

SEVERABILITY BOILERPLATE CLAUSE

Need to know

A severance clause is a boilerplate provision included in many contracts which, in generic form, states that provisions of the contract may be severed if found to be void or unenforceable.

There is, however, debate as to whether there is any consequence or increased risk if a generic clause is not included in a contract, given its primary purpose is to provide evidence to demonstrate the parties' intention that the contract should operate without one or more terms.

For this clause to add value to your contract, it should be tailored to the specific transaction and to your client's needs. For instance, a severance clause may be used to identify non-severable provisions in a contract, to prescribe variable fall-back positions in the event that one or more terms are void or unenforceable, or to permit modification or renegotiation of offending terms under certain circumstances (see item 2 below).

A sample boilerplate clause is set out below. For reasons mentioned, this clause should be considered in the context of the specific transaction contemplated by the contract and the needs of the client.

THE SAMPLE CLAUSE

Any term of this [deed/agreement] which is wholly or partially void or unenforceable is severed to the extent that it is void or unenforceable. The validity or enforceability of the remainder of this [deed/agreement] is not affected.

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1 Severability

1.1 Severability by a court

If asked, a court must consider whether to sever a term or part of a term from a contract. Courts will first look to see whether the parties intended, as a matter of objective construction, the contract to operate as a single, indivisible arrangement, or whether they intended for it to continue even if a part of the agreement was severed.¹

Courts determine the question of severability by looking at (1) the construction of the agreement, (2) the intention of the parties and (3) the importance of the particular term to the whole agreement.

Construction of the agreement

This is a two-step analysis, where the court will consider:

- the consideration provided under the agreement; and

The relevant term being severed must not be the whole or main consideration given by a party under the contract.² That is, remaining terms must continue to be supported by adequate consideration.³

- the nature of the agreement.⁴

The operation of the contract, after severance of the term, must continue to be consistent with general public policy. Severance would not be used in a contract which is, in substance, illegal but it would be used in relation to a restraint of trade clause where covenants are found to be unreasonable and contrary to public policy.⁵

Intention of the parties

It must be shown that the parties intended to make a contract that could operate without one or more terms (whether a whole or a part of a term or an associated transaction).⁶

Importance of the particular term to the entire agreement

A court must be able to sever terms of a contract without having to add to or change any words (referred to as the 'blue pencil' test).⁷ A court will not rewrite a contract to make it valid or able to achieve severability.⁸

In summary, to be able to sever a term the court must be able to determine that:

- the provision(s) to be severed is/are not the main part or substance of the contract;⁹
- the valid elements can be separated from the term(s) to be severed;¹⁰ and
- the remaining provisions of the contract can continue to operate without changing the fundamental nature, scope or effect of the contract.¹¹

Please note that there are also various legislative provisions relevant to arguments concerning the ability to sever a contractual term. These include:

- section 4 of the *Restraints of Trade Act 1976 (NSW)*¹² and section 4L of the *Competition and Consumer Act 2010 (Cth)*,¹³ which provide that contractual provisions contrary to these Acts may be severable;¹⁴
- section 7 of the *Contracts Review Act 1980 (NSW)* prescribes that the relief a court may grant against an unjust contract extends to severing one or more terms; and
- other statutes such as section 69F of the *Banking Act 1959 (Cth)* and section 7 of the *Superannuation Guarantee Charge Act 1992 (Cth)* refer to severability in a more limited way.

1.2 Why is a severability clause used in a contract?

A severability clause is often used in a contract to document the parties' intention that, if a term of their contract is found to be void or unenforceable, it may be severed and that the

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remaining terms of the contract will continue to operate.

However, when used in this generic form there is some debate about whether there is any consequence or increased risk if the clause is **not** included in a contract. That is, a court will likely look to sever part of a contract (either pursuant to legislative power or as a matter of common law) whether or not there is an express severability provision, and whether or not there is express wording purporting to extend the scope of the power to sever. Accordingly, much of its value may be attributed to the commercial position that is brought to bear when parties contest the validity of a particular clause.

2 The better way to use a severance clause

The most effective way to use a severance clause is to tailor it to your client's needs and to the specific transaction contemplated by the contract.

Possibilities include, but are not limited to, using this clause to specify:

- (a) **non-severable clauses in the contract:** A court may sever a term from a contract such that the balance of the contract is not affected, but it may no longer be a contract that your client wishes to be a party to. In that case, a party may prefer that the whole agreement become unenforceable. To prevent this, particular terms which the parties do not want to be severable should be expressly identified, and/or the contract should include an indemnity or a right to terminate in relation to the effect of severance in a particular instance.
- (b) **a mechanism for modification or renegotiation of offending terms:** This clause could also provide a mechanism for modification or renegotiation (to the extent necessary), in the event that clauses or parts of the contract are challenged as void or unenforceable (ie, to give the parties greater control over the process and to mitigate the necessity to litigate).¹⁵

- (c) **jurisdictional limits:** Depending on the circumstance, it may be relevant for this clause to state that, if a term is unenforceable or invalid in one jurisdiction and not in others, it can be severed in that jurisdiction but should remain in operation for the others.
(NB: While clauses dealing with severance in a particular jurisdiction are becoming reasonably common, there is little law directly on the subject and it remains unclear whether severance of this nature is actually possible).
- (d) **a mechanism with variable fall-back options:** This could be useful, for instance, if the contract includes a restraint of trade clause. In that case, the severance clause should refer to, or the restraint of trade clause itself should be drafted in a way that facilitates, severance by setting out several variables so that parameters can be severed with a fall back option remaining in place.¹⁶ Parties should spell out the variables desired and specify the order in which they should apply. That way, if any term is found to be invalid it is absolutely clear what should apply instead. This type of provision should also expressly state that the severability clause is included as a precaution against invalidity only and is subject to severance.

3 How effective is it?

A severance clause will **add value** to your contract if it is tailored to your client's needs and to the specific transaction contemplated by the contract (see item 2 above). However, as mentioned above, when used in the generic form, there may well be no consequence or increased risk if it is not included in a contract.

While a generic severance clause is helpful from an evidentiary perspective (ie to clearly demonstrate the parties' intention), it is not determinative of whether severance can occur.¹⁷ In certain circumstances, provisions cannot be severed and a court will not rewrite a contract to achieve severability.¹⁸ Given this, if a provision is declared void or unenforceable and cannot be severed, it may well render the whole contract void or unenforceable (as applicable), despite the presence of the severance clause.¹⁹

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In certain cases, the use of a severance clause may also be superseded by other provisions. For example, contracts intended to operate over an extended period of time or which may be subject to frequent changes in legislation, may contain a 'change in law' clause dealing with this eventuality, or if there is a 'force majeure' clause in the contract, a change in law resulting in illegality is sometimes listed as a force majeure event.

4 Drafting and reviewing the clause

For reasons already discussed, it is unlikely to make any material difference whether a generic severance clause is, or is not, included in a contract. However, great value and benefit can be achieved if the contract includes a severance clause that is specifically tailored to the deal and to your client (see item 2 above). A court will look to effect the intentions of the parties in any respect.

ENDNOTES

- ¹ *Brooks v Burns Philp Trustee Co Ltd* (1969) 121 CLR 432 at 442 per Taylor J. See also *Life Assurance Company of Australia Ltd v Phillips* (1925) 36 CLR 60 at 72 per Knox CJ.
- ² *Brooks v Burns Philp Trustee Co Ltd* (1969) 121 CLR 432 at 463 per Windeyer J.
- ³ *Horton v Jones* (1935) 53 CLR 475 at 485 per Rich and Dixon JJ.
- ⁴ See for example, *Thomas Brown & Sons Ltd v Fazal Deen* (1962) 108 CLR 391 at 411 per Kitto, Windeyer and Owen JJ.
- ⁵ See *DJE Constructions Pty Ltd v Maddocks* (1982) 1 NSWLR 5 at 10 per Street CJ, *McFarlane v Daniell* (1938) 38 SR (NSW) 337 at 346 per Sir Frederick Jordan. For the relevant considerations in the restraint of trade context see *SST Consulting Services Pty Ltd (ACN 083 263 914) v Rieson* (2006) 225 CLR 516 at 531; 228 ALR 417 at 428-9; [2006] HCA 31 at [46] per Gleeson CJ, Gummow, Hayne, Heydon and Crennan JJ.
- ⁶ *Duggan v Barnes* [1923] VLR 27, *Whitlock v Brew* (1968) 118 CLR 445, *Mercantile Credit v Comblas* (1982) 40 ALR 75 at 84, *G Scammell & Nephew v Ouston* [1941] AC 251, *Electric Acceptance Pty Ltd v Doug Thorley Caravans (Aust) Pty Ltd* [1981] VR 799 at 820-821 per Brooking J.
- ⁷ *Marquett v Walsh* (1929) 29 SR (NSW) 298.
- ⁸ See for example, *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 at 295; [1967] 1 All ER 699 at 705-6; *Marshall v NM Financial Management Ltd* [1997] 1 WLR 1527 at 1532 per Millett LJ (with whom the other members of the English Court of Appeal agreed).

- ⁹ *Mason v Provident Clothing and Supply Co Ltd* [1913] AC 724, *Nicolene Ltd v Simmonds* [1953] 1 QB 543, *Demtear Pty Ltd v Abelian Pty Ltd* [2004] QSC 103 at [41].
- ¹⁰ See for example, *Attwood v Lamont* (1920) 3 KB 571, *Allison v BDO (NSW-Vic) Pty Ltd* [2010] VSC 35 and *Emeco International Pty Ltd v O'Shea (no 2)* [2012] WASC 348.
- ¹¹ *SST Consulting Services Pty Ltd v Rieson* (2006) 225 CLR 516 at 531 per Gleeson CJ, Gummow, Hayne, Heydon and Crennan JJ affirming *McFarlane v Daniell* (1938) 38 SR (NSW) 337 at 345 per Jordan CJ. See also *United Group Rail Services Ltd v Rail Corporation of New South Wales* (2009) NSWCA 177, *Whitlock v Brew* (1968) 118 CLR 445, *David Jones Ltd v Lunn* (1969) 91 WN (NSW) 468 and *Macdonald Holdings (Qld) Pty Ltd v Nikolas* (2007) NSWSC 552.
- ¹² For a discussion of this provision, see *Orton v Melman* (1981) 1 NSWLR 583, *ICT Pty Ltd v Sea Containers Ltd* (1995) 39 NSWLR 640, *Reed Business Information v Seymour* (2010) NSWSC 790 and *Wentworth Partners Estate Agents Pty Ltd (t/as Re MAX Gold) v Gordony* (2007) NSWSC 1135.
- ¹³ See the High Court's analysis of s4L in *SST Consulting Services Pty Ltd v Rieson* (2006) 225 CLR 516 at 533 per Gleeson CJ, Gummow, Hayne, Heydon and Crennan JJ, where the court found, among other things, that on proper construction the provision required rather than permitted severance of the offending contractual term.
- ¹⁴ See also, in relation to the severability of a breach of contract for the sale of goods, s38 of the *Goods Act 1958* (Vic), s33 of the *Sale of Goods Act 1896* (Qld), s31 of the *Sale of Goods Act 1895* (SA), s31 of the *Sale of Goods Act 1895* (WA), s34 of the *Sale of Goods Act 1972* (NT), s36 of the *Sale of Goods Act 1896* (Tas) and s35 of the *Sale of Goods Act 1954* (ACT). See also, in relation to contracts, s4 of the *Frustrated Contracts Act 1959* (Vic), s5 of the *Frustrated Contracts Act 1988* (SA) and s13 of the *Fair Trading Act 2010* (WA). Finally, see also s114 of the *Industrial Relations Act 1979* (WA).
- ¹⁵ *Donwin Productions Ltd v Emi Films Ltd* [1984] CLR 365.
- ¹⁶ R E McGarvie 'Illegality and Severability in Contracts (1977-1978) 13 University of Western Australia Law Review 1, 15. See, for example, *Laybutt v Amoco Australia Pty Ltd* (1974) 132 CLR 57.
- ¹⁷ *Living Design (Home Improvements) Limited v Davidson* [1994] IRLR 67.
- ¹⁸ *Lindner v Murdock's Garage* (1950) 83 CLR 628.
- ¹⁹ *Bennett v Bennett* [1952] 1 KB 249.