COMMENT ON PENALTIES, FORFEITURE AND DILUTION

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One of the observations made by Mr. Justice Clarke in his learned and thoughtful paper is that of the two doctrines of penalties and equitable relief against forefeiture, the latter is likely to prove the more potent force where non-defaulting joint venturers seek to enforce rights of dilution, compulsory assignment or the like. In our view, there is considerable wisdom in this observation; so much so that we have taken it as the theme for this commentary, in which we examine some of the reasons why equitable relief against forfeiture is likely to become increasingly relevant and important.

DISTINCTION BETWEEN PENALTIES AND FORFEITURE

An appropriate starting point is to recall the fundamental elements of each doctrine, and the points of difference between them. The essential distinction between a penalty and forfeiture, as Mr. Justice Clarke noted, is explained by Mason and Deane JJ. in *Legione v. Hateley*:[1]

> A penalty, as its name suggests, is in the nature of a punishment for non-observance of a contractual stipulation; it consists of the imposition of an additional or different liability upon breach of the contractual stipulation. On the other hand, forfeiture involves the loss or determination of an estate or interest in property or a proprietary right.

Forfeiture can be effected by a contractual provision that constitutes a penalty or by one that does not. In either case, equity may grant relief against forfeiture.[2] Thus it would be wrong to regard the doctrines as covering the same field.

On the other hand, the two doctrines have much in common. They have a common origin in the equitable principles applied by the Courts of Chancery, although the modern doctrine of penalties largely consists of common law rules adopted from equity in the manner described by Mason and Wilson JJ. and Deane J. in *AMEV–UDC Finance Ltd. v. Austin*.[3] No doubt because of this common origin, they are, in Mr. Justice Clarke's words, 'both enlivened by considerations of conscience'. Each doctrine affords relief against contractual provisions that operate harshly and unconscionably, but they both approach the problem from different perspectives and use different tests and remedies in resolving it. This is perhaps to be explained by their different historical development and the influence which the common law has exerted over the doctrine of penalties.

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1 (1983) 152 CLR 406, 455.
2 *Ibid*, 425.
3 (1986) 162 CLR 170.

Penalties

The basic rule, of course, is that an obligation to pay a sum of money to another on breach of a contract will only be enforceable if the sum paid is properly to be regarded as a pre-estimate of damages and not a penalty.[4] The courts have developed a set of rules to aid in the determination of this question. Without attempting exhaustively to state those rules, it is pertinent to make several observations concerning them. First, it has repeatedly been said that the question is one of construction depending upon the terms and circumstances of each particular contract, judged as of the time of the making of the contract and not as of the time of breach.[5] A distinguishing feature of this approach is that the character of the contractual provision is to be judged at the date of contracting. The better view is that this judgment is to be an objective one. As Deane J. pointed out in *O'Dea*,[6] even if the parties to an agreement subjectively intended to make a pre-estimate of damages in the event of breach, that pre-estimate will be a penalty if it is either extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed by the breach or, judged as at the time of making the contract, is unreasonable in the burden which it imposes in the circumstances which have arisen.[7]

Secondly, the essence of a penalty still seems to be 'a payment of money stipulated as in terrorem of the offending party'.[8] In *Esanda Finance v. Plessnig*,[9] Wilson and Toohey JJ. noted the argument that the doctrine of penalties can only apply to clauses which compel a payment, as distinct from those which entitle a party to some kind of refund. The argument is not self-evidently correct, because the character of a provision as one imposing a penalty is to be judged as a matter of substance, not form. Wilson and Toohey JJ. did not find it necessary to express any opinion about the argument, but they did remark that even if the argument were correct, equitable relief against forfeiture may be available, citing *BICC plc v. Burndy Corp.*[10]

Thirdly, there appears to be a trend discernible in the more recent cases to allow parties to make their own contractual provision for the consequences of breach, so long as that provision is not 'extravagant, exorbitant or unconscionable'. This sentiment appears most clearly in the observation of Mason and Wilson JJ. in *AMEV–UDC*[11] that '[t]here is much to be said for the view that the Courts should return to the *Clyde-*

4 *O'Dea v. All States Leasing System (W.A.) Pty. Ltd.* (1983) 152 CLR 359, 397 *per* Deane J.

5 *Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Company Ltd.* [1915] AC 79, 86–87; *O'Dea v. All States Leasing System (W.A.) Pty. Ltd.* (1983) 152 CLR 359, 373 *per* Gibbs C.J., 378 *per* Wilson J. and 399–400 *per* Deane J.; *AMEV–UDC Finance Ltd. v. Austin* (1986) 162 CLR 170, 193–194 *per* Mason and Wilson JJ.; *Esanda Finance Corporation Ltd. v. Plessnig* (1989) 84 ALR 99, 105, *per* Wilson and Toohey JJ.

6 (1983) 152 CLR 359, 400.

7 *Cf.* Wilson J. in *O'Dea*, 378.

8 *Dunlop*, [1915] AC 79, 86.

9 (1989) 84 ALR 99, 105.

10 [1985] Ch. 232, 251–252.

11 (1986) 162 CLR 170, 190.

bank and *Dunlop* concept [extravagant, exorbitant or unconscionable], thereby allowing parties to a contract greater latitude in determining what their rights and liabilities will be, so that an agreed sum is only characterised as a penalty if it is out of all proportion to damages likely to be suffered as a result of breach.'[12]

Fourthly, the doctrine of penalties seems to be a much blunter weapon than that of relief against forfeiture. Once a clause is held to constitute a penalty it is unenforceable and, perhaps void *ab initio*, leaving the non-defaulting party to his right to recover damages for breach of contract in lieu of the penalty.[13] In the exercise of its jurisdiction to grant relief against forfeiture, equity can and always has insisted upon terms ensuring that the injured party recovers no more than its actual loss and that the party obtaining relief against forfeiture does not obtain any advantage.[14] The point is amply demonstrated by *AMEV-UDC*. In that case, the owner of equipment had exercised a contractual right to terminate an agreement for hire. The contractual provision providing for the consequences of termination, however, was unenforceable as a penalty. If the owner were to be limited to its right to damages for breach of a non-essential provision of the contract, it would not be able to recover the full amount of its losses consequent upon termination, the reason being that such losses were in part a consequence of breach but in part a consequence of the termination. In these circumstances, the majority held that the owner was in the position of a plaintiff in an ordinary action for damages for breach of contract and so could not recover any losses which were solely the result of the termination of the contract (as distinct from the breach which gave rise to the termination). Mason and Wilson JJ. considered that the common law rules as to penalties did not allow the non-defaulting party to recover so much of the penalty as constituted its actual loss. On the other hand, the dissentients (Deane and Dawson JJ.) contended that there was no reason in principle or justice why the common law doctrine of penalties should render completely unenforceable a contractual obligation which the rules of equity would have effectively enforced up to the amount of the true damnification.[15]

Relief Against Forfeiture

The foregoing aspects of the doctrine of penalties contrast markedly with the flexible principles that govern relief against forfeiture. The general notion underlying equity's preparedness to grant relief against forfeiture is the same as that which underlies much of equity's traditional jurisdiction, namely that a person should not be permitted to use or insist upon his legal rights in a manner which involves unconscionable conduct or which takes advantage of another's special vulnerability or misadven-

12 See also *Esanda Finance* (1989) 84 ALR 99, 103 *per* Wilson and Toohey JJ.
13 *AMEV- UDC* (1986) 162 CLR 170, 191–192, *per* Mason and Wilson JJ.
14 For example *Forestry Commission of New South Wales v. Stefanetto* (1976) 133 CLR 507, 524 *per* Jacobs J.; *AMEV-UDC Finance* (1986) 162 CLR 170, 201 *per* Deane J.
15 Deane J. at 201 and Dawson J. at 216 and 219; *cf. Jobson v. Johnson* [1989] 1 All ER 621

ture for his own unjust enrichment.[16] The jurisdiction in equity takes full account of all relevant circumstances including the circumstances prevailing at the time of breach, is not confined to provisions that oblige a payment to be made and affords ample flexibility to shape the remedy to meet the exigencies of the case. While there are a number of established categories in which relief against forfeiture may be given, those categories are not closed. As *Legione v. Hateley* and *Stern* show, the underlying criterion of unconscionable conduct when given full rein can result in relief against forfeiture being granted in cases where it had previously been thought unavailable. The general vigour of these equitable principles is one reason why we consider that relief against forfeiture will become an increasingly potent force in the field of mining joint ventures. In addition, certain features of the way in which these principles have been expounded and applied in recent cases support this prediction.

In the first place, it now seems to be settled that relief may be, and ordinarily will be, granted where the contractual provision for forfeiture has been made to secure the payment of money and the defaulting party offers to pay the amount owing together with the appropriate compensation.[17] The reason is that in such circumstances the object of the provision has been achieved and it would be unconscientious of the other party to take advantage of the forfeiture. It is not necessary to attract equitable relief that the provision for forefeiture constitute a penalty. Secondly, the cases have drawn a distinction between a forfeiture effected by a contractual provision (usually as a means of insuring performance of the principal obligation) and that effected by the general law following rescission for breach of an essential contractual term. In the former case, it may not be necessary to prove unconscionability except insofar as it is implicit in the non-defaulting party's efforts to insist on forfeiture despite the objective of the forfeiture provision having been achieved by other means. Brennan J. gave this illustration in *Esanda Finance v. Plessnig*:[18] equity may grant a hirer of equipment relief against an exercise by the owner of its contractual right to terminate, repossess and sell the hired goods in the event of non-repudiatory breach because the contractual right is seen as a penalty designed to secure money and a court of equity can impose terms giving the owner all that he is entitled to as a money lender. In the latter case, exceptional circumstances consisting of proof of unconscionable conduct must be shown to warrant relief against forfeiture.[19] *Stern* shows that there is considerable scope for disagreement as to what is capable of constituting unconscionable conduct.

Thirdly, as Clarke stated, it has been held in England that relief against forfeiture is not available in respect of pure commercial contracts that confer no proprietary or possessory rights over real or personal prop-

16 *Legione v. Hateley* (1983) 152 CLR 406, 444 *per* Mason and Deane JJ.; *Stern v. McArthur* (1988) 81 ALR 463, 488, *per* Deane and Dawson JJ.

17 *Shiloh Spinners Ltd. v. Harding* [1973] AC 691, 711; *Legione* (1983) 152 CLR 406 424–425; *Stern v. McArthur* (1988) 81 ALR 463, 468 *per* Mason C.J., 479–480 *per* Brennan J., 488–489 *per* Deane and Dawson JJ., and 497–498 per Gaudron J.

18 (1989) 84 ALR 99, 109, 122.

19 *Legione v. Hateley* (1983) 152 CLR 406, 444–449; *Stern* (1988) 81 ALR 463, 470–471, 478–479, 486–488, 497.

erty.[20] Given that relief against forfeiture is driven by general principles of unconscionability and unjust enrichment, it is difficult to see why any such restriction should exist. It sits ill with the settled principle that equity will grant relief against forfeiture of monetary instalments or payments, at least where the object of the contractual provision effecting that forfeiture is to provide security against breach.[21] It is not, however, a point of great moment in the context of mining joint venture agreements. Such agreements invariably confer proprietary rights upon venturers and contain forfeiture provisions which, by one mechanism or another, effect a forfeiture of proprietary interest or monetary contributions.

Fourthly, after reading the recent Australian cases the impression is that the fact that the parties have stipulated in their contract that a particular forfeiture mechanism is to operate in the event of default is not accorded the same significance in considering whether to grant relief against forfeiture as recent penalty cases have accorded it. Undoubtedly, weight is to be given to the bargain which the parties have made for themselves,[22] but on the scale of things comparatively little weight seems to be accorded where the object of the forfeiture provision is to secure payment or performance. Greater weight is accorded where the forefeiture is the result of the breach of an essential term (e.g. non-payment on the due date, the parties having stipulated that time shall be of the essence), but even then the presence or absence of unconscionable conduct rather than general conceptions of freedom of contract will determine whether or not equity intervenes. In *Stern*, the objection raised by the dissentients was that in the absence of unconscionable conduct equity's ability to grant relief against forfeiture ought not to be used to 'reshape contractual relations' or to engage in 'judicial reformation of contracts'.[23]

Mention should be made, lastly, of the factors which the courts have examined in determining whether there has been unconscionable conduct of a kind warranting equity's intervention to grant relief against forfeiture. Factors which have been considered include the following:

1. the deliberation and seriousness of the defaulting party's breach (including whether the breach was serious, trivial or slight; deliberate, inadvertent or not wilful);
2. the magnitude of each party's loss or gain if the forfeiture is allowed to stand;
3. the likelihood of the non-defaulting party by strict insistence on contractual rights making a windfall profit for which it is not required to account to the other party;
4. whether the conduct of the non-defaulting party caused or contributed to the breach;

20 See *Scandinavian Trading Tanker Co. A.B. v. Flota Petrolera Ecuatoriana* [1983] 2 AC 694; *Sport International Bussum B.V. v. Inter Footwear Ltd.* [1984] 1 WLR 776 and *BICC plc. v. Burndy Corp.* [1985] Ch. 232, *cf. Esanda Finance v. Plessnig* (1989) 84 ALR 99, 105, 112.

21 For example, *Pitt v. Curotta* 31 S.R. 480.

22 *Stern v. McArthur* (1988) 81 ALR 463, 488 *per* Deane and Dawson JJ.; *Shiloh Spinners Ltd. v. Harding* [1973] AC 691.

23 *Stern v. McArthur* (1988) 81 ALR 463, 471 *per* Mason C.J.; 479 *per* Brennan J.

5. what damages or other adverse consequences the non-defaulting party suffered by reason of the breach;
6. if there has been a windfall increase in the value of the forfeited interest, to whom that benefit should go;
7. whether one or other of the established grounds of fraud, accident, mistake or surprise can be made out;
8. whether the transaction as a whole is one designed to secure the payment of money, *i.e.* is the forfeiture provision itself properly to be characterised as one designed to secure the payment of money or the performance of contractual obligations?[24]

The decision in *Stern* is a good illustration of the potency of these equitable rules. There, the purchasers had defaulted under a terms contract of sale some eight years after the contract was made. In that time, the purchasers had constructed a house on the land and the value of the land (in its unimproved state) had greatly increased. The vendors insisted on their right to rescind for breach of an essential term. By a majority of three to two, the High Court granted relief against forfeiture. The critical question was who should have the benefit of the windfall increase in the value of the land, the vendors having offered to compensate the purchasers for the value of the improvements. The majority held that it would be unconscionable for the vendors to take the windfall benefit by insisting on their strict legal rights. Deane and Dawson JJ. would also have granted relief solely on the basis that the terms contract was in essence one whereby the vendors undertook to finance the purchasers upon the security of the land.[25] In a stronger sense, Mason C. J. and Brennan J. argued that unconscionability must be shown to warrant equitable intervention. It was not unconscionable for the vendors to take the benefit of the enhanced land value and to regard such conduct as unconscionable was to eviscerate that concept of its meaning.[26]

NATURAL RESOURCES JOINT VENTURE AGREEMENTS

Most mining and petroleum joint venture agreements contain provisions for the compulsory divestiture (either by dilution or assignment) of a defaulting joint venturer's interest in favour of the other joint venturers. Such provisions, of course, take many forms and have been the subject of several previous AMPLA papers.[27] Among the variables which might apply are compulsory assignment for nominal consideration, compulsory assignment at market value or at a reduction from market value and compulsory dilution (either straight line or stepped) according to expenditure actually incurred or at an accelerated rate. In cases of dilution

24 See *Legione v. Hateley* (1983) 152 CLR 406, 449 *per* Mason and Deane JJ.; *Esanda v. Plessnig* (1989) 84 ALR 99, 112 *per* Brennan J.; and *Stern v. McArthur* (1988) 81 ALR 463, 471 *per* Mason C.J., 489–490 *per* Deane and Dawson JJ.

25 *Stern* 489–490.

26 *Ibid.* 471 *per* Mason C.J., 479–483 *per* Brennan J.

27 See, for example, J.D. Merralls Q.C. 'Joint Venture Agreements — Examination of the Basic Legal Concepts' (1981) 3 *AMPLJ* 1, T. Poulton 'Panel Discussion on Default Provisions in Mining and Petroleum Joint Ventures' (1980) 2(2) *AMPLJ* 350; K.D. McDonald 'Joint Ventures: Breakdowns and Repairs — Rights Upon Default' [1983] *AMPLA Yearbook* 209.

it is common for there to be a threshold (say 5 percent) at which an obligation to assign the remaining interest arises. Often, particularly in resource development and petroleum exploration joint ventures where there is great concern that default could occur during a construction or drilling programme when timely payment of expenses is critical to all concerned, there is an obligation on the non-defaulting parties to pay to the operator the amounts of a defaulting party's unpaid calls. It is also common for joint venture agreements to provide that the defaulting party must pay the amount of all calls in default, with interest, to the other venturers provided they have paid those calls themselves, or at least that compulsory assignment or dilution does not of itself release the defaulter from the obligation to pay calls already made. There may also be rights of dilution withdrawal without default in prescribed circumstances, a right to buy back an interest which has been lost through voluntary or compulsory dilution and provisions for non-consent and sole risk operations.

In this part of the commentary we consider how the doctrines of penalties and relief against forfeiture might apply in some of these circumstances.

It is not always easy to apply the doctrine of penalties, in the strict sense described by Clarke (page 16), to compulsory divestiture. There is no specific secondary monetary obligation on the part of the defaulting party which ordinarily arises on failure to meet a call and which might be attacked as a penalty. An initial question, therefore, is whether the obligation on the defaulting party to transfer all or part of its interest, as distinct from an obligation to pay money, can amount to a penalty. There seems no reason, in principle, to distinguish between pecuniary and proprietary obligations for the purpose of determining whether equity will provide a remedy, but historically the doctrine of penalties has been confined to obligations to pay money. Obligations to transfer property, even where that property has a readily ascertainable value or the parties have agreed upon a procedure for determining value, have generally been the subject of actions for relief against forfeiture, although it is true that in *Jobson v. Johnson*[28] an obligation to transfer shares was held to be a penalty. There is more to the decision in that case than that isolated issue and the circumstances were unusual in that relief against forfeiture was not pursued, but there is no apparent reason why a joint venture interest should be treated differently. The obligation to transfer all or part of the defaulter's interest could be expressed in monetary terms, so that the penalties doctrine is not necessarily excluded. Nonetheless, the existence of the historic distinction between pecuniary and proprietary obligations suggests that, in a joint venture context, an action for relief against forfeiture may be more attractive than one claiming relief against a penalty.

Compulsory divestiture provisions in resources joint ventures, particularly those at the exploration stage, may not fit neatly within the penalties doctrine because it may be very difficult to establish (as at the date of contract) the existence of sufficient disparity between the value of the obligation to transfer a joint venture interest and the maximum con-

28 [1989] 1 All ER 621.

ceivable loss which the innocent joint venturers might suffer through a co-venturer's breach. It is well known that exploration projects may lead to discoveries of great value, but it is far more common to discover either an uneconomic resource or no resource of any consequence at all. It is conceivable, in fact, that an interest in a project may turn out to be a liability rather than an asset, not just because there is no immediate reward for expenditure incurred but also in the sense that the mining titles may require ongoing expenditure without either a right of surrender or a discovery. It is not the case with an exploration project that all expenditure necessarily adds to its value. While it may be possible to make an estimate, as at the date of the contract, of the likely loss that would be incurred by the innocent parties from breach of an obligation to pay calls, it seems to us to be much more difficult to assess the value of the interest to be divested by a defaulter. If that is so, it becomes very difficult to establish that the value/cost of the obligation to divest is out of all proportion with the loss flowing from breach, and therefore that the clause is a penalty. No similar difficulty is encountered with a claim for relief against forfeiture because it is the unconscionability of the forfeiture itself which is then in issue rather than the position at the time of contract. Obviously enough, the greater the value (if any) which the defaulter would receive on divestiture of all or part of its interest the less likely there is to be a disparity between the value of the interest transferred and the innocent parties' loss which would allow the divestiture obligation to be treated as a penalty. An obligation to assign for nominal value might more easily be seen as a penalty, although in the circumstances described above it might turn out to be a better proposition for a defaulter to lose its interest to its co-venturers than to continue with the project. However, while an assignment at full market value is clearly much less likely to be attacked successfully as a penalty, it may be that the market value of the interest is less than the special value of the interest to the defaulting party. This might occur where the defaulter joins a project in order to secure adequate supplies of a very limited commodity which, for reasons applicable only to it, cannot be obtained elsewhere. None of this is to say that judgment of costs and losses cannot be made as at the time of contract. Our point is that it is very difficult to make the pre-estimate or comparison as at the date of contract because there are very many unknowns. Therefore, a claim for relief against forfeiture may be easier to establish than a penalty.

A provision for compulsory divestiture on default was considered recently by Tadgell J. in *CRA Limited v. New Zealand Gold Field Investments Limited.*[29] In that case a joint venture had been formed on the familiar basis that each party must contribute to expenditure in proportion to its participating interest. The agreement provided that in the event that one party failed to contribute its share the other could elect, after notice and allowing the defaulter a period to remedy the default, either to require the defaulter to dilute its interest according to a formula or to oblige the defaulter to assign its interest to the other party at 95 percent of market value. The defendant failed to pay a series of cash calls and the

29 Unreported, Supreme Court of Victoria, 10 March 1989.

plaintiff elected to require the defendant to assign its interest. The defendant claimed that the relevant provision was a penalty, but acknowledged the right of the plaintiff to require a transfer of its interest. The real issue, therefore, was the enforceability of the 5 percent discount. Tadgell J. considered that the essential purpose of the provision was neither to compensate the non-defaulting party nor to punish the defaulter; it was primarily directed to dealing with and accommodating a default in a fashion most conveniently suited to overcoming it in the interests of the progress of the project. As to the amount of the discount, Tadgell J. considered that it recognised an actual diminution in value of the interest that would be required under the provision by the non-defaulting party. His Honour accepted evidence that the parties had agreed, in the negotiations leading up to the agreement, that in the circumstances of default transfer at full market value would not be appropriate and recognised the high costs and risks of exploration projects generally, in particular for those conducted in a foreign country. It is implicit in his Honour's judgment that he did not regard the 5 percent discount as 'extravagant, exorbitant or unconscionable'.

The case demonstrates that it would not be possible to impugn such a provision as a penalty unless it is out of all proportion to the loss that would be suffered by reason of the disruption of the venture consequent upon the default. It also suggests the flavour that negotiations might need to have if the ability of compulsory divestiture provisions to withstand attack as a penalty is to be maximised. There are two other points arising from this decision which are worthy of comment. First, his Honour left open the right of the plaintiff to seek damages for breach. The fact that succession to the defendant's interest was at less than market value clearly would affect the quantum of damages, but it is interesting to consider what damages the plaintiff might claim. The second point is that the defendant did not argue relief against forfeiture. One can speculate as to the reasons for that, just as much as in *Jobson v. Johnson*,[30] but if the defendant had sought relief against forfeiture it would have had to establish that it was unconscionable for the plaintiffs to take the defendant's interest and it must also have been willing to pay the unpaid calls, interest and costs. There is little doubt that provisions such as these are drafted at least in part as an encouragement to performance of the agreement but, as Tadgell J. recognised, they also have much to do with the continuing efficient conduct of the project rather than creating security for unpaid calls. There is, therefore, recognition of the particular circumstances of resources joint ventures, and it may be that such agreements are sufficiently peculiar to make an action for relief against forfeiture quite difficult.[31]

It is quite conceivable that, between the time of default and the time a claim for relief against forfeiture is made, the value of the project changes dramatically. As was the case in *Stern*,[32] the question where any increase (or, for that matter, decrease) in value in the joint venture interest should fall needs to be considered. Should a defaulter be deprived of its

30 [1989] 1 All ER 621.
31 See also *Monarch Petroleum N.L.v. Citco Australia Petroleum Ltd.* [1986] WAR 310.
32 *Stern v. McArthur* (1988) 81 ALR 463.

share in a project that has suddenly increased in value following the discovery because of a failure to pay calls of amounts that, in light of a discovery, are relatively insignificant? To what extent is the defaulter's contribution (or lack of it) to costs of the discovery relevant? Natural resources projects are not the same as the sale of land cases, particularly in relation to the risks involved. A venturer which defaults and loses its interest also loses its share of the risks of the project, so that it may be difficult to argue that it is nonetheless entitled to share in the benefits upon the payment of calls in arrears plus interest and costs. Should a venturer be permitted to wait and see how things turn out? It seems to us that it is very difficult to draw an analogy between payment obligations under natural resources joint venture agreements and mortgages, as in the judgments of Deane and Dawson JJ. in *Stern*. There is no sense in which the defaulter can be seen as paying off a loan given to it for the purpose of purchasing its interest in the project, although clearly the position might be different in the case of a farm-in agreement. Rather, the venturers commit themselves to expenditure on assets which may or may not grow in value, for their common benefit. Nor are divestiture obligations easily characterised as security for contributions to expenditure.

To what extent can factors outside the control of the innocent parties constitute unconscionability for the purposes of a claim for relief against forfeiture? Again, as Clarke has said (page 13), the judgment of Deane and Dawson JJ. in *Stern*[33] did not depend on proof of unconscientious conduct on the part of the party enforcing the obligation to transfer. It is easy enough to see unconscionability in a windfall gain in the value of real estate, but windfall gains in a resources project are, it seems to us, in quite a different category given the risks of the industry. Other factors outside the control of one or all of the parties might be considered — for example, the availability of geological information to a party which holds both a joint venture interest and an interest in an adjoining property may be enough to make it unconscionable for that party to insist on its rights to a transfer of the defaulter's interest. This raises the interesting possibility that, in a multi-party joint venture, it might be unconscionable for one innocent venturer to insist on divestiture but not for another. While in principle there is nothing wrong in this, the result may be a realignment of joint venture interests which the parties never intended.

As Clarke has said (pages 15–16) the position in relation to divestiture by election is settled in England — compulsory dilution or assignment in these circumstances cannot constitute a penalty — but not so in Australia. Nevertheless, where the rate of dilution is generally in proportion to contributions and dilution is at the election of the party concerned, claims of either penalty or relief against a forfeiture could be quite difficult to establish. The position might be easier if a party is faced with a choice of either electing to contribute to a project which it cannot afford, diluting voluntarily at an accelerated rate or diluting at an even greater rate on default. It seems to us that there is scope to argue that,

33 *Ibid.*

given those (admittedly unusual) choices, equity might assist the voluntary diluter even though dilution is in exercise of a contractual right.

Sole risk and non-consent clauses should, it seems to us, generally be treated similarly to dilution by election as in each case the loss of interest by a party which does not participate in operations by less than all of the venturers flows from an exercise of a contractual right. Similarly, the right to take up an interest in a sole risk project or to be reinstated in a non-consent project, at a premium, is an exercise of a contractual right. Again, however, it is not impossible to imagine circumstances in which it might appear unconscionable for a party to insist on the premium: for example, to propose operations where it knows its co-venturer cannot afford either to participate or to pay the premium necessary for reinstatement and then to undertake those operations on a sole risk or non-consent basis may be unfair. Nevertheless, no breach is involved — nothing more than the exercise of contractual rights.

Finally, it is appropriate to make some remarks on Clarke's comments on the APEA default clause (page 19). It is arguable whether a clause has 'the earmarks of a penalty' if it obliges the defaulting party to pay to the non-defaulters respectively their proportions of all calls properly made on the defaulter and which it has failed to pay prior to losing its interest in the project, or to pay interest on those amounts, at least insofar as those calls relate to expenditure incurred prior to the default. An arrangement of this kind was contemplated by the documents considered in his Honour's decision in *Offshore Oil v. Southern Cross Exploration*[34] and it seems to us that in such cases the defaulter's obligation to pay flows from the terms of the agreement applicable prior to and quite independently from the breach. Considered from another aspect, the opportunity to pass a joint venture interest across to a co-venturer with a proportionate share of joint venture expenses attached to it would be a clear incentive to default in an unpromising project. There are two other categories of calls which might well be open to attack: calls made prior to default but in respect of expenditure to be incurred after default, and calls made after default in respect of post-default expenditure pursuant to a pre-default budget. His Honour's criticism of the clause lies in the fact that the non-defaulters can succeed to the defaulter's interest yet leave the responsibility for ongoing obligations in respect of post-default expenditure and approved budgets with the defaulter. In these circumstances there would clearly be a windfall to the non-defaulters, who would have both the defaulter's interest and the benefits, if any, that go with it but none of the risk or liability to contribute to cash calls. The amount of windfall, of course, depends on the size of the relevant budget. It is interesting to consider where liability for costs following a well blow-out might fall.

The position might be different if some value were to be attributed to the divested interest. If the innocent parties were to succeed to the defaulter's interest at a price payable to the defaulter which is determined on the basis that calls had been paid, it would be more difficult for the

34 Unreported, Supreme Court of New South Wales, March 1987.

defaulter to argue that the continuation of the obligation to pay calls to the innocent parties is in the nature of a punishment for breach.

Perhaps, in drafting the clause, it was felt that the non-defaulters would not exercise their contractual rights to recover future expenses from the defaulter if they were to succeed to its interest. That possibility, however, seems to us to be unlikely to be sufficient protection against an argument that compulsory divestiture in those circumstances is unconscionable.