INTERPRETATION OF CHARGING CLAUSES: EDWARDS INDUSTRIAL PRODUCTS PTY LTD V THWIN AND ZAW

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By: Simon Moen, Natalia Tan

Charging clauses are found in a raft of commercial documents including guarantees, construction contracts, agreements for lease, leases and deeds between a landowner and a local authority. This decision is a helpful reminder of the requirements to create a valid charge and the rights that are available to a charge holder if a charge is found to have been properly created.

An equitable charge typically arises by agreement between the parties, under which the charged property is made liable for or is appropriated to secure the performance or discharge of the relevant contractual obligation.

On 20 February 2025, in a decision of Lundberg J, the Supreme Court of Western Australia in the matter of *Edwards Industrial Products Pty Ltd v Thwin and Zaw* [2025] WASC 48 declined to grant the plaintiff the relief it sought under a charging clause. At issue was whether a charging clause in the contract to lease ceased to have effect upon the execution of the formal lease, which did not contain a similar term.

This case note considers the court's interpretation of the relevant charging clause, through its application of the established principles relating to equitable charges, the doctrine of merger and entire agreement clauses.

UNDERLYING FACTS

The facts of the case are uncontroversial. The action concerned a lease arrangement over a commercial property in Kenwick (Property). The plaintiff (Lessor) was the owner of the Property, and the defendant (Lessee) leased the Property to run a business of repairing bumpers.

On 16 April 2014, the parties executed a contract to lease the Property (Contract to Lease). The Contract to Lease appears to have been a standard REIWA form where details are inserted and blanks are completed. Six weeks later, on or around 1 June 2014, the parties executed a formal lease concerning the same Property (Lease). In or about November 2019, after the Lease had expired, the Lessor sent the Lessee a letter claiming moneys due under the Lease. The Lessee did not pay the money, and on 20 November 2019, the Lessor lodged an absolute caveat against the Lessee's residence, claiming an interest as chargee.

CHARGING CLAUSE

In this case, the relevant clause in dispute was clause 7.2 of the Contract to Lease, which read as follows:

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7.2 The Guarantors and the Lessee jointly and severally agree to charge any other land in which they have a partial or full interest as owner both now and at any time in the future in favour of the Lessor as security for repayment of any money due and payable to the Lessor under the lease. If a Lessee is in default of its obligations pursuant to the lease, the Guarantor and the Lessee agree that the Lessor will be entitled to register an absolute caveat against their land until the default is remedied (the 'Pleaded Equitable Charge').

Importantly, there was no equivalent clause within the Lease itself, and such absence was the central issue addressed in the case.

ISSUES ARISING AT TRIAL

Two primary issues (which this article frames into questions) arose at trial being (at [13]–[15]):

- Firstly, did clause 7.2 of the Contract to Lease immediately give rise to the Pleaded Equitable Charge?
- Secondly, and in the event that an equitable charge arose upon execution of the Contract to Lease, did the charge survive and form part of the formal Lease, or did the charge cease to exist upon execution of the Lease?

PRINCIPLES OF CONSTRUCTION

The court identified that the issues raised required an application of the orthodox principles of contract construction. Relevantly, the court restated (at [32]–[34]):

- The proper construction of a commercial contract is to be determined objectively having regard to its text, context and purpose;
- The contract will be given a businesslike interpretation on the assumption that the parties intended to produce a commercial result; and
- Where a commercial transaction is implemented by various instruments, all of the contracts or documents may be read together to ascertain their proper construction, at least where they are executed contemporaneously or within a short period.

Furthermore, where parties to an existing contract enter into a further contract which varies the original contract, the determining factor is always the intention of the parties as disclosed by the later agreement (at [35]). As identified by *Taylor J in Tallerman & Co Pty Ltd v Nathan's Merchandise (Victoria) Pty Ltd* (1957) 98 CLR 93 at [22], it may be material to determine whether:

- The effect of the second contract is to end and replace the first contract; or
- The effect of the second contract is to leave the first contract standing, subject to the alteration.

EQUITABLE CHARGE

The court discussed the common law regarding equitable charges. His Honour noted that charges are creatures of equity and are only enforceable in equity (at [36]). Further, there is no transfer of title or possessory title in the charged property (at [38]). Relying on *Morris Finance Ltd v Brown* [2017] FCAFC 97 (*Morris Finance Ltd v*

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Brown), His Honour restated that the right or remedy of a chargee is the enforcement of the charge by judicial order for sale (with an ancillary order for possession) or the appointment of a receiver (at [36]–[38]). Although the court did not cite the following quote from *Morris Finance Ltd v Brown*, it provides a helpful explanation of the concept of a charge (at [38]):

> The chargee has no self-help remedy… but must obtain the assistance of a court of equity to realize or enforce the charge. Usually, upon default a chargee is entitled to an order for sale, although given that an equitable jurisdiction is being invoked there may be discretionary aspects to the exercise of that jurisdiction.

The requirements to establish an equitable charge, as restated by Derham AsJ in *Morris Finance Ltd v Commonwealth Bank of Australia*, are as follows:

- An intention to create a charge;
- If over land, the presence of writing;
- The existence of definite ascertainable property, including future property, over which it is contemplated that the charge will exist; and
- Consideration (where necessary) (at [39]).

As to the first requirement, there (crucially) needs to be a manifestation by the parties of an immediate intention to charge, and not merely a promise to charge in the future (at [40]).

DOCTRINE OF MERGER

The court found that it is well established that where parties to a simple contract later execute a deed for the purposes of carrying out their agreement, the simple contract will be discharged and become “merged” in the deed. His Honour stated that this doctrine will preclude the parties from invoking their previous agreement for the purposes of modifying the later contract (at [49]).

ENTIRE AGREEMENT CLAUSES

The court observed that entire agreement clauses come in different shapes and sizes. As a general proposition, such clauses are intended to achieve contractual certainty about the terms agreed by the parties and nullify prior collateral agreements relating to the same subject matter (at [75)].

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PLAINTIFF LESSOR'S SUBMISSIONS

The Lessor submitted that all of the requirements for the creation of an equitable charge had been satisfied. It claimed that even a contractual clause which states a party “will charge” property may nonetheless still create an immediate charge.

They also submitted that the doctrine of merger did not apply so as to extinguish the Pleaded Equitable Charge.

As to the operation of the entire agreement clause, the Lessor distinguished the charging clause from the other terms in the Contract to Lease, in that, the charge arose upon execution of the Contract to Lease. Whereas none of the other terms of the Contract to Lease had any effect until the Lease was executed.

It is on the above basis that the Lessor sought declaratory relief and orders, including a declaration that the Pleaded Equitable Charge was granted by the Contract to Lease, that the charge secured payment obligations owed by the Lessee, and the charge attached to the private residential property (at [21]-[25]).

DEFENDANT LESSEE'S SUBMISSIONS

The defendant's main argument was that the charging clause was not included in the formal Lease. They contended that if the court found that an equitable charge did arise under clause 7.2, the Contract to Lease merged in the making of the Lease (i.e., the Contract to Lease was extinguished). Lastly, it was submitted that the “real completed contract” was to be found in the Lease alone, and the Contract to Lease could not be used to enlarge or modify the Lease (at [26]–[30]).

COURT'S JUDGEMENT

Was Clause 7.2 Effective to Create the Pleaded Equitable Charge?

The court found that the plaintiff failed to demonstrate the first element identified in *Morris Finance Ltd v Commonwealth Bank of Australia* and thus did not establish an equitable charge (at [92]). The court reinforced that there needed to be an immediate intention to create a charge and that a statement of future intention will not be sufficient (at [85]). His Honour found that the terms “agree to charge” and reference to “money under the lease” indicated an objective intention that the charge would become effective once the Lease had been executed (at [87]). In His Honour's opinion, in the circumstances where a later instrument replaces an earlier instrument, the significance of the phrase “agree to charge” takes on a “strong flavour of futurity” (at [89]). The court also accorded significance to the subsequent language used in the clause, which referred to the “lease” rather than the “contract”, which was the language used in some other clauses (at [90]). Therefore, it was not intended to be an immediately operative provision.

Did the Pleaded Equitable Charge Continue Following the Execution of the Lease?

If the court was wrong in that conclusion and the Contract to Lease had created the Pleaded Equitable Charge, the question then became – did the charge survive the execution of the Lease (at [98])? His Honour concluded that the real completed contract was the formal Lease itself, which was intended to wholly replace the Contract to Lease (at [119]). In coming to this conclusion, it found among other things that:

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- The Contract to Lease was a simple contract which was objectively intended by the parties to be overtaken by a formal lease instrument (at [102]);
- The charging clause was not incorporated in a schedule which sets out mandatory terms to be incorporated into the formal Lease (at [104]);
- The charging clause was not included in the formal lease, and no equivalent clause was included, this omission was of real significance (at [107]);
- The Contract to Lease would only be binding until the execution of the Lease (at [108]);
- The parties agreed that the covenants in the Lease, once executed, would take priority over the terms of the Contract to Lease (at [109]);
- The formal Lease was prepared by solicitors pursuant to a process by which the parties were permitted to include and remove further terms, and the plaintiff – Lessor – had a stronger bargaining and drafting position (at [110]);
- No evidence had been adduced to explain the omission of the charge from the Lease (at [111]); and
- The Lease incorporated an entire agreement clause (at [113]).

The court also observed that to require the parties to search through the prior, largely superseded agreement would be commercially impractical and likely generate confusion (at [123]). Therefore, the court declined to grant the plaintiff the relief which it sought.

IMPORTANCE OF THE DECISION

This decision is a reminder that the miscellaneous provisions at the end of an agreement serve a purpose and do inform the court's interpretation of the agreement.

The decision emphasises the importance of either:

- Incorporating the terms of a preliminary agreement or earlier contract in the subsequent more formal agreement; or
- Advising the client that certain terms of the preliminary agreement or earlier contract have not been included in the subsequent more formal agreement and taking the client's instructions in that regard.

It underscores crucial lessons for practitioners involved in drafting commercial contracts, particularly charging and entire agreement clauses. It reinforces the importance of precise contract drafting and cautions practitioners against using language which may indicate a future intention or obligation in a charging clause, as opposed to an immediate intention or obligation.

Expressions such as “agree to charge”, “will charge” or “shall charge” are to be avoided, unless that is the intent. But if an immediate intention to charge is intended, then include additional wording which clearly demonstrates the immediate intention to charge.

Reflecting upon the decision, it should be considered if language such as “hereby charge with immediate effect” should be used to more easily conclude that the charge is intended to immediately come into force and effect.

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Given the rights available to a charge holder, the charge itself must strictly comply with the test at law to create a valid charge and ambiguity in a charging clause is likely to be interpreted against the charge holder.

Charges should not be granted lightly. Landowners and grantors often fail to appreciate the powers that the law grants a chargee.

Where land is mortgaged, the mortgage typically requires prior consent of the mortgagee before a charge can be granted. The failure to obtain that consent is usually a breach of the mortgage.

As noted in this decision, where there has been a default, the charge holder can seek an order for the sale of the charged property.

KEY CONTACTS



SIMON MOEN
PARTNER

PERTH
+61.8.9216.0947
SIMON.MOEN@KLGATES.COM



NATALIA TAN
LAWYER

PERTH
+61.8.9216.0902
NATALIA.TAN@KLGATES.COM

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