

“Reasonableness” and withholding consent to an assignment of contractual rights



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1 What is the purpose of this paper?

The purpose of this paper is to provide an overview of:

- the legal principles relevant to determining “reasonableness” in the context of withholding consent to an assignment of contractual rights (ie where such consent “*may not be unreasonably withheld*”)
- the effect of purported assignments when consent is withheld or not obtained.

2 What is the short answer/what are the key considerations?

2.1 Key considerations for determining “reasonableness”

“Reasonableness”, in this context, is assessed by an objective standard and is given a broad and common sense meaning.¹ Simply put, the withholding must be “*objectively reasonable*” in the particular circumstances, but the terms and proper construction of the relevant contract are paramount.²

Decisions to withhold consent should be based on factors “*relevant*” to the contract. Acting in this manner facilitates a party’s ability to demonstrate that their decision would equally have been reached by an objective and reasonable person.

Factors “*relevant*” to the contract will differ in each case and heavily depend on the particular circumstances including the nature and object of the specific contract and the purpose of the clause prohibiting the “*unreasonable*” withholding. Relevant factors may include any defaults in obligations under the contract,³ or the solvency or identity of a party (particularly in continuing contractual relations).⁴

While there is no obligation to explain or give reasons to support a decision to withhold consent, a court may interpret “*unreasonableness*” from a lack of explanation (especially if reasons are requested by other contracting parties).⁵

A party’s actions in withholding consent will generally be considered “*unreasonable*” if the grounds relied upon to support the withholding are:

- extraneous or disassociated from the subject matter of the contract⁶
- materially inconsistent with any provision(s) of the contract⁷

1 *In the matter of Idoport Pty Ltd ACN 075 318 106; In the matter of Idoport Pty Ltd (In Liq) (Receivers Appointed)* [2012] NSWSC 524 (**Idoport**), [50].

2 *Cathedral Place Pty Ltd v Hyatt of Australia Ltd* [2003] VSC 385, [25]; *Idoport*, [52]; *St Barbara v Hockley No 2* [2013] WASC 358, [39].

3 *Idoport*, [85].

4 *Fulham Partners LLC v National Australia Bank Ltd* [2013] NSWCA 296 (**Fulham**), [90].

5 *Idoport*, [57].

6 *Fulham*, [44].

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- based on collateral or improper considerations.⁸

Facts not known to a party refusing consent, but existing at the time of refusal, may be used at a later time to support the “*reasonableness*” of their decision to withhold.⁹ Equally, facts existing at the time consent was refused, but not actually or constructively known to the party refusing consent, may also be relied on to establish that a reason for the refusal was “*unreasonable*”.¹⁰

The party alleging “*unreasonableness*” has the onus of proof and must demonstrate that the withholding was *objectively unreasonable*.¹¹

2.2 *Effect of purported assignments where consent is withheld or not obtained*

A party may attempt to assign the benefits of a contract where consent has not been provided (ie, where consent is sought and withheld or where it has not been sought at all). These purported assignments (ie, those in breach of express provisions of the contract) are generally ineffective.

There is little by way of authority directly on point, but the starting point will *always* be a question of construction as to what was objectively the intention of the parties in the given situation.

3 “Reasonableness” and withholding consent

The “*reasonableness*” of withholding consent (relating to an assignment of contractual rights, or otherwise) is most often disputed in leasing contracts and other real property transactions. There has been some judicial support for extending those authorities to a wider commercial context. However, recent appellate authorities emphasise that the meaning of the phrase “*not to be unreasonably withheld*”, and those like it, will depend in each case on the particular contract and circumstance in question.

3.1 *Consent and the common law right of assignment*

Assignment is a process which brings about the change in Ownership of contractual rights (contractual benefits), but not contractual obligations (contractual burdens).

At common law, a contracting party (the **assignor**) has the right to transfer contractual rights to a third party (the **assignee**), *without* the consent of other parties to the contract (the **obligor/s**) (except in rare situations where the rights are non-assignable, for example where they are personal.). Restrictions on assignment are frequently included in contracts to exclude or limit this common law right. For instance, contracts often include a provision that parties may only assign their rights under the contract with the consent of other parties and regularly provide that such consent “*must not be unreasonably withheld*”.¹²

Where a party attempts to assign without consent, or without seeking consent, purported assignments are likely to be ineffective (see item 4 below).

⁷ *EDWF Holdings 1 Pty Ltd v EDWF Holdings 2 Pty Ltd* (2010) 41 WAR 23; [2010] WASCA 78 (EDWF), [115].

⁸ *Ibid*, [89], [242].

⁹ *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd* [1979] HCA 51; (1979) 144 CLR 596; 26 ALR 567 (**Secured Income**), 581-2.

¹⁰ *St Barbara Ltd v Hockley [No 2]* [2013] WASC 358, [158]-[182].

¹¹ Fulham, [59].

¹² It is also possible for a court to imply a restriction on the exercise of the discretion to provide consent, provided it is not inconsistent with the remainder of the contract. Including a reference to “*absolute discretion*” provides a basis for a party to claim that an implied term would be inconsistent.

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3.2 Leading High Court authority on “reasonableness” and withholding consent

The leading High Court authority considering “reasonableness” and withholding of consent (albeit, not used here as a mechanism to limit common law assignment) is *Secured Income Real Estate (Australia) Ltd v St Martins Investments Pty Ltd*¹³ (**Secured Income**).

In *Secured Income*, a contract for the sale of land provided that all leases of the premises after the contract’s execution (prior to settlement) should be approved by the purchaser, but that approval was not to be “*capriciously or arbitrarily withheld*”. Mason J (with whom Gibbs, Stephen and Aickin JJ agreed):

- held that “*arbitrarily*” connotes “*unreasonably*” in the sense that what was done was done “*without reasonable cause*,” and doubted whether “*capriciously*” added anything further¹⁴
- on the issue of what constituted “unreasonableness”, adopted an earlier statement of Walsh J that “*the reason for refusal must be something affecting the subject matter of the contract which forms the relationship between the landlord and the tenant, and not something extraneous and dissociated from the subject matter of the contract.*”¹⁵

3.3 Secured Income principles extended to commercial contexts

In *Cathedral Place Pty Ltd v Hyatt of Australia Ltd*,¹⁶ Nettle J held that “*logic dictates*” that the approach taken to consents to assignments of leases in cases such as *Secured Income* should be extended to a hotel manager’s consent to the assignment of the hotel Owner under a hotel management agreement.¹⁷ However, his Honour emphasised that the considerations that may be relevantly taken into account when reasonably withholding consent under a provision will *always* depend on the particular contract.¹⁸

This approach was endorsed in *EDWF Holdings 1 Pty Ltd v EDWF Holdings 2 Pty Ltd*¹⁹ (**EDWF**), which concerned a clause in a joint venture agreement and whether a joint venture participant had unreasonably withheld its consent to a change of control of another participant. Buss JA contrasted the nature of a joint venture transaction with that of a grantor/grantee of a right under a contract or a lessor/lessee relationship, which do not involve the common pursuit of a venture, and in which the fundamental rights and interests of the parties in respect of the subject matter of the transaction will usually be opposed.²⁰

His Honour (with whom Owen and Newnes JJA agreed) held that:

- it was “essential to exercise caution in reviewing authorities decided in different contractual settings”²¹
- each case turns on its own contractual provisions and individual facts and circumstances (ie, “the terms of the contract are paramount”)²²
- the proper construction of a particular contract will determine the permissible grounds on which consent may be refused.

¹³ [1979] HCA 51; (1979) 144 CLR 596; 26 ALR 567.

¹⁴ Ibid, 578.

¹⁵ Secured Income, citing *Colvin v Bowen* (1958) 75 WN (NSW) 262, [264].

¹⁶ [2003] VSC 385.

¹⁷ Ibid, [18].

¹⁸ Ibid, [25].

¹⁹ [2010] WASCA 78.

²⁰ EDWF, [113]. The distinction in this context is discussed at some length by Bryson J in *Noranda Australia Ltd v Lachlan Resources NL* (1988) 14 NSWLR 1, [21].

²¹ EDWF, [113].

²² Ibid.

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- the proper construction of a particular contract will determine the permissible grounds on which consent may be refused.

His Honour further concluded, after considering the relevant clauses of the joint venture agreement that, in general, a party would be acting *unreasonably* in withholding its consent if the grounds for withholding:

- are not honestly held
- are extraneous or unrelated to the objects of the contract, or to rights, benefits or obligations of the affected party or other participants under the contract
- are not permissible under the contract, or are materially inconsistent with its provisions, properly construed
- on the basis of the facts and circumstances, objectively ascertained, as at the date on which consent was refused, are unreasonable.²³

*Re Idoport Pty Ltd (In Liquidation) (Receivers Appointed)*²⁴ concerned a clause in a consulting agreement which restricted Idoport from encumbering its rights under the agreement without its lending bank’s consent, whose consent should not be unreasonably withheld. Idoport sought to create charges over its contractual rights in favour of a third party and requested the bank’s consent, which was refused. The chargees then instituted proceedings against the bank. The New South Wales Supreme Court determined that the bank had acted reasonably in the circumstances, because its decision to withhold consent had been made on factors directly relevant to the contract.²⁵ On appeal, Basten JA (with whom Bergin CJ in Eq and Barrett JA agreed)²⁶ confirmed the first instance decision and determined that the bank’s reasons for refusing consent were all concerned with the status, both legally and financially, of the proposed assignor and assignee. His Honour held that these reasons were legitimate grounds on which to reasonably withhold consent because they did not relate to matters extraneous to the agreement and were not collateral, extraneous or improper considerations.²⁷

While the court emphasised that the question of “*reasonableness*” must be determined by reference to the particular contract, the following principles were also useful in determining the “*reasonableness*” of the withholding. Namely, that:

- it is a question of fact whether the withholding is “*reasonable*” and the expression should be given a broad and common sense meaning²⁸
- the “*unreasonableness*” of the withholding is determined objectively having regard to all the circumstances of the case, including the reasons given (or not given) to support the withholding²⁹
- it is objectively unreasonable to withhold consent for the purpose of achieving an objective that is “*a collateral advantage outside the terms of the contract*”.³⁰

In *St Barbara v Hockley [No 2]*³¹ (discussed at item 4.1 below), Beech J applied the approach outlined in *EDWF* above, but emphasised that the proper construction of the relevant contract was of “*central*

²³ EDWF, [115].

²⁴ [2012] NSWSC 524.

²⁵ *Ibid*, [85].

²⁶ See generally *Fulham Partners LLC v National Australia Bank Ltd* [2013] NSWCA 296.

²⁷ *Ibid*, [89], [96]-[97].

²⁸ *Idoport*, [50].

²⁹ *Idoport*, [51].

³⁰ *Idoport*, [53].

³¹ [2013] WASC 358.

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significance” in determining whether the grounds for withholding consent relate to the pursuit of the objects of the contract (ie and are reasonable), or whether they are extraneous (ie and are unreasonable).³²

3.4 Prescribed instances of “unreasonableness”

In *Lockrey v Historic Houses Trust of New South Wales*³³ the NSW Court of Appeal gave effect to a consent provision that set out express examples in which consent could be deemed unreasonable.³⁴ In that case, the lessor refused to grant consent for an assignment of a lease and, because the situation was covered by the contract it was unnecessary for the Court to determine the “*reasonableness*” of the refusal.

This demonstrates that one way to effectively rule out any ambiguity surrounding “*reasonableness*” is to expressly prescribe circumstances or provide examples in the contract where conduct would be deemed “*unreasonable*”.

4 Effect of assignment where consent is withheld or not obtained

A party may attempt to assign the benefits of a contract where consent has not been provided, either because consent is sought and withheld, or where it has not been sought at all.

In this context, the validity of the purported assignments may be challenged by the obligor (ie the party burdened by the benefit purportedly assigned). The better view is that these purported assignments are invalid and of no effect as between the obligor and the purported assignee, because until consent has been obtained the right remains incapable of assignment. The consent operates as a condition precedent to any assignment. In these instances, the assignee may have a claim for breach of contract against the purported assignor for failing to deliver what was promised. The assignor may also potentially sue the obligor for breach of an express obligation to not unreasonably withhold consent, if that is the circumstance.

It is conceivable that in a particular case consent was intended to operate as a condition subsequent such that the assignment was effective, but liable to be discharged if consent is not forthcoming. However, there would need to be sound commercial reasons for the assignment to operate in such a manner and for a court to accept this construction.

There is little by way of authority directly on point. As such, the starting point will always be a question of construction as to what was objectively the intention of the parties.

4.1 Purported assignments where consent is “unreasonably” withheld

Beech J’s decision in *St Barbara v Hockley [No 2]*,³⁵ demonstrates that a party who has “*unreasonably*” withheld consent to an assignment of contractual rights may, if the court sees fit, be compelled to do all things necessary for the transfer to proceed.³⁶ However, without court intervention, the purported assignment is ineffective (see item 4.3 below).

³² Ibid, [39].

³³ (2012) 84 NSWLR 114.

³⁴ See also *Eso Australia Resources Pty Ltd v Southern Pacific Petroleum NL (Receivers and Managers Appointed)* [2004] VSC 477.

³⁵ *St Barbara v Hockley No 2* [2013] WASC 358 (**St Barbara**).

³⁶ *St Barbara*, [270].

Background

St Barbara announced that it would be selling certain assets to Hanking Gold Mining Pty Ltd (**Hanking Gold**). Those assets included a mining lease (**Tenement**) held by St Barbara, which was the subject of a Sale of Mining Lease Agreement (**Agreement**) between St Barbara and Desmond Hockley. The Agreement provided that 25% of the gold mined by St Barbara from Clough Lode (the area where the Tenement was located), was to be delivered to Mr Hockley with the balance belonging to St Barbara. Mr Hockley’s share of gold was also subject to the deduction of 25% of the mining costs in mining the Clough Lode. Clause 14 of the Agreement provided that:

“Either Party may assign his entire interest in the mining lease and his rights under this deed to a third party, PROVIDED THAT such third party shall agree in a deed with the other Party to be bound by the terms of this deed in all respects and the assigning Party first gets the written consent of the other Party (which shall not be unreasonably withheld).”

St Barbara and Mr Hockley were also parties to an agreement entitled Supplemental Agreement to Sale Agreement (**Supplemental Agreement**), which imposed mining and reporting obligations on St Barbara. By letter of 10 January 2013, St Barbara sought Mr Hockley’s consent to the proposed assignment of the Tenement and rights under the Agreement to Hanking Gold. Mr Hockley declined to provide his consent to the assignment and provided some of his reasons in a letter to St Barbara dated 20 January 2013. On 5 February 2013, Mr Hockley wrote again to St Barbara and set out reasons for his refusal to consent. On 30 April 2013, St Barbara commenced proceedings against Mr Hockley seeking, among other things, a declaration that Mr Hockley had unreasonably withheld consent to the assignment to Hanking Gold.

Decision and principles

As mentioned above, Justice Beech applied the approach outlined in *EDWF* (discussed above), but emphasised that the proper construction of the relevant contract was of “*central significance*” in determining whether the grounds for withholding consent relate to the pursuit of the objects of the contract or whether they are extraneous.³⁷

Justice Beech also considered the question of whether facts existing at the time consent was refused, but not actually or constructively known to the party refusing consent, could be relied on to establish that a reason for the refusal was “*unreasonable*”. This question had not been dealt with directly by any of the cases to date. The converse proposition that facts not known to the party refusing consent, but existing at the time of refusal, could be used to support the “*reasonableness*” of the decision was established in *Secured Income*. Justice Beech noted that the exercise of the contractual power to withhold consent was tested by an objective criteria of unreasonableness which does not differentiate between whether the facts can be used to support or weaken the “*reasonableness*” of the decision. This meant that St Barbara could rely on facts not actually or constructively known to Mr Hockley to support the unreasonableness of the decision.³⁸

Mr Hockley, in effect, relied on five pleaded reasons for the refusal which related to aspects of Hanking Gold (including its capacity to perform obligations under the agreements to be assigned), mining costs, any mining Hanking Gold might do of the Clough Lode and existing disputes between St Barbara and Mr Hockley. Beech J approached the question of the “*reasonableness*” of withholding consent by first construing the Agreement and Supplemental Agreement so that legitimate or extraneous considerations could be identified.³⁹ Each of Mr Hockley’s pleaded reasons for refusal were then considered by reference to the facts available at the time consent was refused.

Justice Beech ultimately found that none of Mr Hockley’s pleaded reasons for refusal to consent to the assignment supported a reasonable withholding of consent. His Honour:

- made a declaration that Mr Hockley had *unreasonably* withheld his consent to the assignment to Hanking Gold

³⁷ St Barbara, [39].

³⁸ St Barbara, [39]-[44].

³⁹ St Barbara, [44]-[46].

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- ordered Mr Hockley to do all things necessary for the transfer of the Tenement to Hanking Gold.

4.2 Failure to seek consent is lack of consent and an invalid assignment

As a matter of logic, if consent has not been sought, then there is no operational consent. It follows that any purported assignment should be treated the same way as if consent had been (reasonably) refused.

This approach appears to have been accepted by Fryberg J in *Ace Property Holdings P/L v Australian Postal Corp*,⁴⁰ where his Honour stated (citing *Hendry v Chartsearch*) that: “...consent cannot be said to have been withheld unless and until it has been asked for. It is no answer that no reasonable objection could have been made if consent had been sought.”⁴¹

4.3 Legal effect of prohibition on assignment more generally

Prohibitions on assignment can either be drafted as promises (eg “*agreement not to assign*”) or as restrictions (eg “*no entitlement to assign*”). There is a doctrinal difference between these in the sense that a mere promise not to assign should result in the assignment being effective, but giving rise to a right to damages. However, it would need to be clear that this was the intention of the parties.

Generally, even where the language of promise is used courts construe the clause as a true prohibition on the basis that the parties intended such an operation when incorporating the provision. More importantly, and as discussion of the *Chester* decision (discussed below) suggests, even where a court considers that parties did intend to include a mere promise not to assign, this will not result in the court upholding the assignment because to do so would involve them enforcing one contract (to assign) that is in breach of another contract (not to assign).

Generally speaking, a purported assignment of a contractual right in breach of a provision of the contract prohibiting assignment is ineffective. In *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd*,⁴² Lord Browne-Wilkinson (with whom the other Law Lords agreed) said:

*“[A] prohibition on assignment normally only invalidates the assignment as against the other party to the contract so as to prevent the transfer of the chose in action: in the absence of the clearest words it cannot operate to invalidate the contract as between the assignor and the assignee and even then it may be ineffective on the grounds of public policy...[T]he existing authorities establish that an attempted assignment of contractual rights in breach of a contractual prohibition is ineffective to transfer such contractual rights...If the law were otherwise, it would defeat the legitimate commercial reason for inserting the contractual prohibition, viz to ensure that the original parties to the contract are not brought into direct contractual relations with third parties.”*⁴³

There is a view that in this case Lord Browne-Wilkinson only intended to say that the prohibition merely prevented the obligor having to account to the assignee. That is, the prohibition characterised the obligation to perform rather than the right to assign. It would follow that the right to assign remains assignable in equity. Despite this, the weight of authority has treated the judgment as recognising that the parties can, by incorporating a prohibition of assignment, rob the contractual rights in question of their characteristic of assignability.

For example *Hendry v Chartsearch Ltd*,⁴⁴ concerned a clause that stated that the relevant party was not “*entitled*” to assign (ie a prohibition). Millett LJ said that a clause must take effect according to its tenor. He thought the assignment was effective as between the assignor and assignee, but that it was ineffective to create a breach of contract between the assignor and obligor (that is, its language did not incorporate a promise not to

⁴⁰ *Ace Property Holdings P/L v Australian Postal Corp* [2010] QCA 55, at [188].

⁴¹ See also *Owners of Strata Plan 5290 v CGS & Co Pty Ltd* [2011] NSWCA 168, (2011) 281 ALR 575.

⁴² *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85.

⁴³ *Ibid*, at [108] per Lord Browne-Wilkinson (with whom the other Law Lords agreed).

⁴⁴ [1998] C.L.C 1382; EWCA Civ 1276, *The Times*, 16 September 1998; cited in *Chitty on Contract*, [19-044].

assign that would have been breached upon the attempted assignment). As between the assignor and the obligor it was simply without effect.⁴⁵

Earlier in *R v Chester and North Wales Legal Aid Area Office (No 12)*,⁴⁶ a case involving a prohibition in the form that the relevant party “shall not assign” (ie, a promise not to assign), Millett LJ concluded that the prohibition prevented equitable assignments, and said that “equity will not enforce the performance of an obligation [that is, a promise to assign] which constitutes a breach of a prior contract with a third party [that is, the obligor]”.⁴⁷ Millett LJ recognised the distinction between a promise not to assign and a clause that negated any power to assign. In *Hendry*, he noted that a prohibition need not take the form of a covenant not to assign or reserve a power to treat an assignment without consent as a repudiatory breach of contract. It was sufficient, he thought, if the clause was in a form that disentitled a party from assigning. It appears his view was that any form of language would render any assignment ineffective.⁴⁸

Australian authority appears to follow the English approach.

In *Re Idoport*⁴⁹ (discussed above), Ball J held that generally, a purported assignment of a contractual right in breach of a provision of the contract prohibiting assignment is ineffective. His Honour cited Lord Browne-Wilkinson in *Linden Gardens* holding that it is necessary that such assignments be rendered ineffective because otherwise “it would defeat the legitimate commercial reason for inserting the contractual prohibition...[being] to ensure that the original parties to the contract are not brought into direct contractual relations with third parties.”

Even if the prohibition is subject to consent, which in turn is expressed to not be unreasonably withheld, the result appears to be the same at present. If the obligor is found to have “unreasonably” withheld consent, the purported assignment is still not effective (although, the withholding party may be compelled, should the court see fit, to do all that is necessary for the transfer to proceed).⁵⁰

In *Fulham Partners* (the *Re Idoport* appeal),⁵¹ Basten JA observed that the appellant’s pleadings presumed that an unreasonable withholding of consent was equivalent to a grant of consent, although this argument was not pursued at trial or on appeal. Despite this, his Honour rejected this argument and instead approved *Linden Gardens Trust Ltd v Lenesta Sludge Disposals Ltd* [1994] 1 AC 85. Practically, however, it would appear to be open to a party to seek specific performance of the contract and require the obligor to provide consent to the assignment.⁵²

For reasons above, clients need to be aware of the uncertainty that can arise in relation to prohibitions on assignment and consider expressly providing for the consequences of an attempt to assign in the face of a clause restricting or prohibiting such right. For example, parties can expressly agree that any attempt to assign in breach of the clause has no effect or amounts to a repudiatory breach of the agreement.

45 See also *Freakley v Centre Reinsurance International Co* [2005] 2 BCLC 530, [540] per David Richards J.

46 [1998] 1 WLR 1496.

47 *Ibid*, [1501]. See also *Australian Olympic Committee Inc v The Big Fights Inc* [1999] FCA 1042, [119–20]; *Australian Rugby Union Ltd v Hospitality Group Pty Ltd* (2000) 173 ALR 702, 735 (affirmed (2001) FCR 157). See further *New Zealand Payroll Software Systems Ltd v Advanced Management System Ltd* [2003] 3 NZLR 1, [7], suggesting that a purported assignment in the face of a prohibition was a breach of contract and the only question was whether it should be compensated in damages or whether it should simply be held that the assignment never occurred. General principle dictates if it constitutes a breach of contract it must give rise to a right to damages.

48 GJ Tolhurst, *The Assignment of Contractual Rights*, Hart Publishing 2006, p 249-261.

49 [2012] NSWSC 524.

50 *St Barbara*, [270].

51 [2013] NSWCA 296.

52 If there was no basis upon which the obligor could have “reasonably” withheld consent, there is weak authority that the assignment may be effective: *Hendry v Chartsearch Ltd* [1998] C.L.C 1382; EWCA Civ 1276, *The Times*, 16 September 1998, per Evans LJ (in the minority). However, the issue has not been determined by Australian courts. See generally discussion in GJ Tolhurst, *The Assignment of Contractual Rights*, Hart Publishing 2006, p 249-261.

5 Final notes

A party faced with the task of obtaining consent from another party in similar circumstances now has the benefit of guidance and an awareness of common issues they could encounter from the decisions outlined above.

EDWF, Re Idoport and *St Barbara v Hockley [No 2]* all emphasise that a proper construction of the relevant contract is necessary to identify whether the grounds for withholding consent are legitimate and not extraneous to the contract’s objects. The question of reasonableness is an objective one based on all of the facts and circumstances existing at the time of the decision, whether known to the party refusing consent or not, and can be relied on to support the reasonableness or unreasonableness of the decision.

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