence of the lost opportunity. In particular, it stressed the risk that the development would not have proceeded at all because the parties may not have resolved their differences as to the amount and payment of the tenant's contribution to the LWC under clause 2.2(b) of the AFL. Consequently, Woolworths submitted that the judge should have taken into account that there was a substantial risk that no lease would have eventuated and applied a discount accordingly.

427 Woolworths also pointed to other matters it characterised as risks attending the potential realisation by NES of the commercial opportunity including funding not being available to NES, a planning permit may not have been granted, costs associated with the development which may have affected the ability of NES to obtain funding and the cost of the works to comply with a permit (should one be issued). In respect to this last matter, Woolworths pointed to the risk that the development would not have progressed due to flood inundation issues. The judge found that the store could have been constructed without the need for modification[224] and, in any event, Woolworths would have agreed to design changes reasonably necessary to mitigate any flood inundation issues.[225] When it came to assessing the *Sellars* discount, the judge did not refer to any risk associated with flood inundation.[226] In addition, Woolworths submitted that the judge had failed to take into account the general risk attending all property development that for one reason or another, the development would not proceed.

428 Finally Woolworths submitted that the risks associated with the cash flows

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224 Reasons [290].

225 Ibid.

226 Reasons [390]. See [405] above.

(the risk that all of the options would not have been exercised) should have been taken into account in the valuation of the lost opportunity — as would have been the case if the methodology endorsed by the experts had been adopted. Having failed to do that, if those risks were to be taken into account as part of the *Sellars* discount, then Woolworths contended 25 per cent was grossly inadequate.

429 NES contended that the role of expert evidence had been overstated by Woolworths and that in truth, expert evidence is to assist not usurp the Court's role. NES submitted that in this case the judge was best placed to assess the risks. NES submitted that the judge was entitled to exercise his own judgment and was not bound to accept even uncontradicted expert evidence. In its submission, the judge was free to adopt whatever approach he considered most accurately valued the loss, even if this was against the weight of the expert evidence. NES contended that the judge's approach was consistent with the experts' evidence comparing cash flows that would have been earned against its actual cash flows and referred to the expert evidence that there are various methods by which cashflow may be measured. NES submitted that all that Ms Wright did was to agree at a very high level with Mr Stone that the appropriate methodology was a comparison between the but for cashflows and the actual cashflows. However, NES argued that no expert gave evidence that the method employed by the judge would be inappropriate for any reason. Nor, in the submission of NES, did Ms Wright or Mr Stone express a view as to the appropriateness of a DCF methodology over the methodology the judge used. They were simply not asked to do so. So far as Ms Wright is concerned, NES submitted that she took a neutral position in relation to the DCF methodology and simply criticised some of the inputs Mr Stone used. So, NES submitted, having regard to what Ms Wright was asked to do, it was not true that Ms Wright and Mr Stone had agreed on the method to be employed. So far as Mr Stone was concerned, NES submitted that the judge had considered his opinion as to the appropriate method of valuation of the loss and had rejected it finding that that method would not give NES the compensation to which it was entitled.

430 NES relied on the fact that its particulars had set out the method for calculating its loss, that Woolworths had put on no evidence about that method, that Mr Stone calculated the loss by the method used by the judge and that Mr Stone was not cross examined about that calculation. It contended that the judge was better placed than the experts to apply a methodology for calculating loss because, unlike the experts, he had heard evidence about the specific risks associated with the stream of income. NES submitted that the base loss having been discounted for all risks, there was nothing erroneous in applying a risk free discount rate to obtain the net present value.

431 NES submitted that what was important was that the judge undertook an assessment of the contingencies and made allowances for them and it did not matter whether the form of allowance was within or separate to the *Sellars* discount. It was important that the judge did not allow a discount more than once for each risk. NES characterised the attack by Woolworths to be one as to the adequacy of the allowance for risk. In this regard, it urged this Court to exercise restraint before interfering with the judge's assessment and submitted that appellate intervention is only warranted where there is patent error or the amount awarded is plainly wrong or unjust. NES submitted that these grounds of appeal sought to challenge factual findings made by the judge and none of them was glaringly improbable or contrary to compelling inferences. The findings related to the risks of the parties not reaching agreement about the LWC or tenant's contribution to it; the risk of variations and cost increases being borne by Masters and Vaughans; the risk that not all options would be exercised; the risk that NES may not have been able to exercise the option to purchase the land; the risk of NES not obtaining funding; and the risk that planning approval would not have been forthcoming.

432 So far as taking into account flood inundation issues, NES contended that the judge had considered that it presented no risk to the development, only a risk in relation to additional cost which would have been borne by NES. As to Woolworths' assertion that the conditions in any planning permit may have prevented the project

from proceeding, NES submitted that Woolworths had failed to call any evidence of this. Consequently, it was not a risk that the judge was required to take into account. On the other hand, NES submitted that the judge had taken into account the risks identified by Ms Wright.

433 As concerned the risk associated with the non-exercise of the options, NES submitted that Woolworths led no evidence as to there being any jeopardy in relation to their non-exercise and the 12 year lease with six options of five years each was what Woolworths had requested. NES submitted that the evidence showed that at the time, Woolworths was very keen to roll out the Masters' stores and was committed to that plan.

Analysis — Given the opportunity that has been lost, what methodology should have been applied to calculate the loss and what discount should have been applied?

434 As set out above, the judge applied a DCF methodology for presumed net rental value over the life of the lease combined with the projected residual value of the land in 2052 (calculated by using the CI methodology based on presumed rental on expiry of the last option in 42 years and a yield rate of between 6.5 and 6.75 per cent). As noted above, the judge assessed the total loss of NES at $14.5 million before applying a discount (other than a discount for the time value of money). Before turning to the more substantive aspects of the judge's assessment, in passing we would note that to the extent that the judge may have relied on Mr Lonergan's textbook, this was not well founded. Mr Lonergan was not a witness, his textbook was not evidence and was not put to any witness who adopted what was said in it.[227]

435 As we have said, the opportunity that was lost did not include the opportunity to own the Strathdale property. Consequently, the inclusion by the judge of an amount for the residual value of the land would overcompensate NES. We accept that NES may have been entitled to some compensation in respect of the

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227 See *PQ v Australian Red Cross Society* [1992] 1 VR 19.

loss of the contribution that Woolworths would have been required to make to the LWC. As NES did not proceed with the purchase of the land, it may be that only nominal compensation would be payable. Given our other findings, and as the parties' submissions did not address this issue, it is not necessary nor desirable for us to form a final view in this regard.

436 That leaves the net present value of the surplus rent which Mr Stone calculated to be $10,722,842. At least conceptually, when risk is taken into account, it might be expected that there would not be a significant difference in outcome regardless of whether the methodology endorsed by the experts was employed or whether the approach that the judge adopted was used.

437 In our opinion, it was open to the judge to depart from the evidence of Mr Stone and Ms Wright in the circumstances of this case, particularly that part of their evidence which assumed an illustrative value for the property (assessed using the CI method of valuation) and then used that illustrative value as a proxy for the future cash flows. That methodology may have some benefits. It is a simple valuation method which takes into account (through the application of yield) what the market considers the embedded risks in the lease to be. It may be a good proxy for future cash flows. However, in this case, NES did not intend to sell the property or assign the benefit of the lease. Logically then, a calculation of the net present value of the surplus rent over the life of the lease more accurately aligns with what would have occurred had there been no breach. It was open to the judge to adopt that methodology. Of course, that methodology requires the application of a discount to reflect the risks that attend the lease itself, those risks not having been factored in as is the case by the application of a yield using the CI method.

438 For the purposes of this part of our reasons, we are assuming that the judge was correct as to his findings about the Rider Hunt estimate and the tenant's contribution to the LWC as a lump sum. On that hypothesis, the judge would have been correct to assess the risk of the parties not agreeing in relation to the LWC or

Woolworths contribution to it as very low.

439 Nevertheless, if the opportunity were realised to some extent, the discount applied by the judge did not take into account the very high risk that not all of the options would be exercised. The only relative 'certainty' was for the first 12 years of the lease. By their very nature, the five options were uncertain. They were exercisable by Woolworths not NES. As such, it was Woolworths that had full control. The options spanned 30 years (on the assumption that each option would be exercised). Whether the later options would have been exercised must be even more uncertain than was the likelihood of the exercise of the earlier options. Indeed, each option bore more risk than the last. As a matter of common experience, one cannot but help observe that the face of retail businesses and how they operate has changed significantly over the last 10 years. There is no reason to expect that there is not more change to come. Mr Jackson's evidence is consistent with these observations. Woolworths would have had to make a commercial decision each time an option fell due. Undoubtedly this would involve it taking into account, each time, projected changes for its business and how its competitors were conducting their businesses.

440 When considering the acceleration of risk as each option passes, it is instructive to consider the breakdown of the calculations undertaken by Mr Stone. In this regard, his calculation shows that less than $4 million of the total rental surplus is for the first fixed term of 12 years with the balance of just over $40 million being attributable to 30 optional years.[228] In our view, the figure of 25 per cent does not reflect that the judge took into account the real risk that not all of the options may be exercised. It is simply far too low a figure. As noted above, the judge stated that with each consecutive term, the risk increased. We would categorise that risk as escalating to very high by the time of the later options and, on its own, it warranted a much higher discount to be applied.

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228 The calculation performed by Mr Stone shows that the total rental surplus over the prospective 42 years of the lease (if all options were exercised) would be $44,363,210. Of that amount, only $3,933,660 is for the first fixed term of 12 years.

441 Once that is taken into account, together with the other risks (including the usual risks associated with any property development) a discount of more than 50 per cent and likely closer to 75 per cent was warranted. In the circumstances, it is not necessary to discuss in detail the other risks that affected the opportunity and that would affect the amount of the discount to be applied. In addition, given our findings in respect of liability for breach, we do not propose to say more about the methodology to be adopted nor about the discount to be applied.

(g) Other grounds

442 In view of the conclusions which we have reached about liability, and our conclusions thus far concerning damages (had liability been established), it is unnecessary to consider further the grounds concerning damages, the yield that the judge applied and interest.

CONCLUSION

443 For the foregoing reasons, we would grant leave to appeal and allow the appeal.